

**Small Business Lending  
for Economic Development  
Volume II:**

**Model Urban Programs**

**By**

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and  
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## Preface

This publication describes a variety of targeted small business lending programs, all of which are aimed at providing financing to small businesses serving, employing, or owned by residents of modest-income urban neighborhoods. Some of the programs aim to increase the number of conventional small business loans in these underserved markets. Others seek to provide less conventional economic development tools to stimulate economic activity in communities that have been neglected by the private market. In total, these programs offer a spectrum of models that can be used to promote the development of small businesses and jobs for residents of modest-income urban neighborhoods.

These programs were selected based on how effectively they target underserved markets, while maintaining sound and efficient operations. While there may be other equally effective programs across the nation addressing these markets, we feel confident that these programs are examples of current best practice.

The programs range from community reinvestment agreements between banks and community-based coalitions to comprehensive community development financial institutions that make and service their own loans. Previous research and experience suggest that the financing needs of firms seeking large loans (e.g., more than \$250,000) are relatively well met. Therefore, programs making most of their loans in the \$10,000 to \$250,000 range were emphasized, with some emphasis on those making loans of less than \$100,000. (Due to extensive research being conducted elsewhere, microenterprise lending initiatives, which focus primarily on financing self-employed individuals with extremely small loan amounts, were not considered in this project.) The report also focuses on efforts that provide debt financing, or debt-equity hybrids, rather than those that predominantly make equity investments.

This report is a companion to another Woodstock Institute publication, *Small Business Lending for Economic Development Volume I: Strategic Responses for Urban Communities*, which provides a foundation for developing small business financing efforts aimed at benefiting residents of modest-income urban neighborhoods. This first report attempts to capture some of the fundamental, strategic lessons learned during the Institute's research on small business lending programs. It is also intended to support Community Reinvestment Act policy and organizing in the small business arena as well as to draw critical attention to how economic development expenditures are allocated at various levels of government. The report suggests a general prescription for identifying economic development objectives, defining targeted markets, ascertaining financing needs in these markets, and choosing appropriate tools to address these needs.

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## **I. Small Business Lending for Economic Development**

### **Strategies for Urban Community Economic Development**

The focus of this report is on capital-based strategies for community economic development and, in particular, on increasing lending to small and minority-owned businesses in ways that will benefit modest-income urban neighborhoods.<sup>1</sup> Given the trends of larger employers downsizing and moving farther from urban centers, many look to small business as a promising vehicle for the creation of jobs, income and wealth for residents of these areas. Critical to the overall health of these neighborhoods is the formation and growth of small businesses that are likely to employ, serve, or be owned by neighborhood residents.

While the broader concern is with small business development benefiting targeted areas, the focus of this report is capital-based strategies. It is important to keep in mind that other approaches are at least as important, if not more important, to economic and small business development aimed at benefiting residents of modest-income neighborhoods. These include labor-based, land-based, management and production-based, and marketing-based strategies. Labor-based strategies focus on training and placing residents in jobs and deal with issues of employment access -- for example, providing information on jobs to residents, opening up and building employment networks, battling discrimination, and overcoming barriers of distance between jobs and residents. Land-based strategies address the need for affordable and appropriate land for industrial and commercial development. Land-banking and special zoning districts are examples of such approaches. Management and production-based strategies are relatively new, gaining popularity in the late 1980s, and have been most commonly applied at a statewide or regional level, as opposed to a community level.<sup>2</sup> Such strategies focus on maintaining or improving the management capacity and competitive advantage of local firms through financial and technology audits and other methods. Marketing-based economic development strategies involve assisting firms with identifying and serving potential customers. Export promotion and procurement programs are examples of this type of strategy. These other strategies can each be a vital, even crucial, part of a comprehensive economic development strategy, but they are beyond the scope of this report.

Capital-based strategies, which are of principal concern here, often focus on assisting small business owners with financing the plant, machinery and equipment, and working capital needed to begin, maintain or expand operations. Such strategies might involve the use of both debt and equity financing, or some hybrid of the two. A very common hybrid is subordinated debt, which largely resembles conventional debt but, because it may be secured by weak collateral and is repaid after senior loans, begins to look like equity. A debt-equity hybrid might also be used when a loan is made to a firm that would

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<sup>1</sup> Neighborhoods with median incomes below 80 percent of the metropolitan median are typically classified as low- and moderate-income. These are what we mean by modest-income neighborhoods.

<sup>2</sup> Peter K. Eisenger, *The Rise of the Entrepreneurial State*, Madison: University of Wisconsin Press, 1988.

ordinarily be considered too high-risk for debt financing. In such cases, the lender might include an “equity kicker” feature, in which loan repayments are based upon the success of the firm (e.g., a minimum plus some percentage of revenue or profit).

While equity financing is crucial to small business development, most small firms in urban areas will have difficulty affording the costs of conventional, outside equity. A better approach to reaching a broader range of firms is to offer debt and debt-equity hybrids that are less expensive. For many small urban businesses, personal wealth and friends and family will remain the principal foundation for the equity in their business. Businesses that become relatively large and are poised to grow into middle-market companies may need venture capital. While venture capital is beyond the scope of this report, access to it, especially for minority-owned firms, remains an important issue for urban economic development.

Capital-based efforts can be combined with other types of economic development strategies to increase benefits to local residents. For example, loan programs can be tied to local hiring and training programs. Similarly, loans can be made after some management assistance or review has occurred, or such assistance may be offered after firms receive financing.

No serious examination of the problems of urban neighborhoods would suggest that the provision of credit to small businesses, by itself, is sufficient to revitalize the economies of most distressed areas. Investment in small businesses is just one ingredient in the development of local businesses and their links to residents. But the power of investment flows should not be underestimated.

### **Small Business Credit and Development Finance in the Urban Context**

The lack of access to capital and credit remains a significant barrier to small business development and growth, particularly among minority-owned firms and businesses located in modest-income urban neighborhoods. Research by Timothy Bates of Wayne State University shows that levels of credit and capital are key determinants of business viability for small, young firms.<sup>3</sup> Faith Ando of the University of California at Los Angeles has found that African-American firms, on average, actually have lower debt-to-equity ratios than white-owned firms, which could impede their development.<sup>4</sup>

The importance of credit to firm viability makes access to credit a key issue. Minority-owned firms suffer from poor access to bank credit, even after controlling for business characteristics. Using data from the 1987 U.S. Census Bureau’s Characteristics of Business Ownership database, Bates has found that small, young, African-American-owned firms are able to leverage only 89 cents of debt for every dollar of owner equity,

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<sup>3</sup> Timothy Bates, *Banking on Black Business*, Joint Center for Political and Economic Studies, 1993.

<sup>4</sup> Faith Ando, *An Analysis of Access to Bank Credit*, Center for Afro-American Studies, University of California at Los Angeles, 1988.

while small, young, white-owned firms are able to obtain \$1.79 of debt per dollar of equity, even after controlling for age and management experience.<sup>5</sup>

Ando surveyed firms in business at least two years and controlled for a variety of credit risk factors including the firms' credit ratings. Her study corroborates Bates' finding that African-Americans have inferior access to business credit.<sup>6</sup>

Bates has also found that the location of a business is an even more important factor in access to credit than minority ownership status, with firms located in minority neighborhoods having inferior access to credit. This finding was corroborated by a 1993 survey of small business owners in the Chicago area by Yankelovich Partners and sponsored by a consortium of large Chicago-based banks. Yankelovich found that firms in modest-income census tracts, most of which are heavily minority, reported lack of access to credit to be a "very serious problem" almost twice as often as firms located in upper-income tracts (29 percent to 16 percent), and firms in minority tracts reported lack of access to credit as a very serious problem two-and-one-half times more often than firms in predominantly white tracts (38 percent to 15 percent). Yankelovich also found that, among respondents who have ever applied for a bank loan, applicants from upper-income tracts received the full amount of their loan request at a 40 percent higher rate than applicants whose businesses were located in modest-income tracts (88 percent versus 63 percent).<sup>7</sup>

Studies based on surveys can never capture all of the factors that are appropriately or inappropriately considered in the granting of business loans. Some businesses in modest-income areas and minority-owned firms might be expected to face greater business risks and poorer cash flow, and these factors may not be adequately controlled for in any particular study. But the prospects for business success hinge, in part, precisely on their ability to gain adequate capital and credit.

