MONTANA ORGANIZING PROJECT

The Montana Partnership Bank

Building a Stronger Local Economy

Montana already has the pieces in place to create a bank that will keep public money in Montana and help Main Street businesses prosper. Here's how.

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About

Montana Organizing Project (MOP) is a collaboration of diverse community, civic, labor and faith groups and community members who have come together to form an organization. We actively work for economic, racial and social justice, promoting the dignity and empowerment of people with low and middle incomes whose voices have not been heard in their communities. • *montanaorganizingproject.org*

The Alliance for a Just Society is a federation of community-based social and economic justice organizations. • *allianceforajustsociety.org*

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Montana Public Funds:
Building a Partnership Bank

Montana has an opportunity to build off the successes of its current financial structure and improve Montana's local economies. By creating a partnership bank, Montana would keep more dollars in Montana, improve the flow of capital through community banks to Main Street businesses and family farmers, and create a more resilient local financial sector.

After analyzing the successes and limitations of how Montana currently handles public funds and investments in Montana businesses, we recommend:

1. Evolving the Board of Investments' successful In-State Lending Program into a full partnership bank.
2. Investing available State loan capacity to capitalize a Montana Partnership Bank.
3. Divesting from state investments in Wall Street banks and international financial corporations and depositing this portion of public funds in the partnership bank.

The bulk of Montana's state deposits and long-term investments currently flow into out-of-state investments, while businesses and farms struggle with the need for better access to capital, which weakens small business and family farm sectors. However, despite the flow of money out of state, Montana has a relatively good track record of investing in partnership with community banks to provide capital to new and expanding businesses and develop much-needed infrastructure. But Montana faces limitations in its ability to do more of this.

A Montana Partnership Bank is the key to directing more public investments into Montana communities. Such a bank would also increase the resilience of Montana's economy and provide more returns at the community and state levels, by partnering — not competing — with local financial institutions.

A Strong Community Financial Sector
Serves Main Street Businesses and Family Farmers

The Montana Community Bank sector is generally stronger than in other states. That said, a down economy coupled with regulator pressure on local banks and changing safety and soundness ratios[1] has led to community banks being hesitant and/or unable to lend, despite plenty of liquidity (i.e. lots of deposits).

Small businesses and family farms that are ready to expand are also often hesitant. Those that have strong financials — especially three years of continuous and growing profits, low levels of debt in relation to their assets, and excess profits — are getting loans. The Small Business Administration, Farm Service Agency, and U.S. Department of Agriculture, among others, have extended credit for a segment of the businesses and farms with less-than-

[1] Increased capital ratio requirements plus loan losses quickly eat up a community bank's ability to lend.

perfect loan applications. Montana, through the Board of Investment's In-State Loan Program, has improved the quality of credit for many Montana projects, partnering with community banks to provide long-term, fixed-rate loans and interest rate reductions for projects that create and maintain jobs. Despite the strengths of the community banking sector and the state partnership loan programs, small businesses and family farmers still complain about difficulties accessing credit. Further, Montana faces many challenges in meeting existing needs, not the least of which are credit risk for banks already heavily scrutinized and risk for state investments other entities are unwilling to make.

The primary desired outcomes in establishing the Montana Partnership Bank include a redirection of public funds from Wall Street into Montana's economy, increasing the flow of money through the community financial sector, which, in turn, keeps credit flowing to Main Streets and family farms. This is a long-term investment in creating a more resilient community financial sector for the health of Montana's economy. A portion of profits could be diverted into shorter-term economic development tools to help more vulnerable sectors and businesses gain footing and strengthen and grow their businesses (newer and small family farmers, smaller investors looking to invest in main street business districts, communities looking to invest in new local businesses and cooperatives, etc.). While this may be needed in Montana, it is outside the scope of this paper.

North Dakota's Bank: Generating Higher Returns

The Bank of North Dakota (BND), created in 1913, is the nation's only state-owned partnership bank. Most states have developed ways to handle banking functions and administration of economic development, but only BND operates as a bank, which gives it greater capacity and flexibility to deploy public funds to local communities.

North Dakota's investment, or equity, in BND is currently near $400 million. This, for a bank, allows it to accept deposits of around $4 billion and to manage total assets of $5.375 billion. These assets include $1.4 billion in cash and $1 billion in securities, allowing it to keep funds safe and liquid for the state. The other $3 billion is invested in partnership with community banks to businesses and residents across North Dakota (BND 2011 Annual Report). In addition, BND handles the banking services for the state, something other states typically contract with Wall Street or large national banks.

The Bank of North Dakota pays a market rate yield to the state for the state's deposits. BND then lends out a portion of these funds and generates a profit on the difference between what it costs to run the bank (including paying yields on deposits) and what it makes on loans. In the banking world, returns of 1%-2% on the total assets of a bank is considered good. BND has averaged 1.7% over the past decade.

When you consider the state's investment in the Bank of North Dakota, or BND's equity, this translates to an average return of 22% over the past decade, far better than investing in Wall Street investments. Over this decade, BND has typically returned an average of $30 million each year to the general fund, using the remainder to grow the state's equity in the bank and thus BND's capacity to lend.[2]

[2] BND 2011 Annual Report.

Montana Public Funds: Where the Money Goes

The Montana Board of Investments (BOI) is the dominant player in Montana public funds. The BOI was created to provide a centralized place to manage state funds, public retirement funds, and state compensation insurance funds, and to create rules and supervision of municipal funds.[3] The BOI does not provide banking services, with the state contracting with US Bank and carrying a deposit balance of around $15 million.[4]

Funding: The total balance of all funds was $13.5 billion as of June 2011. Pensions (predominantly Public Employees' and Teachers' Retirement) and Trusts (including Coal Tax Fund) amount to just over $10.1 billion. The remaining categories include: Insurance $1.4 billion, Treasurer's funds $1 billion (of Montana's $4 billion in total cash and investments), Local Government funds $415 million, Agency Cash $342 million, University funds $202 million, and Debt Service funds $27 million.

How Montana and North Dakota Govern Their Financial Institutions

The Montana Board of Investments

The Board of Investments is composed of nine members:

1. A member of the Public Employees Retirement System board
2. A member of the teachers' retirement board
3. Seven members who cover four areas:
    a. Financial community
    b. Small business
    c. Agriculture
    d. Labor
4. Two ex officio, nonvoting legislative liaisons of different political parties

The BOI employs an Executive Director, a Chief Investment Officer and a range of professional staff covering credit analysis, investment analysis, portfolio managers, accounting, and research.

The Bank of North Dakota

Members of the Industrial Commission oversee the Bank of North Dakota. Members are the Governor, who acts as chairman, the Attorney General, and the Commissioner of Agriculture of the State of North Dakota.

The Bank also has a seven-member Advisory Board appointed by the Governor. The members are knowledgeable in banking and finance. The Advisory Board reviews the Bank's operations and makes recommendations to the Industrial Commission relating to the Bank's management, services, policies and procedures.

BND, like a bank, employs a team of professionals to manage its investments and lending.

Investments: Each of these fund types invests in an array of options, including Cash Equivalents (highly liquid short-term funds), Public Stock (ownership of equity in publicly traded companies), Fixed Income (includes U.S. Agencies like Fannie Mae, Freddie Mac),

[3] Municipalities place their funds with BOI or local financial institutions at their discretion.
[4] BOI financial audit June 30, 2011.

Loans (see In-State Loan Program, below) or Private Equity and Real Estate (see Guaranteed Loan Purchase Program, below). Except for public retirement and insurance funds, no public funds can be invested in corporate capital (common) stock, though they can be invested in business activity in Montana that retains or creates new jobs (see In-State Loan Program, below).