In addition to problems with access to conventional bank credit, businesses in modest-income communities and minority-owned firms may also suffer from poor access to economic development financing. Government action does not always remedy the biases of private lenders. In fact, government programs, if not targeted, can actually exacerbate the problems of credit access. For example, the U.S. SBA 7(a) program, the largest program of credit enhancements for small businesses in the country, is not targeted in any significant way toward modest-income urban neighborhoods and SBA lending appears to be skewed away from such areas. Woodstock Institute research on SBA 7(a) lending in the San Antonio area shows that, while modest-income zip codes contained approximately 55 percent of nonmanufacturing establishments and 54 percent of these firms' sales and receipts, these zip codes received only 34 percent of the 7(a) loans and

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<sup>5</sup> Timothy Bates, *Banking on Black Business*, 1993.

<sup>6</sup> Faith Ando, 1988.

<sup>7</sup> Yankelovich Partners, *Identifying the Unmet Credit Needs of Small Businesses in Cook County*, Chicago, October, 1993.

33 percent of the loan dollars obtained by nonmanufacturing firms in the area from December, 1993 through November, 1994.<sup>8</sup>

### **The Community Reinvestment Act, Economic Development Programs, and Small Business Lending**

The 1977 Community Reinvestment Act (CRA) is intended to assure that conventional banks and saving and loans provide credit throughout their service areas, including modest-income areas. CRA allows community-based organizations to challenge bank applications for mergers and acquisitions if they feel that an institution is not meeting credit needs in the community. It is clear that CRA has been used effectively to boost conventional residential lending by banks, as well as to encourage the development and sustenance of a new set of financing tools for housing development. This combination then created the supply of capital and credit that allowed affordable housing to become a more viable and active development opportunity. Thus, the presence of CRA has had both a direct and indirect effect in this arena.

Despite the importance of small businesses to community building and the barriers to small business credit faced by minority-owned firms and businesses located in modest-income neighborhoods, CRA has not had as strong an impact on small business financing and development. This has been due, in part, to a stronger focus by regulators and activists on housing, as well as the availability of detailed data on residential loans.

CRA can be used by stakeholders to encourage financial institutions to work with government programs that will enable them to do more small business lending in underserved markets. To combine CRA and development finance tools most effectively, stakeholders and lenders must know more about the most effective tools for reaching businesses in urban neighborhoods in cost-effective ways. These might include innovative bank programs, revolving loan funds and the use of government credit enhancements. Certainly, CRA has already been critical to promoting the development of targeted small business lending efforts by banks and to increasing banks' support of public and community economic development programs. But these sorts of efforts have paled in comparison to corresponding activities in the housing arena.

CRA, by itself, will not result in all small business financing needs being met in a community. When banks are asked to serve businesses that do not meet conventional underwriting criteria or are not profitable at some modest level, credit enhancements and incentives can prove crucial to the efforts of banks, bank consortia, and community-based lenders to stimulate business development in these markets. At the same time, government economic development financing programs, no matter how promising, will

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<sup>8</sup> Immergluck, Daniel, *Moving to Economic Development: A New Goal for SBA Loan Programs*, Woodstock Institute, August, 1995.

not be effective if banks do not support and participate in them. A dual strategy of using both CRA and enhancements is needed to address the financing needs aggressively.

### **Tools for Reinvestment: Advocacy and Lending for Small Business Development**

Tools for promoting small business lending to meet the needs of firms in underserved markets can range from CRA organizing campaigns to developing a new community development financial institution. While there are a wide variety of approaches to providing economic development finance and improving small business access to credit, most fall into the following general categories:

- CRA Advocacy and Bank-Community Partnerships
- Specialized Bank Programs
- Multibank Efforts
- Government Administered Programs
- Community Development Lenders

Programs in each of these categories may interact with, or even depend upon, programs in another category. For example, particular specialized bank lenders, multibank efforts and community development lenders may all utilize government-administered lending programs, such as the SBA 7(a) guarantee program, for a substantial portion of their activities. And CRA advocacy efforts may encourage the formation or strengthening of a specialized bank program or the support of a community development lender.

### **CRA Advocacy and Bank-Community Partnerships**

Although CRA has been used most effectively in the housing arena, a number of community reinvestment advocates around the country have utilized CRA to improve access to small business financing and to encourage the use of economic development tools in underserved communities. Community organizations can approach banks that are, or are likely to become involved in, mergers and acquisitions to obtain formal, best effort commitments to maintain or increase lending in specific areas. In some cases, agreements are sought because a lender has done a poor job in the past of serving businesses in certain markets. These agreements might call for increases in lending in particular neighborhoods or in particular loan types or sizes. In other cases, there is concern that a new institution acquiring an existing bank may not maintain the performance and service of the existing lender. Such concern is often justified in light of the evidence that mergers and acquisitions tend to affect banks' attention to small business financing and services adversely. In either case, good CRA agreements require the bank to report its lending activities to the community during the life of the agreement, including the location and types of loans.

CRA advocacy and negotiations can be important tools in maintaining and increasing small business lending to targeted markets. When concerned merely with the distribution of conventional lending or with access to credit by less profitable borrowers, such tools may even be sufficient to meet stakeholder objectives. Moreover, these efforts might be combined with the incentives offered by state and local public deposit

programs described below. On the other hand, to address economic development needs of many communities more fully, CRA advocacy and agreements need to be paired with specialized lending and economic development financing programs. Without such programs, banks will not generally take on the risks of more challenging projects that can create substantial numbers of jobs and stimulate significant economic development.

### **Specialized Bank Programs**

Most banks provide a wide variety of products and services to a broad array of customers. To do this, they often utilize specialized units within their organizational structures. Even within commercial lending, banks employ specialized units or lenders focusing on areas such as asset-based lending, middle-market companies, etc. In the same way, some banks have identified community economic development lending as a specialized task that they can best carry out through a particular bank unit. These lenders typically seek to increase their activity in modest-income neighborhoods and lending to minority-owned firms, in large part to maintain or improve their CRA ratings. One approach is to serve businesses whose financing needs either entail a different, and perhaps more labor intensive, approach by the bank, or require some sort of credit enhancement to mitigate risks or uncertainties.

Some banks create specialized programs by establishing separately regulated entities known as bank community development corporations (bank CDCs).<sup>9</sup> Bank CDCs are able to offer alternatively structured loans and even make equity investments. Typically, bank CDCs work with other parts of the parent financial institution to make loans that would not be conventionally bankable. Regulators allow banks to invest small portions of their capital in CDCs, without adversely affecting safety and soundness examinations.

Whether via a separate internal unit or through a bank CDC, specialized bank units develop expertise in government economic development programs and form relationships with economic development organizations serving targeted neighborhoods. Lenders for such programs often encounter firms with less sophisticated financial skills or whose businesses fall short of the bank's conventional credit standards. By using an SBA 7(a) loan guarantee or a state or local economic development program, the lender can structure a loan the bank can make. In the case of bank CDCs, the specialized lender may structure a loan that utilizes both regular financing from the parent bank together with subordinate financing from the CDC.

### **Multibank Programs**

In many cases, markets and financing needs may be identified that banks may be unwilling to serve alone due to risk or cost concerns. Smaller banks might feel that they

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<sup>9</sup> Note that bank CDCs are not the same as community development corporations, which are nonprofit community-based development organizations whose typical mission is comprehensive community development.

cannot afford a specialized unit themselves to address these markets, but might be able to share the costs of such a unit with other lenders.

In some of these cases, banks may pool their resources and risks to create some sort of pooled lending entity. A common form for such an entity is the multibank CDC. The multibank CDC is a separately regulated institution that gains its capital from a group of banks serving similar service areas. Multibank CDCs typically focus on modest-income areas and can be organized as either for-profit or nonprofit organizations. For-profit CDCs cannot issue dividends during the first three years of operations and must reinvest dividends in community projects after that.

### **Government-Administered Business Financing Programs**

Key players in promoting small business lending in underserved markets are federal, state and local governments. One relatively easy way that state and local government can support financing of businesses in targeted markets is through strategically placing their deposits with banks who serve these markets. Treasurers can either use broad screening or incentive programs, or place a specific deposit in a participating bank for each eligible loan it makes. The latter is commonly known as a linked-deposit program. It is important to distinguish public deposit programs from traditional development finance programs that utilize credit-enhancements, such as guarantees or subordinate financing. Linked-deposit programs do not typically offer any type of credit enhancement that significantly affects the underwriting risk incurred by the lender. Rather, these programs generally only reward banks for making more loans in underserved markets, while sometimes providing a lower interest rate to borrowing firms.