Lending: Statutorily, the board cannot make a direct loan to an individual borrower, but may purchase a loan or portion of a loan originated by a financial institution operating in Montana. This includes loan participations (see In-State Loan Program, below) and buying residential mortgages from banks operating in Montana, allowing more credit to flow through local banks (see Guaranteed Loan Purchase Program, below). These restrictions ensure the state is partnering with the community financial sector and result in a significant reduction of risk for public funds. To give a sense of size, total funds available to help Montana businesses and build infrastructure via the In-State Loan Programs are $365 million. The residential guaranteed loan program has peaked at $324 million in 2002.[5]

Structure: For the sake of clarity, comparing BOI's total operations to a partnership bank is an apples-to-oranges comparison. A Montana Partnership Bank would be a subset of the state's total assets under management. Practically, it makes sense to consider Montana's successes and opportune sources of funding. The early years of a Montana Partnership Bank would see an institution much smaller than the Bank of North Dakota, perhaps an early-stage target of $100 million in equity and total deposits of $1 billion. Thus, for the purpose of seeing more Montana money stay in Montana, we will focus on four areas that the Board of Investments oversees. Existing tools can be used to increase returns for Montanans through a Montana Partnership Bank, including:

1. Short Term Investment Pool (STIP) that holds liquid funds by making a variety of short-term investments (including investing directly in Wall Street banks);
2. In-State Loan Program that partners with Montana community banks;
3. Guaranteed Loan Purchase Program that uses public investment funds to stimulate flow of credit through Montana banks by buying government-guaranteed home mortgages;
4. Linked Deposit Program, providing liquidity (deposits) to community banks when they make loans in the interest of Montana economic development.

1. Short Term Investment Fund (STIP)

STIP is the place the state and municipalities deposit funds they need within a relatively short time. STIP is run like a mutual fund, meaning it is managed so that funds are "liquid" to make withdrawals on short notice. By having a consolidated pool across so many agencies, the STIP can anticipate withdrawals and make higher-rate investments while keeping enough liquid at any given time. This is similar to how banks manage for liquidity and return on their funds that are not lent out.

As of June, 2011, the STIP fund totaled $2.4 billion with approximately 40%, or $1 billion, invested in Wall Street securities, i.e. directly invested in corporate securities and corporate debt for Wall Street banks and international financial corporations such as JP Morgan Chase,

[5] BOI 2011 Annual Report, p. 45.

Wells Fargo, and Wachovia, among others.[6] While many of these corporations are deemed too big to fail and thus have an implicit (and sometimes explicit) government guarantee so that they can invest in higher-risk, higher-return investments, they are not particularly focused on the health of Montana's local economies, but on maximizing financial returns for their shareholders.

We recommend that this $1 billion be divested from Wall Street investments and deposited into a Montana Partnership Bank.

2. In-State Partnership-Loan Programs

Montana is already doing things that a successful partnership bank would do, such as prioritizing a significant amount of funds to be used to partner with existing community banks to meet the credit needs around the state. This lending is done through the In-State Loan Program, funded through the Coal Tax Trust Fund.

As of June 2011, the fund was approximately $843 million, of which up to $365 million can be invested directly into Montana businesses and infrastructure projects. These funds have a "special emphasis on investments in new or expanding locally owned enterprises."[7] Specific statutory investment preferences are targeted toward loans that:

- Assist employee-owned enterprises to retain or create jobs for Montana residents or other economic benefits for Montana, including raising per capita income;
- Help locally owned enterprises to expand or establish new operations;
- Provide jobs for current Montana residents rather than to attract non-residents;
- Improve energy efficiency and promote a healthy and clean environment
- Aid the Montana agricultural sector, specifically "the processing, refining, marketing, and innovative use and promotion of Montana's agricultural products";
- Benefit small- and medium-sized businesses as defined by the board

Additionally, when businesses demonstrate they have created and maintained jobs, they are eligible for significant interest rate reductions. In calculating jobs, the state looks at salary thresholds using Montana average weekly wages multiplied by the number of jobs required for each tier of incentives. Lower-paying jobs require more jobs to be created in order to qualify for interest rate reductions. By doing this, the State is not giving away tax breaks up front, but rather making contributions for each month the business is employing Montana residents and making their loan payments.