A perhaps more important governmental tool to small business lending efforts are economic development finance programs, including federal SBA programs as well as state and local efforts. If the small business financing needs identified by stakeholders include loans for businesses that are not conventionally bankable, these tools can prove to be a critical component of the reinvestment effort. Banks cannot be expected to lend to businesses with shortfalls in collateral or insufficient operating histories. Other borrowers may require long-term financing that is too risky or costly for banks to offer without some sort of credit enhancement.

Beyond getting directly involved in the lending process, either through loans or guarantees, government can make investments in or support community development. Some local governments, for example, contract with community development lenders to serve businesses in their jurisdiction, rather than attempt to make loans through their bureaucracies. Such support can go beyond actual financing and include support for technical assistance and loan packaging efforts as well.

## **Community Development Lenders**

When conventional financial institutions or multibank efforts are insufficient to address the small business financing needs identified by stakeholders, even when they have access to government credit enhancements and incentives, then a specialized community development lending organization may be an important tool for meeting economic development objectives. These might take the form of what is now known as a community development financial institution, such as a community-based revolving loan fund or credit union, or a quasi-governmental organization.

Some cities have recognized that municipal government provides a poor environment for business development financing. This has often been due to the difficulties caused by direct political involvement in the lending process and by the delays and limited responsiveness that plague many state and local government agencies. To remedy this problem, some local governments have spun-off quasi-governmental development organizations or have contracted with community-based organizations.

### **The Research**

In order to identify best practice models for financing small businesses in targeted urban markets, names and addresses of more than 200 small business lending programs were collected from a wide variety of sources, including existing literature, trade and other press, trade associations such as the American Bankers Association, community development associations including the National Association of Community Development Loan Funds and the National Community Reinvestment Coalition, federal banking regulators, and others. The survey was somewhat self-selecting, in that the surveyed groups were told that the goal was to identify model programs making substantial volumes of loans to businesses in modest-income areas and to minority-owned firms. Of those surveyed, more than 50 organizations returned substantially complete surveys. From these surveys, 22 organizations were identified that operated programs meeting the following initial screening criteria:

- They target unmet small business financing needs either among firms located in modest-income neighborhoods or among minority-owned businesses in urban areas.
- They were making a substantial number of loans in recent years.
- They had at least one full year of lending experience.
- They were not focusing primarily on large loans (e.g., more than \$300,000).<sup>10</sup>
- They were not experiencing significant loan performance problems.

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<sup>10</sup> In general, firms needing larger loans are better served than those needing smaller loans. These firms tend to be more established, have more collateral to offer and have better financial documentation for lenders to review. At the same time, smaller borrowers tend to be less sophisticated, posing equal or greater costs to lenders while offering smaller fees, making such lending less profitable. Also, larger borrowers tend to have less difficulty accessing economic development financing from states and localities.

In-depth interviews were conducted with these 22 organizations, including site-visits to many of them. From these interviews, 11 programs were selected as models for profiling here. These were chosen not just because they were perceived as effective in meeting lending objectives, but also because they offered a variety of sound approaches to increasing small business lending where it is needed.

## **II. Key Lessons**

In surveying and studying targeted small business lending programs throughout the country, a number of key lessons were identified for small business lending programs targeting modest-income neighborhoods and minority-owned firms. These lessons fall into the following categories:

- Defining Objectives and Markets
- Products, Credit Enhancements, and Delivery
- Scale and Scope of Operations
- Using The Community Reinvestment Act (CRA)
- Sources of Funds
- The Status of Community Development Lending
- Technical Assistance
- The Role of Government in Small Business Financing
- Monitoring and Tracking Impact

### **Defining Objectives and Markets<sup>11</sup>**

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<sup>11</sup> Some of the key lessons on defining objectives and identifying markets are discussed more fundamentally in *Small Business Lending for Economic Development I: Strategic Responses for Urban Communities* by Daniel Immergluck and Malcolm Bush, Woodstock Institute, 1995, a companion to this report.

Managers of sound economic development and small business financing programs understand their mission and objectives. While most lending programs have fairly clear proximate objectives (e.g., doing 20 loans per year), many have not clearly defined their ultimate objectives, such as jobs for local residents, goods and services, or other benefits. Underserved markets whose development is likely to help reach these objectives are then identified and targeted. After identifying ultimate objectives and targeted markets, more proximate objectives can then be defined. For example, if objectives include developing local businesses that will employ local residents in a specific area in which few banks are active, then proximate objectives might include increasing the activity of conventional banks making loans in the area.

***...many [lending programs] have not clearly defined ultimate objectives, such as jobs for local residents, goods and services, or other benefits.***

In Camden, New Jersey, for example, the *Cooperative Business Assistance Corporation (CBAC)* includes increasing conventional bank lending in Camden as one of its objectives. By pooling its own loan capital with that of six banks, and then co-lending with individual banks, *CBAC* has been able to introduce lenders into the severely underbanked city of Camden, while financing businesses for near-term job creation and economic development.

One key distinction among programs is whether they adopt a geographic, minority business, or sectoral approach to small business lending, or some combination of the three. Some programs target their lending to firms located in specific neighborhoods, particularly modest-income areas, because firms in these areas are seen as benefiting local residents. Others focus on lending to minority-owned businesses throughout a larger region, recognizing that minority-owned firms disproportionately employ minorities. Still others identify an entire industry within a metropolitan area that may offer substantial employment and service opportunities to modest-income residents. Some ambitious lending programs aim to combine more than one of these approaches.

*Southern Dallas Development Corporation*, for example, combines both a geographic and minority business approach in its development financing efforts. While *Southern Dallas* offers SBA loan products throughout the city of Dallas, approximately 80 percent of its loans go to firms in modest-income areas, particularly southern Dallas, and more than 70 percent have gone to minority-owned firms.

An example of a sectoral approach is provided by the *Center for Community Self-Help* in North Carolina. While adopting geographic and minority business approaches for many of its programs, *Self-Help* also operates a child care financing initiative, which provides financing and technical assistance to small firms in a growing, legally complex, and critical industry.

## **Products, Credit Enhancements, and Delivery**

Some look to special products or credit enhancements as a sort of magic bullet. They hope to find a loan product that is suitable to all difficult credits, inexpensive to administer, only used where it is needed, and able to provide the type of capital that many small firms need. In fact, special products and innovative credit enhancements are often overrated. There often exist plenty of such tools to meet the financing needs of targeted markets, and what is lacking are the financial institutions and development agents capable of or motivated to deliver the tools to where they are most needed.

Whatever the need, the financial products are only one part of the solution. Another major part is the political and economic will to invest in a strategy that will deliver

***...financial products are only one part of the solution. Another major part is the political and economic will to invest in a strategy that will deliver these products to where they are most needed.***

these products to where they are most needed. Financial engineers can concoct all sorts of credit enhancements, including guarantees, subordinated debt, equity kickers, and capital access portfolio insurance. But these products need to be delivered to businesses, and must be delivered in careful and cost-effective ways.

Notwithstanding their significance being frequently overrated, these tools remain important ingredients to effective small business financing programs. Development finance programs typically utilize at least one type of credit enhancement to stimulate small business lending and investment. In some cases, programs merely provide the enhancement--a loan guarantee for example--and a conventional bank is the initiator of the credit. This is particularly common among government administered programs, where agencies tend to have trouble identifying and servicing appropriate markets and are better suited to enhancing private credit through sharing risk or costs.

Connecticut's *Urbank Program*, for example, simply offers matching capital access portfolio insurance to lenders making small business loans to eligible firms in distressed areas. Capital access insurance, which involves the government agency matching a bank's and firm's contribution to a loan loss insurance fund for the participating bank, utilizes a "market mechanism" to screen out borrowers that would qualify for conventional bank loans. Because capital access borrowers must contribute to the loan loss reserve, they are expected to avoid the program if they can qualify for less expensive, conventional debt elsewhere. The Connecticut program also offers supplemental insurance for loans to firms in the most difficult markets, on which the program originally focused. The capital access approach requires little government agency staffing, and does not suffer from some of the bureaucratic delays common to more direct government-administered business financing programs.

In other cases, however, development finance programs identify borrowers worthy of special products or enhancements, structure the total financing package, and provide much or all of the financing directly. This is particularly common among targeted bank programs, multibank efforts, and community development lenders.