Four key programs demonstrate that Montana has a successful record of partnership banking: the Commercial Loan Participation Program, Value-Added Loan Program, Infrastructure Loan Program, and Intermediary Re-lending Program.
Commercial Loan Participation Program

This loan participation program, as with the Bank of North Dakota, is a pure partnership program, in which a community bank originates a loan and comes to the state to partner. BOI can take up to 80% of the loan request. If a business comes to a community bank for a

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[6] BOI financial audit June 30, 2011.
[7] BOI Governing Laws and Constitution, p. 18.

$10 million loan, the local bank could carry $2 million on their books while BOI takes $8 million. Meanwhile, the local lender gets a fee for servicing its 20% and BOI's 80%, thus increasing the revenue per loan dollar for the community bank (and streamlining the size of the BOI operations needed to administer the program). The BOI portion is a long-term, fixed-rate loan up to 25 years, while the community bank portion tends to be more like typical commercial loans that are fixed for five, seven, or 10 years. Participation ratios are reduced for riskier sectors (e.g., hotels), for higher loan-to-value ratios, or weaker loan applications (i.e. community bank must take a higher percentage of risk for these scenarios).

Community banks seek to partner for a variety of reasons. Primarily, the long-term fixed rate helps them put together an overall better deal for borrowers (helping community banks compete with Wall Street banks). Also, when banks reach their maximum loan size, say, $2 million (which would apply to three-fourths of the banks in Montana), then they can still compete for larger deals (up to $10 million if it's split 20-80).

The other incentive for community banks to partner is that businesses that create jobs are eligible for an interest rate reduction of 0.05% for every new job, up to 50 jobs. This is an ongoing "prove it and you get the discount" program, so the state is not locked into an incentive for a company that does not perform.[8]

Loans for this program are statutorily limited to 25% of the Coal Tax Trust Fund (equivalent to $210 million). At the end of June 2012, the BOI had 162 loans, for a total portfolio of $135.5 million, and $75 million available to lend.[9] The size of loans permitted for a business is determined by jobs created over a four-year period, long-term corporate and personal income tax projections, the ability of the local community to provide infrastructure[10], and the impact to existing jobholders in terms of increased salaries, wages, and business incomes (i.e., the multiplier effect). The average loan on BOI books is $836,000, but large deals — like $10.6 million for facilities for Direct TV, $5 million for GE building (60% taken by BOI) — throw this off. The minimum loan size is $250,000 and the majority of loans are given to Main Street Montana businesses.

This loan portfolio has shrunk significantly over the past few years, with borrowers choosing to refinance with a community bank for today's lower rates. BOI does not administer loan refinances, prioritizing new credit for expansions and other purposes. Additionally, banks have tremendous excess liquidity, and they would want to keep any loans they can make that regulators would approve on their own books, and not share with BOI. Community banks are eager to refinance existing businesses to carry more of the businesses loans on their books. That said, these long-term, fixed-rate and interest-rate reductions for new jobs are incentives that help borrowers. However, even though these loans would better serve the borrower, community banks need loans, so they often don't seek to partner. Borrower education may be needed, as BOI does not directly market, relying on their community bank partners to initiate loans.

As far as a Montana Partnership Bank is concerned, this kind of commercial lending is exactly the type of activity that strengthens the community financial sector, facilitating

[8] BOI "Laws," 22-23.
[9] BOI, personal communication.
[10] Montana also offers an INTERCAP program to assist municipalities.

public investments into Main Street businesses while sharing the risk with local banks, and generating a multiple of returns — job creation and returns to the state. A Partnership Bank would be uninhibited from purchasing a portion of a refinanced loan originated by a community bank, giving smaller banks more flexibility to grow with their customers.

Value-Added Business Loan Program

Funding for this program, which is also a loan participation program in partnership with community banks, is separate from the Coal Tax Trust Fund, with total loans capped at $70 million. The program primarily offers low-interest loans to value-added businesses that create or retain jobs. Refinancing may be an option for loans that would result in retained jobs. Maximum loan size for the BOI portion is $8.4 million (1% of Coal Trust Fund), and interest rates are tied to jobs created and retained. For 15 or more jobs, the first five years of the loan are locked in at 2%; for 10-14 jobs, it is locked at 4%, with the loan adjusting to 6% for the next five years.[11] These lower rates help these expanding businesses stabilize their growth and build their equity.