One of the most common forms of credit enhancement used by development finance lenders is the SBA 7(a) guarantee. The 7(a), which provides 75 to 90 percent guarantees of small business loans made by banks and approved nonbank lenders, is the most widely

used small business credit enhancement in the country. While the 7(a) program is not significantly targeted by geography or minority, many of the programs profiled here have taken advantage of the program, particularly the targeted bank efforts of *Society's Community Development Lending Group* in Cleveland and *Bank of Boston's First Community Bank*.

Other common development finance products and enhancements include subordinated debt, lower-interest loans made possible through Community Development Block Grant funds and other sources, and co-lending between conventional lenders and development finance programs. *Cooperative Business Assistance Corporation* in Camden, for example, has a loan pool capitalized with bank and government community development funds, which it then co-lends with individual participating banks to eligible firms.

Credit enhancements and products must be chosen and designed to fit the economic development objectives and targeted markets of the small business financing effort. Some products are designed for firms that are very close to being conventionally bankable, while others permit a larger risk tolerance or are well suited to firms that banks do not serve well.

***Credit enhancements and products must be chosen and designed to fit the economic development objectives and targeted markets of the small business financing effort.***

*Southern Dallas Development Corporation* runs four programs, each with its own source of funds, to address a range of development objectives, markets and risks. Its Community Development loan program uses CDBG funds to finance higher risk businesses with the potential to create substantial numbers of jobs. It also makes small loans to early stage firms via SBA's microlending initiative. The Southern Dallas Development Fund, a multibank CDC funded by private bank capital, finances businesses that are near-bankable. Finally, the Dallas Business Finance Corporation, *Southern Dallas' SBA 504* program, finances relatively bankable, established firms that are seeking longer term, fixed-rate financing for job-creating business expansions.

### **Scale and Scope of Operations**

Most small business lending programs targeting modest-income urban areas face the challenge of achieving a scale sufficient for impacting economic development and employment. At the same time, these programs face severe resource constraints and are forced to string together funding from fees and interest, bank support, government funding and foundations. Specialized bank programs and bank CDCs may be pressured by the upper management of their banks to become profitable or more profitable. Nonprofit lenders are often without access to the wider sources of revenue, including deposits and services, to which banks have access. Thus, achieving sufficient scale can be even more important for these programs.

In order to operate a small business financing program at reasonable costs, it is usually necessary to reach some minimum scale of operations. Larger scale operations also mean

showing greater impacts so that private, government, and foundation funding are forthcoming.

***...to operate a small business financing program at reasonable costs, it is usually necessary to reach some minimum scale of operations.***

In addition to reaching sufficient scale, small business lending programs must determine the appropriate scope of their operations. Some lenders aim only to make very small loans, seeing larger loans as better served by conventional banks. Yet making smaller loans

often generates less net income and sometimes requires subsidy. This is one reason why many who seek to make smaller loans also make larger loans, which can generate income for the lending operation. This is especially critical to community and minority business development lenders that do not have access to the revenue sources of a large bank.

Operators of development finance efforts must choose among a spectrum of markets, ranging from those that are served very poorly by conventional lenders to those that are served much better by conventional lenders. In general, those markets that have the capacity to generate substantial operating income through fees and interest payments will most likely be better served. Thus, pragmatically, it may not be reasonable to operate a program that targets only those markets that are highly neglected, while ignoring other development finance opportunities that can generate operating income for the overall lending effort. For targeted bank programs, this may be less of a problem, as long as upper management of the bank recognizes its obligation to serve less lucrative markets. But for nonprofit lenders, in particular, it may be helpful to identify some markets and products that can generate income for the organization. These revenues can, in turn, support lending efforts aimed at less lucrative markets.

*Bankers CDC* in San Diego provides a good example here. This multibank effort is privately capitalized by a consortium of banks. It was established to make loans to mostly younger firms seeking loans of under \$50,000. Banks tend not to serve this market aggressively, especially in modest-income areas. *Bankers CDC* was initiated by the *Small Business Finance Corporation (SBFC)* of San Diego, a large nonprofit SBA 504 lender that makes more than 100 SBA 504 loans annually and packages another 100 SBA 7(a) guarantees. *SBFC* generates substantial revenue from its 504 lending activity, through which it supports the operation of *Bankers CDC*.

### **Using The Community Reinvestment Act**

The Community Reinvestment Act (CRA) can be an important tool in inducing small business lending in targeted markets. The examples of the Maryland Alliance for Responsible Investment and the Delaware Community Reinvestment Action Council provide two examples of direct results of CRA advocacy. Because only limited data will be available under new CRA regulations, it remains important that community organizations require detailed data disclosure on small business lending. It is helpful to require data summarized by zip code or census tract that can be viewed historically. Data should be broken out by size of loan and, if possible, size of business. Additional

information on the number of government-enhanced loans, loan purposes, and special rates and terms can also be requested. Finally, it is important to attempt to obtain data on the bank's lending patterns *before* any CRA agreement, so that increases or declines in activity can be detected. The technology of identifying loans by census tract or zip code has advanced considerably, and most banks are able to provide these summaries at little or no cost.

But CRA is not just a tool for advocacy groups and involves more than negotiating agreements for conventional bank lending in targeted areas. Development finance efforts that focus on modest-income urban communities can also use CRA to encourage banks to be important partners in capitalizing and participating in their programs. Under new CRA regulations, banks that make loans through or invest in community development lenders will receive formal CRA credit through an "investment test." In many of the interviews conducted during the research, bankers and community development lenders cited CRA as a key motivation for bank participation in small business financing programs. In the case of targeted bank programs, it is apparent that many of these programs would not exist but for CRA.

***...CRA is not just a tool for advocacy groups and involves more than negotiating agreements for conventional bank lending...***

*Mellon Bank CDC* is a bank CDC that is a successor to a lending unit of Mellon Bank, which in turn was created after Pittsburgh community organizations approached the bank about establishing a targeted lending pool. *Society's Community Development Lending Group (SDDC)* and multibank CDCs like *Bankers Small Business CDC* in San Diego and *SDDC's Southern Dallas Development Fund* are other examples of development finance programs in which bank investment and participation is clearly tied to CRA.

## **Sources of Funds**

The sources of funds, both operating and capital, for small business financing programs include banks, government, foundations, and earned income. Banks are, of course, the principal source of capital for targeted bank programs and multibank efforts. But banks are a major source of capital for community development lending efforts as well. Bank capital alone, however, is rarely sufficient to address all types of markets and economic development objectives. Programs that seek to take greater risks than banks in order to stimulate investment and jobs in an area need access to alternative sources of funds. One primary source has been Community Development Block Grant funds, which many community development lenders have combined with bank and other sources to address more difficult financing opportunities that also promise significant employment impacts.

Other common sources for capitalizing and supporting lending activities are the Economic Development Administration and the Small Business Administration. The SBA's 504 program, which provides long-term fixed-rate financing for fixed assets, and the SBA microloan program have perhaps been most effectively used to support targeted

development finance. The agency's most popular program, the 7(a) guarantee, has also been used by economic development programs, but the bulk of 7(a) lending is not targeted.

Another potential source of funds are linked-deposits, either from government or private sources. Wholesale or special purpose banks may be good sources for such deposits, which can provide below market-rate funds for lending activities. Delaware Trust obtained a \$2 million deposit from MBNA America Bank, a credit card bank looking to gain CRA credit.

Although some community development lenders have received significant investment and support from foundations, business development continues to be a relatively unpopular arena for support from this sector.

***..the consolidation of the banking industry means fewer and fewer banks, especially locally based ones, will be around to provide funding.***

Overall, the prospect for raising funds for business financing, especially for operations, does not look good. While new CRA regulations provide for explicit credit for investments in community development lenders, the

consolidation of the banking industry means fewer and fewer banks, especially locally-based ones, will be around to provide funding. At the same time, federal budget cuts promise to reduce sources such as Community Development Block Grants that have often provided core support for development finance efforts in modest-income urban areas.

### **The Status of Community Development Lenders**

In order to sustain strong small business lending efforts, it is important that these programs and their staff are treated as important parts of their larger organizations and are viewed externally as achievement-oriented operations and professionals. This is particularly important in the case of specialized bank programs. These efforts cannot be seen as the "charity" cases in the

***...it is important that these programs and their staff are treated as important parts of their larger organizations and are viewed externally as achievement-oriented operations and professionals.***

bank. The specialized unit must be seen as a challenging and rewarding environment, offering opportunities for respect and advancement. Bank of Boston's *First Community Bank* staff stressed the regard in which they are held within the bank. They have established the unit as a department where good people are placed.