Infrastructure Loan Program

When businesses expand, infrastructure — water, sewer, road improvements — is needed to accommodate them. BOI can provide loans to municipalities to accommodate expansion, while businesses agree to a fee (i.e. loan repayment). If a business is creating at least 15 new jobs, it is eligible for the interest rate reduction to be passed through to them in the form of lower fees. Also under separate allocations from the Coal Tax Trust Fund, total infrastructure loans are capped at $80 million. The loan size is tied to the number of jobs created, and businesses can write off the local government use fee. Profitable companies are incentivized for building municipal infrastructure while the state justifies it through increased jobs and income taxes.

These loans are different than INTERCAP, which also provides financing to municipalities for infrastructure development. Funding for INTERCAP comes from bond proceeds, and funding amounts are evaluated annually.

Intermediary Relending Loan Program

Economic development funds are typically revolving loan funds, which means they can be maxed out fairly easily and banks must wait for loan repayments before lending more. The Intermediary Relending Loan Program seeks to address the reality that, in the right situations, recapitalizing these funds can encourage growth. Through this program, loans are made to Economic Development Organizations so they can relend. Loans are limited to $500,000, with total outstanding loans capped at $5 million. This is an effectively way to extend good economic development programs when needed.

In addition to the In-State Lending Programs, BOI has two programs to stimulate more credit flow through the local lending sector, one to free up more capacity to lend and the other to provide more deposits to lend.

[11] BOI "Laws" p. 21.

3. Guaranteed Loan Purchase Program

Because of the way financial markets have evolved, most community banks and credit unions sell conventional mortgages and government-guaranteed loans originated under programs from the Federal Housing Authority (FHA), Veterans Administration (VA), and Small Business Administration (SBA), to larger institutions or to investment funds. These are low-risk loans with a federal guarantee that are better suited for long-term investments. Finding ways to keep this revenue stream in-state could be a benefit to Montana.

Montana, in fact, has a history of preventing these investments from moving out-of-state. The Montana Public Employees' and Teachers' Retirement Funds have dedicated a small portion of their investments for such loans, stimulating the flow of capital through community banks to Montana residents and keeping these funds in-state. Community banks retain the servicing of these loans (receive payments, work out issues if they arise) so the investment funds do not need to. This is similar to BND buying FHA-, VA-, and SBA-guaranteed loans, which total $530 million for BND. BOI has $26 million outstanding as of June 2011, though the program peaked in 2002 with $324 million.[12] (Borrowers refinancing for lower rates contributed to the decline.)

BOI currently cannot justify buying more loans because of higher desired returns for the pension funds. BND, on the other hand, can justify more than half a billion in such investments because it operates as a bank, and these loans help diversify its portfolio. In addition, buying such loans is a service to the community bank sector, as community banks prefer to sell these loans to BND because banks like Wells Fargo will directly market their clients. It is also important to keep in mind that BND uses these low-risk guaranteed loans to balance its portfolio as part of its operations that lead to 20% or more average annual returns on its equity.

4. Linked Deposit Business Loan Program

Banks must constantly manage their deposits and loans to keep them in balance. The smaller the community bank, the more out-of-sync they can get, with deposits coming in at different times than loans going out. Montana BOI created a way to aid community banks when they make loans that the state likes. With this program, the state places a deposit equivalent to the loan made, "linking" that deposit to the loan and essentially providing the liquidity the bank needs to do more loans. This is merely a liquidity tool, as the state has no risk if the loan fails.

The state also requires the bank to collateralize any uninsured deposits, protecting the state from bank failure. With the current economic environment — community banks have excess deposits because they are hesitant to lend due to regulator scrutiny and changing targets for bank equity to asset ratios — banks do not need liquidity, nor would they want to incur the extra costs to collateralize unneeded deposits. However, while this program is not currently being used, it will be essential when the banking environment shifts.

[12] BOI Annual Report, p. 45.

Building Upon Success: Growing the In-State Loan Program into a Partnership Bank

Montana has a strong structure in place with a solid record that takes many of the unknowns out of a transition to launching a partnership bank. The Board of Investments, through the Short Term Investment Pool, manages short-term funds in a manner similar to how a bank manages funds to keep deposits safe and liquid. And the In-State Lending Program has a track record of successfully partnering with Montana community banks to deploy capital to businesses creating jobs for residents.

By operating its own bank, Montana can evolve its lending programs to keep more public funds in-state and more capital accessible to Montana businesses and family farmers, all while creating more resilience for the Montana community financial sector and meeting or exceeding investment portfolio targets. Additionally, operating as a bank would not preclude the state from continuing its successful economic development programs that coordinate partnership lending with incentives that benefit companies when they create and maintain good-paying jobs.

While the structure of Montana's programs looks to be quite effective, the amount of money flowing through these programs is relatively small, compared to neighboring North Dakota. The critical difference between the Bank of North Dakota and the way Montana currently manages its short-term funds and in-state investments is a question of scale. BND operates as a bank while the BOI manages funds. When BOI lends through the In-State Lending Program, it is through revolving loan funds, which must be repaid before being lent out again. By operating as a bank, North Dakota's $400 million of investments in BND creates $3 billion in lending; BOI's funds, meanwhile, are limited to 1-to-1.

A Montana Partnership Bank could build off the In-State Lending Program's successes by reducing risk and increasing efficiency. Loan participations drastically reduce risk because the state only evaluates loans that community banks have deemed are acceptable credit risks and for which they are willing to take a lead in funding. Because of this, and because the Montana Partnership Bank should continue to be run by bankers governed by high-quality lending standards like the In-State Lending Program (and BND), we should continue to expect extremely low default rates. Indeed, currently just two of Montana's loans are past due.[13]

Participation lending also increases efficiency, as there is no need for additional branches, ATMs, or retail sales staff. Both BND and BOI provide lower-rate financing for targeted sectors as prioritized by their respective legislatures. Also, while the Montana In-State Loan Program does not offer refinances because of its economic development mission, refinances (in partnership with community banks) to improve business cash flow would be an excellent source of revenues for a partnership bank. In short, a Montana Partnership Bank can be as effective or more as the Bank of North Dakota at deploying public investments and deposits into strengthening the economies across the state.

[13] BOI personal communication.

Obviously, with lending comes risks. The Bank of North Dakota has a proven track record with risk, and the track record of the Board of Investments, with its in-state lending programs, is equally solid. It is essential that Montana continues sound lending practices, which are necessitated if it is to continue partnering with community banks on a larger scale, since the latter cannot participate in above-average risk lending.

With any state venture into business activities, a secure firewall between politics and sound business must be in place. Hiring banking professionals and operating in accordance with prudent banking standards help mitigate political influence. It appears BND has maintained its independence to operate as an actual bank for more than a generation. BOI, with its In-State Lending Program, seems to have also maintained the ability to run an objective and independent program. It is essential that this remains true moving forward.

One of the primary objections to evolving the Board of Investments into a full-fledged partnership bank is that the In-State Lending Programs have a significant amount of unused capacity. Why expand if current funds are not being deployed? The answer is in the difference between a revolving fund and a bank. A revolving loan fund cannot leverage deposits, so bank-like lending rates tend to be subpar, compared to the possibilities of investing out-of-state via Wall Street. A bank, as the Bank of North Dakota has consistently demonstrated, has more of an ability to outperform returns on its equity. To put this in real terms, the loan portfolio of the In-State Investments has averaged an impressive 5.1% over the recession.[14] BND on the other hand, makes a smaller return on the total assets it manages (1%-2%) which translates to more than 22% on the state's equity investment due to its ability to conservatively leverage public funds in partnership with local banks.

Partnership Bank Creates Local Multiplier Effect, Ultimately Strengthening Montana's Economy

The return from a partnership bank extends beyond the investment returns in the bank.

Additional returns include the benefits of a stronger and more resilient community financial system and the economic multiplier that a strong local financial system brings to its communities. This multiplier comes in the form of community bank profit, local salaries and local professional services and supply chains.