In addition to the problem of status and respect is the issue of financial compensation of individual lenders. Because such units typically deal with smaller companies and smaller loan amounts, traditional commission incentive structures are problematic. Community development lending may require more sophisticated skills than those employed in commercial lending to large firms, while offering few of the financial bonuses. Staff at Society Bank's *Community Development Lending Group* cited this problem as a real obstacle to retaining high quality staff.

## **Technical Assistance**

Technical assistance is an important tool that can help reduce the screening and transaction costs faced by lenders serving targeted markets. Without access to such services, community development lenders can sometimes find themselves spending a great deal of time with loan applicants that will not qualify for financing. Developing relationships with loan screening or packaging organizations can reduce search costs for the lender. Packaging and technical assistance can also result in better loan applications with more complete information, reducing the uncertainty in the lending process and thus the overall risk faced by the lender.

***...technical assistance can also result in better loan applications with more complete information, reducing the uncertainty in the lending process and thus the overall risk faced by the lender.***

Most of the model programs identified here do not provide technical assistance or loan packaging themselves, but they work with other organizations, such as small business development centers or local development groups, that provide such services. *Mellon Bank CDC* and the *Center for Community Self-Help* are examples of two efforts that provide loan packaging or other forms of technical assistance to small firms. Some efforts, however, shy away from providing such services directly due to potential lender liability issues.

Either way, it is clear that loan packaging and other technical assistance are crucial resources to these lending programs. *Society's Community Development Lending Group* works with loan packagers at a Cleveland-area manufacturing technology center, where packagers are equipped with laptop computers for delivering on-site assistance. *SCDLG* also works with community development corporations in Cleveland. *Bankers CDC* has begun including an escrow on some of its loans that is to be used by the firm owner to obtain bookkeeping and financial skills training from a certified public accountant.

## **The Role of Government in Small Business Financing**

The lesson here is clear: keep government agencies out of the direct lending process as much as possible. There are three principal reasons for this. First, individual lending decisions cannot be sound if they are subject in any way to political interference. Programs that permit political interference in the application and approval process will clearly not be able to achieve goals of sustainability or economic development. Second, even if sound lending practices can be sustained in government-administered programs, it is difficult to target lending activity to where and whom it is most needed. Constituent pressure leads many government-based lenders to a "peanut butter" approach to economic development,

***The lesson here is clear: keep government agencies out of the direct lending process as much as possible.***

where resources are spread evenly across political subdistricts regardless of need. Finally, government administrative constraints can delay communications and negotiations with small businesses that can render development assistance useless.

The *Maryland Small Business Development Finance Authority (MSBDF)* contracted with a private management company to manage and staff its operations, enabling it to reduce its application processing time by at least three weeks. It has also gained greater control over its staffing, which is critical for development finance work. *MSBDF* found the constraints of having its routine legal work conducted by Maryland attorney general staff to be one of the largest obstacles to program responsiveness. The histories of *Southern Dallas Development Corporation* and *Cooperative Business Assistance Corporation* also speak to the importance of taking government out of direct control of the business financing process.

### **Monitoring and Tracking Impact**

Ideally, small business lending efforts should track their activity and their impact against desired outcomes. Programs should not just track numbers and dollar amounts of loans made and to whom, but they should monitor the job creation and retention and other economic development effects caused by their financing. Unfortunately, this is no simple feat. Even among programs that are required to itemize and monitor job creation due to their source of funds (e.g., CDBG), the state of the art here is not very good. Job creation statistics are often based on unverifiable estimates of firm owners. When employment is monitored, an effort is rarely made to isolate the cause of the change, or to compare the change in employment to similar firms who were not assisted.

***In a climate of scarce resources... expecting programs that are looking to increase their impact to invest heavily in technical evaluations is not very realistic.***

Sound evaluation of the impact of lending efforts is a substantial task. This is not to say that such efforts should not be done, at least on a spot basis. In a climate of scarce resources, however, expecting programs that are looking to increase their impact to invest heavily in technical evaluations is not very realistic. An alternative is for those interested

in such evaluations to look at a sample of strong programs, evaluate them rigorously, and extend the lessons learned to the practices and policies affecting most programs.

### **III. Profiles of 11 Small Business Lending Programs**

#### **CRA Advocacy and Bank-Community Partnerships**

Delaware Community Reinvestment Action Council and  
Delaware Trust Company, Wilmington, Delaware

Maryland Alliance for Responsible Investment and  
NationsBank, Baltimore, Maryland

#### **Specialized Bank Programs**

First Community Bank, Boston, Massachusetts

Mellon Bank Community Development Corporation, Pittsburgh, Pennsylvania

Society National Bank Community Development Lending Group, Cleveland, Ohio

#### **Multibank Efforts**

Bankers Small Business Community Development Corporation in San Diego,  
California

#### **Government-Administered Programs**

Maryland Small Business Development Finance Authority, Maryland

Urbank Connecticut Small Business Reserve, Connecticut

#### **Community Development Lenders**

Center for Community Self-Help, North Carolina

Cooperative Business Assistance Corporation, Camden, New Jersey

Southern Dallas Development Corporation, Dallas, Texas

**Delaware Community Reinvestment Action Council  
and  
Delaware Trust Company**

**Wilmington, Delaware**

<b>Types of Organizations:</b>	<i>Delaware Community Reinvestment Action Council:</i> a 501(c)(3) nonprofit organization  <i>Delaware Trust Company:</i> a regulated financial institution
<b>Program Start Date:</b>	1988
<b>Service Area:</b>	State of Delaware
<b>Targeted Market:</b>	Designated modest-income census tracts in Delaware
<b>Loan Products:</b>	Small business loans from \$10,000 to \$500,000; uses SBA 7(a) guarantees and other enhancements
<b>Lending Activity:</b>	157 business loans totaling approximately \$6.9 million in 1993 under Community Partnership program
<b>Staffing/Operations:</b>	Lending done through 26 branches with 13 commercial lenders assisted by two administrative staff
<b>Notable Features:</b>	Lending agreement resulted from CRA advocacy; targeted lending has been incorporated into Delaware Trust's regular lending activity

**History and Description**

Delaware Community Reinvestment Action Council (DCRAC) negotiated a community lending agreement with Delaware Trust Company in 1988 when Delaware Trust was being acquired. Under the agreement, the bank committed \$50 million over five years for housing and commercial lending to designated modest-income census tracts.

DCRAC was created in 1987 as a coalition of community groups which assembled in order to challenge the proposed acquisition. The council included housing groups, civil rights organizations, community development corporations, and other community-based organizations. DCRAC commissioned a study examining the lending records of the major

lenders in the Wilmington area, which found that the banks were not lending in the modest-income markets.

Under the 1977 Community Reinvestment Act, DCRAC filed a challenge to the acquisition, holding up the merger until a lending agreement was signed. The Pennsylvania-based parent, Meridian Bancorp, has assets of approximately \$14 billion, and Delaware Trust has \$1.5 billion in assets in the state, controlling an estimated 15 percent of the statewide commercial lending market.

In April of 1988, DCRAC and Delaware Trust signed a contract, and DCRAC withdrew its challenge to the merger. This was a five-year agreement, effective from 1988 to 1993. While Delaware Trust reached its stated goals in 1991, the bank voluntarily continued its efforts and extended its commitments through 1995.

As stated in the agreement, the bank committed \$50 million over five years for home mortgage, home improvement, small business, and community development loans to 31 designated modest-income census tracts. These tracts had been identified in 1984 as economically depressed by the Delaware General Assembly. Like many CRA agreements, this one primarily focused on housing, with business lending and economic development constituting a smaller piece of the overall program. Products featured in the Community Lending Program included reduced-rate and reduced-fee mortgage loans for first-time homebuyers, and reduced-rate home improvement, small business, and community development loans. In addition, the program created a forum for counseling on such topics as home purchase or improvement financing, personal budgeting and financial planning, small business planning, and business loan packaging.

An oversight committee composed of members of the community and bank representatives met regularly to review the contract as it was being implemented. Initially, the committee met monthly; later, meetings were quarterly. The committee consisted of four community members from DCRAC and three representatives of Delaware Trust. Under the terms of the agreement, the bank developed a monthly summary of its lending in the designated areas. For each tract and type of loan, the bank recorded how many loans had been approved, denied, and withdrawn. The report also provided the number and dollar amount of loans in each census tract by type of loan.

Although DCRAC did not approach Delaware Trust to renew the lending agreement, Delaware Trust voluntarily continued the targeted lending program. The bank completed its stated goals in 1991, 18 months ahead of schedule. At that point, Delaware Trust pledged to continue beyond its goal. When the five years of the contract were up, the bank set new lending goals through 1995. The lending agreement introduced Delaware Trust to a new market that has been incorporated into a targeted focus for the bank.

## **Loan Products**

The bank primarily uses three programs to focus on disadvantaged businesses: the SBA 7(s) guarantee; the Delaware capital access program; and a private linked-deposit

program. Delaware Trust is an active user of SBA 7(a) loan guarantees. This bank is the leading SBA lender in its local market and has been a preferred SBA lender since October of 1993, the first in Delaware. Delaware Trust uses SBA guarantees particularly to enhance the applications from higher risk businesses.

During the last year and a-half, Delaware Trust has participated in the Delaware Capital Access Program, in which the State of Delaware funds a loan loss reserve. The bank also uses an interest rate write-down program, made possible by a linked deposit from MBNA America Bank, NA (a credit card bank).

In July 1991, MBNA bought a \$2 million certificate of deposit at Delaware Trust in order to provide below-market funding for small business loans. MBNA, a limited purpose bank, made this linked deposit to help satisfy its obligation under CRA. Businesses with sales under \$1 million which are located in a low-income census tract are eligible to borrow at 1-1/2 percent below prime. The loan amounts are typically between \$50,000 and \$60,000. Through the end of 1994, \$2,132,000 in loans had been extended under the program.

### **Lending Activity**

Under the Community Partnership program from April 1988 to April 1993, Delaware Trust made more than \$60 million in investments, lending for home purchase, home improvement, as well as small business. The bank made 517 small business loans worth approximately \$26.5 million. Most of these loans were for small amounts of less than \$50,000. All went to businesses in modest-income tracts, with a significant portion going to businesses in the city of Wilmington. In Wilmington, a city of 80,000, approximately 80 percent of the residents have incomes below the metropolitan median income level. In 1993, Delaware Trust made 157 small business loans to low- to moderate- income areas for approximately \$6.9 million. Of these, an estimated 130 went to businesses in the city of Wilmington. Delaware Trust has sustained a loss rate of approximately three percent of originations for these loans.

### **Staffing/Operations**

Delaware Trust targets modest-income areas through its regular line lending staff. Generally, lending is done through branch managers and loan officers. There are 26 branches and 13 business banking lenders. Lenders are familiar with the products and enhancements that can be used to make these customers more bankable. In addition to the lenders, two administrative staff oversee the targeted lending program and community reinvestment activity.

Delaware Trust does not provide technical assistance to borrowers. However, the bank has relationships with technical assistance providers to whom borrowers can be referred. The small business development center at the University of Delaware offers courses for business owners and start-ups, as well as one-on-one assistance. In addition to the Wilmington location, there are satellite offices in southern Delaware.

## **Notable Features**

The Delaware Trust Company Community Partnership Program was the product of a lending agreement between a community organization and its local bank. The agreement specified a dollar goal, target neighborhoods, and loan products. In addition, a committee met regularly to review lending activity. Although the community group did not approach the bank to renew the agreement contractually, the bank has incorporated targeted lending into its regular activity. Indeed, after the contract ended in 1992, Delaware Trust set new minimum annual lending goals for each of the calendar years 1993 through 1995 for 46 specific census tracts:

Residential Mortgage Loans	\$7,500,000
Home Improvement Loans	\$1,200,000
Small Business Loans	\$6,000,000
Community Development Loans	\$ 300,000

This CRA agreement succeeded in directing the bank to a new market to which the bank has made a continued lending commitment.

One element of the program that has added to its success is the support of bank management. Delaware Trust's strong CRA ratings has helped keep the Board of Directors and upper management supportive of these efforts.

**Contacts:** Michael Skipper, Delaware Trust  
Kemo Jabbar-Bey, Metropolitan Wilmington Community  
Development Corporation  
Rashmi Rangan, Delaware Community Reinvestment Action  
Council

**Interview Date:** March 20, 1995

**Maryland Alliance for Responsible Investment  
and  
NationsBank (formerly Maryland National Bank)**

**Baltimore, Maryland**

<b>Types of Organizations:</b>	<i>Maryland Alliance for Responsible Investment</i> : a coalition of nonprofit organizations  <i>NationsBank</i> : a regulated financial institution
<b>Program Start Date:</b>	1987
<b>Service Area:</b>	Baltimore, Maryland
<b>Targeted Markets:</b>	Designated modest-income census tracts primarily in the city of Baltimore; minority- and women-owned businesses in the state of Maryland
<b>Loan Products:</b>	Small businesses loans \$25,000 to \$250,000; uses SBA 7(a) guarantees and other enhancements
<b>Lending Activity:</b>	34 small business loans totaling nearly \$2.2 million in 1993 under the lending agreement
<b>Staffing/Operations:</b>	NationsBank's Community Development Services Department, Community Development Lending Group, and regular commercial lending structure
<b>Notable Features:</b>	Lending agreement resulted from CRA advocacy; includes specific dollar and geographic targets, oversight committee, and detailed monthly lending reports

### **History and Description**

Maryland Alliance for Responsible Investment negotiated a lending agreement with Maryland National Bank in 1986, in which the bank committed \$50 million over the following five years for lending to designated neighborhoods in the Baltimore area. The agreement included residential and commercial lending and targeted specific underbanked zip codes, primarily in the city of Baltimore.

In 1986, Maryland Citizen Action Coalition assembled a group of organizations to study the potential for stimulating economic development in Baltimore in the context of the

Community Reinvestment Act. The announcement of Maryland National Bank's intention to merge galvanized this alliance of community groups, civil rights organizations, housing groups, community development corporations, women's organizations, and a community credit union to intervene in the acquisition as Maryland Alliance for Responsible Investment (MARI). Under the 1977 Community Reinvestment Act, this coalition challenged the acquisition of American Security Bank by Maryland National Bank. Prior to this, CRA challenges were unprecedented in Baltimore.

Maryland National, a \$12.6 billion asset bank, signed a lending agreement with MARI in November, 1986 that took effect in July, 1987. The bank agreed to make best efforts to lend a minimum of \$50 million over the next five years for housing construction, purchase, and rehab, as well as small business lending. This effort focused on 20 low- to moderate-income zip codes, primarily within the city of Baltimore. Eligible businesses under this commitment were those located in and employing the residents of a targeted area with annual revenues of less than \$5 million.

The agreement specified that 50 percent of the funds would go to households. The next 35 percent of the funds would go to housing developers, and 15 percent of the lending would be for commercial uses. Additionally, 50 percent of the small business lending was reserved for loans no larger than \$50,000.

The contract was revised in 1989, when Maryland National acquired another bank. This change extended the agreement to 1995 and increased the dollar amount committed to \$80 million. The bank specified that \$12 million to \$32 million would be used for lending to small businesses. Businesses owned by minorities and women located in the state of Maryland were also targeted under the agreement.

NationsBank acquired Maryland National Bank in 1993, at which time it agreed to continue the existing agreement. NationsBank's acquisition of Maryland National meant the entry of a big, national financial player to the Baltimore market. NationsBank Corporation, with assets of approximately \$170 billion and operations in nine states plus Washington, D.C., is the fourth largest bank holding company in the country. In Maryland, NationsBank has assets of about \$18 billion and dominates the small business market, controlling an estimated 25 percent.

During the term of the lending agreement, a committee with three to four MARI representatives and three to four bank staff has met monthly to review lending activity. The bank provides data on loan approvals and closings for this committee to examine. For each loan, this monthly report lists the dollar amount committed, the type of business, the purpose of the loan, and the zip code of the business.

While the agreement expired in Spring of 1995, NationsBank has pledged orally to carry on with the practices stated in the lending agreement, without committing specific dollar amounts. However, the bank has agreed to continue providing monthly lending summaries for oversight meetings which will continue to include MARI representatives.

## **Loan Products**

NationsBank makes loans to a range of businesses for a variety of purposes. Borrowers include manufacturers and service industries, as well as professional businesses. Most loans are for working capital and commercial real estate (purchase and renovation), both in the form of lines of credit and term loans. As stated in the lending agreement, half the loans are for dollar amounts of less than \$50,000.