Profit for locally owned banks flows to local communities rather than absentee shareholders. Bank CEOs and top-level management live in local communities and pay state and local taxes, keeping money from flowing to distant corporate centers. Local financial institutions hire local attorneys, CPAs and other professionals, and purchase supplies from local companies.

To the end of strengthening its community lending system, BND offers many "bankers' bank" services to North Dakota community banks and credit unions, services that typically only Wall Street banks and distant private institutions provide.

[14] BOI personal communication.

Moving Forward

By evolving the BOI into a partnership bank, Montana can facilitate more flow of capital, building a strong portfolio of assets similar to BND. To launch the bank, we need to address:

1. Start-up capital
2. Source of deposits
3. Lending activities
4. Growth

1) Start-Up Capital: Tapping Unused Capacity

BOI currently has $50 million to $100 million in unused capacity for lending to Montana businesses and infrastructure. This unused portion of the Coal Tax Trust Fund that is dedicated to In-State Lending could be invested as equity into a Montana Partnership Bank. These funds would go further than the current revolving loan fund, allowing the partnership bank to leverage up to $1 billion in assets, so long as an equivalent amount of deposits could be obtained.

2) Deposits: Divesting from Out-of-State Interests

The Board of Investments currently has approximately 40%, or $1 billion, invested in Wall Street banks and international financial corporations that do not have a vested interest in the health of the Montana economy. Divesting from these investments and depositing these funds would be an ideal use of public funds.

3) Lending Activities: Capacity Building Provides a Transition

We cannot expect to establish a partnership bank in Montana and immediately deploy $1 billion in funds. It will take time to find participation deals with local lenders and to buy quality (and guaranteed) mortgages from Montana community banks. It could easily take years, perhaps a decade, to grow into its capacity. This gives the new Montana Partnership Bank time to transition. It would be up to the bank directors and Executive Director to establish a target portfolio, though, given the track record of the BOI, it makes sense that this portfolio would include commercial loan participations, guaranteed residential and SBA mortgages, agricultural loans (a state bank is a great "patient capital" source of funding to complement community bank services for long-term farmland mortgages as current BOI and BND experience attest). This, essentially, mirrors the success of the Bank of North Dakota portfolio, without creating a full state bank.

4) Growing the Bank through the Coal Tax Trust Fund

Growth comes from two sources — retained profits or capital injections. The slow and steady way is to retain a portion of profits and grow organically. It also makes sense to develop into an optimal size and then grow organically from there. One way to do that is to continue investing Coal Tax Trust Funds as they become available. By statute, the Coal Tax Trust Fund is to endeavor to invest up to $365 million into Montana businesses and infrastructure. It would take only a portion of this to capitalize a significant-sized partnership bank.

Given the leverage potential, investing these dedicated Coal Tax Trust Funds and into a Montana Bank would allow for much more lending than can be done through a revolving loan fund. Since a significant portion of these funds are already lent out, just $50 million to $100 million initially would be available, justifying up to a $1 billion bank (based on ballpark banking capital ratios). As the Montana Partnership Bank proves itself, additional long-term investments could be divested from Wall Street and then used to grow the partnership bank over the decades.

Conclusion: Partnership Bank a Step in the Right Direction

A Montana Partnership Bank is not a quick fix to current lending gaps; when investing public funds into a state institution, it is essential that we insulate from above-average risk and political influence for investing capital based on short-term political gain, and control for risk by partnering with existing financial institutions according to prudent banking standards. The existing record of success for the In-State Lending Program demonstrates that Montana already has the ability to do so.

If the goal is to extend credit where credit is not currently flowing, then the emphasis should be on economic development tools like loan guarantees and dedicated funds to be lent to businesses that are not credit-worthy for existing financial institutions. These funds should be legislatively appropriated and justified based on pros and cons for the overall state budget. We are advocating that such economic development is important, but that Montana is missing an opportunity to keep more state funds in-state, and increase its capacity to partner with Montana community banks by establishing a partnership bank.