NationsBank uses a variety of enhancements to complete these deals. The bank is a preferred SBA lender. (Maryland National Bank was a preferred lender since 1989.) NationsBank also works with the Maryland State Business Development Finance Authority and other city and state programs.

## **Lending Activity**

In 1993, NationsBank made 34 loans worth approximately \$2 million to businesses in designated zip codes of Baltimore. Of these, 19 were for amounts less than \$50,000. Through the duration of the program, from 1987 to 1995, NationsBank and Maryland National Bank made 219 loans totaling \$15 million to eligible businesses. Of that total, more than 60 percent, or 136 loans, were for less than \$50,000. The loss rate for these loans has been kept to about 1-1/2 percent of originations.

NationsBank keeps track of its lending to the designated zip codes, detailing commercial and residential lending and providing these data to MARI on a regular basis.

## **Staffing/Operations**

The MARI-Maryland National agreement was concerned with preparing applicants for borrowing, as well as providing credit to the targeted areas. For this reason, one component of the agreement was that the bank would provide funding for community-based organizations to do home purchase counseling, as well as offering other guidance services. In addition, the bank supports a Small Business Resource Center which offers a variety of educational resources for small businesses. This Center provides technical assistance, seminars, and workshops to business owners referred by MARI, NationsBank, and other sources.

On the credit side, the targeted commercial lending is carried out through NationsBank's regular small business lending department, Business Banking. This unit handles businesses with up to \$4 million in annual revenues. These lenders are familiar with the lending agreement, as well as with the enhancement products available to them. The business lenders provide their lending data to NationsBank's Community Investment Group on a regular basis as part of NationsBank's internal oversight and in support of this lending.

## **Notable Features**

The CRA challenge launched by MARI in 1986, resulted in an unprecedented lending commitment to Baltimore's neighborhoods. The Maryland National Citizen Action Council was successful in uniting a broad group of local community groups to demand increased access to credit for the modest-income areas. Some particularly important features of this agreement include:

- Specific dollar goals for housing, development, and business investment
- A commitment that 50 percent of small business lending would be for dollar amounts less than \$50,000
- Disclosure of monthly lending including loans denied, withdrawn, and approved; zip code of the borrower; the dollar amount requested; the type of business; and the purpose of the loan
- Oversight committee composed of bank representatives and MARI members meeting monthly since 1987

**Contacts:** Thomas Chalkley, Maryland Alliance for Responsible Investment  
Barry Blumberg, NationsBank

**Interview Date:** June 13, 1995

**First Community Bank  
Bank of Boston**

**Boston, Massachusetts**

<b>Type of Organization:</b>	Full service division of the <i>Bank of Boston</i> with branches located in inner-city areas
<b>Program Start Date:</b>	1990
<b>Service Areas:</b>	Modest-income urban neighborhoods in Massachusetts, Rhode Island, and Connecticut
<b>Targeted Markets:</b>	Small businesses located in urban centers of seven New England cities, additionally targeting minority-owned businesses in the adjacent areas
<b>Loan Products:</b>	Small business loans up to \$5 million; SBA 7(a) guarantees and other enhancements
<b>Lending Activity:</b>	70 small business loans, totaling \$14 million in 1993 in targeted Boston and Providence neighborhoods
<b>Staffing/Operations:</b>	Lending unit has 22 staff, which includes 13 lenders
<b>Notable Features:</b>	Has the support and resources of \$45 billion <i>Bank of Boston</i> ; 24 branches in urban neighborhoods; employs a 60 percent minority workforce; profitable unit

### **History and Description**

First Community Bank (FCB) was established by Bank of Boston (BKB) to deliver community banking to minority and modest-income urban neighborhoods. Functioning as a bank within a bank, FCB operates 24 branches in seven cities of the Northeast. Within the bank, FCB is an independent department similar to business banking or corporate finance departments.

BKB created FCB largely in response to a 1989 Boston Federal Reserve lending bias study, which provided evidence of discrimination in mortgage lending in the Boston area. The bank management decided to confront the problem partly by targeting Boston's inner-city neighborhoods. The bank set a longer-term goal of reaching into all the major urban areas within the bank's service area of southern New England. Achieving that goal would affect 80 percent of the modest-income communities within BKB's designated CRA area.

Management felt that in order to succeed in the inner city, BKB needed a unit that would specialize in that market. A department called Boston First Banking was created in Boston in March, 1990, with nine branches and 70 employees. Two lenders started doing small business lending that same year in Boston's Dorchester community. In addition, BKB created a range of "entry level" retail banking products, the "First Step" line. The First Step Mortgage was designed for first-time homeowners, and First Step checking and savings programs were meant for less experienced retail banking customers. The First Step program additionally grew to include special products for home improvement and small business lending.

During 1993 and 1994, Boston First Banking branched into other New England cities and became First Community Bank. FCB has grown to 24 branches in seven cities: Boston, Fairhaven, Hartford, Holyoke, Providence, Springfield, and Worcester.

FCB has located its branches primarily in modest-income neighborhoods. Customers served are principally residents and businesses in these areas, although FCB also lends to minority-owned businesses located outside the targeted area. FCB offers these customers all the conventional services offered by BKB, as well as the range of First Step products. FCB handles business borrowers from the targeted neighborhoods and surrounding areas unless the loan request is larger than \$5 million; in that case, the applicant is referred to BKB. Approximately 40 percent of FCB's commercial clients require some sort of credit enhancement, while the remainder can be served with conventional products.

### **Loan Products**

FCB offers conventional products available at BKB in addition to the First Step line for a variety of purposes, including real estate, equipment, and working capital. FCB makes use of any available government enhancements to make small business loans. BKB is a preferred SBA lender, and both FCB and BKB lenders use 7(a) guarantees. The 7(a) is the most commonly used enhancement for small business loans, accounting for an estimated 20 percent of FCB's small business loans. Overall, approximately 40 percent of FCB's small business loans utilize some form of credit enhancement.

FCB also offers full-service residential and consumer banking services, including low-downpayment and reduced-fee mortgages and low-balance checking and savings accounts. Additionally, Business Focus Deposit Accounts and Business Focus Credit Accounts are designed to meet the needs of small businesses.

### **Lending Activity**

FCB makes loans to a variety of businesses for a range of purposes. Targeted businesses are those located in minority and modest-income neighborhoods of the cities served by FCB. However, these lenders also work with minority- and women-owned businesses throughout New England.

In 1993, when FCB was active primarily in Boston and Providence, FCB made 70 small business loans, totaling approximately \$14 million. The vast majority (about 85 percent) of these went to borrowers in modest-income neighborhoods. Additionally, an estimated 70 percent of borrowers were minorities. From 1990 to 1994, FCB made an estimated 300 loans. While the size of loans can range up to \$5 million, most are quite small. In 1993, more than 80 percent of FCB's commercial loans were for less than \$80,000, with approximately 25 percent for less than \$20,000. FCB's small business loans have performed satisfactorily, with minimal charge-offs.

FCB, as a whole, generates a profit for BKB. Small business lending is subsidized with profits from other services. In this way, community deposits subsidize economic development in the community.

### **Staffing/Operations**

FCB is a division of BKB. FCB calls itself a bank within a bank in that it functions as an independent full-service bank within BKB, but it is not separately chartered. FCB manages its own branches, trains its employees, and markets its products. Customers interact with FCB employees when they enter branches of FCB. Nevertheless, FCB does make use of BKB credit officers and the consumer finance division.

FCB has 24 branches in seven cities of Massachusetts, Rhode Island, and Connecticut. These branches are run by 224 employees, 13 lenders handle small business lending. As part of its strategy to reach its target market, FCB has focused on creating a diverse workforce: 60 percent of employees are members of minority groups, and 70 percent are women.

Within BKB, FCB is considered a respected department, conducting bank business by providing financial services to a segment of their clientele. FCB has worked to fight the notion within the bank that it is a "charity" department or CRA compliance exercise. More than merely combating stigma, FCB has created a feeling of elite professionalism. Establishing itself as an independent, professional division has been especially important to recruiting and retaining staff and to maintaining the respect of the rest of the bank employees.

### **Notable Features**

First Community Bank benefits from Bank of Boston's tremendous resources. The second largest bank in New England, BKB reaches throughout much of southern New England. As an independent division, FCB can combine BKB's resources with a community focus to be a community bank in inner city neighborhoods that have been historically underserved by financial institutions. FCB has located branches in these neighborhoods and focused on both residents of the areas and businesses in the broader regions that may not have been well served by the conventional market. In addition, BKB has made an effort to reach the majority of the low- and moderate-income neighborhoods within its service area. While FCB started in Boston, more recently, new branches have opened in other cities with significant minority populations and modest-

income areas. By targeting specific neighborhoods and specializing in those areas, FCB lenders have been able to make good loans and to increase their presence in these communities.

FCB has had the support of the bank's upper management. By creating a sense of elitism and professionalism among its employees, FCB has both recruited experienced staff and commanded respect from the rest of BKB. In this way, FCB has created for itself a name that is respected throughout the bank.

**Contact:** Jeffrey Zinsmeyer, First Community Bank

**Interview Date:** February 21, 1995

## Mellon Bank Community Development Corporation

### Pittsburgh, Pennsylvania

**Type of Organization:** Bank holding company community development corporation

**Program Start Date:** 1986

**Service Areas:** Modest-income areas in *Mellon Bank's* service area, with particular focus on Pittsburgh and Philadelphia

**Targeted Markets:** Near-bankable small businesses, and minority-owned firms

**Loan Products:** Loans to small businesses and nonprofits; subordinate loans in conjunction with senior bank financing; loan packaging for businesses in targeted markets using non-CDC *Mellon Bank* and government financing

**Lending Activity:** 36 small business loans for \$1.4 million in 1993 (not counting loan packaging using non-CDC funds)

**Staffing/Operations:** Two full-time professionals with one support staff; formal network of ten liaisons in markets outside of Pittsburgh

**Notable Features:** CDC structure permits flexibility in structuring and participating in projects, while still having access to the resources of the parent institution

### History and Description

Mellon Bank Community Development Corporation (MBCDC) is a bank community development corporation that was established in 1986 to serve the credit and investment needs of modest-income communities in Mellon Bank's service area, which now includes Pennsylvania, Delaware, southern New Jersey and the Maryland suburbs of Washington, DC. MBCDC makes subordinate and specially structured loans to small businesses, as well as housing and real estate projects, with special emphasis on Pittsburgh and Philadelphia. The CDC is wholly-owned by Mellon Bank Corporation with offices located in Mellon Bank facilities. While the headquarters of MBCDC are in

Pittsburgh, Mellon's corporate headquarters city, MBCDC has formal staff liaisons in Philadelphia, as well as in Mellon's seven other regions.

The history of MBCDC stems from earlier entities within Mellon Bank. In the late 1960s, the bank had established a Small Business Management Section, a section being the smallest organizational unit within Mellon. The Section's responsibility was to package SBA loans and originate loans to minority entrepreneurs. In 1981, the Section was reorganized into the Mellon Community Development Division.

When community development organizations in Pittsburgh and Philadelphia began approaching the Community Development Division in the early 1980s about creating a small fund for community development projects, Division staff began researching possible vehicles for such a fund. They talked with officials from the Office of the Comptroller of the Currency and the Federal Reserve Board, who explained the advantages of the bank community development corporation model. This structure removes some of the regulatory constraints that banks face, including the ability to provide subordinate debt and equity financing.

In 1986, Mellon reorganized its Community Development Division into MBCDC, a bank holding company CDC regulated by the Federal Reserve Board, making it one of the earliest Federal Reserve CDCs. The role of MBCDC is to ensure that projects that are important to modest-income segments of the Mellon's service area are looked at creatively and responsively. The CDC structure allows MBCDC to develop specialized skills and flexible products geared towards historically underserved markets.

MBCDC, which began in 1986 with \$500,000 of capital and a \$3 million line of credit from Mellon Bank, has grown to the point where it had \$10 million in capital, a direct portfolio of \$7.7 million, and other investments of \$5.2 million by the end of 1994, and has been growing by about 25 percent annually in recent years. The CDC began lending at a substantially larger scale in 1989.

## **Loan Products**

MBCDC works to package and sometimes finance loans for small businesses in modest-income neighborhoods, particularly for minority-owned businesses. MBCDC makes loans to firms that are not conventionally bankable, but it typically does so in conjunction with a senior, conventional loan from Mellon Bank, or some other lender. On small business loans, the CDC does not typically participate at levels beyond \$50,000, but total project costs may range from a few thousand dollars to nearly \$400,000. MBCDC's loans are either direct, discrete loans to the borrower, subordinated to a separate senior loan, or are subordinate participations, where the CDC buys a portion of the senior lender's total loan. While it made direct loans without partnering with a senior lender when starting out, MBCDC had more difficulties with these loans and so has refrained from financing 100 percent of project debt in most cases.

MBCDC is not just a provider of credit; it is involved in structuring and packaging small business and nonprofit loans involving government enhancements throughout the bank. It follows a four-stage process for packaging and funding projects. Because it has access to the regular lending facilities of a large, regional bank, it first looks to structure deals using conventional bank products. After identifying gaps that the bank cannot fill, MBCDC then looks for government enhancements, such as SBA guarantees, to make projects feasible. If further enhancement is needed, MBCDC identifies the amount and structure of its own participation that is required. Finally, failing to identify sufficient financing from all of these sources, referrals to finance companies or equity investors may be required.

Loans are priced at or below market rates, and terms are flexible. MBCDC is able to structure repayment terms to improve a project's cash flow, including using longer amortizations or deferring principal payments. In addition to loans for a variety of business needs, including working capital, MBCDC makes loans for commercial real estate, dental and medical professionals, and contractors. MBCDC also finances housing projects and community development organizations.

MBCDC develops most of its business through Mellon Bank. It also participates in local development activities and utilizes a general marketing brochure.

### **Lending Activity**

MBCDC packages and makes loans to small businesses. Using MBCDC funds, the organization had made 127 small business loans as of late 1994, for a total of \$3.9 million. These loans typically cover only a portion of corresponding project financing, so that project sizes range from \$3,000 to \$400,000. In 1993, MBCDC made 36 loans for \$1.4 million and, of these, 24 were for amounts of less than \$50,000. Of these same 36 loans, 80 percent went to establishments located in modest-income urban neighborhoods, and 78 percent went to minority-owned businesses. Small business loans have performed well, with only a few loans having been charged off since inception.

In addition to lending its own funds, MBCDC packages financing for Mellon Bank using government enhancements. MBCDC has packaged approximately 250 loans for small businesses, including those that have obtained some MBCDC financing. In essence, MBCDC staff act as the resident experts in government enhanced financing within Mellon Bank, and as a resource that can be accessed throughout the bank. Moreover, prior to any final denial by the bank, MBCDC performs a second review of projects that might significantly benefit modest-income communities.

### **Staffing/Operations**

Core staff consists of MBCDC's president, a real estate lender, and an operations manager. MBCDC has a small board that includes the head of retail banking and an

executive vice president of Mellon Bank. The organization also utilizes a formal network of ten liaisons in markets outside of Pittsburgh, including three in Philadelphia and one in each of Mellon's seven other regions. These liaisons assist in structuring, packaging, and underwriting projects in their market areas. In addition to formal liaisons, MBCDC works through many informal liaisons throughout Mellon Bank.

### **Notable Features**

Because it is part of a large regional bank holding company, MBCDC has the advantages and disadvantages of a large regional financial institution. The CDC structure allows it to be more flexible in structuring and participating in projects, while still having access to the resources of the parent institution. MBCDC can leverage both capital and staff resources by working with the more conventional areas of the bank. At the same time, the CDC is subject to the direction of the parent corporation's board of directors. The ability of MBCDC to continue its growth will hinge upon the attitude and support of upper management at the parent institution.

**Contact:** William Whitfield, Mellon Bank CDC

**Interview Date:** March 2, 1995

## Society National Bank Community Development Lending Group

Cleveland, Ohio

<b>Type of Organization:</b>	Specialized unit of <i>Society National Bank</i>
<b>Program Start Date:</b>	1989
<b>Service Area:</b>	Cleveland metropolitan area
<b>Targeted Market:</b>	Near-bankable small and minority-owned businesses in modest-income neighborhoods in Cleveland area, especially in the city of Cleveland
<b>Loan Products:</b>	Small business loans from \$10,000 to over \$1 million; uses SBA 7(a) guarantees and other enhancements
<b>Lending Activity:</b>	Approximately 80 small business and commercial real estate loans in 1993; approximately 15 loans to nonprofit organizations and churches; business/nonprofit commercial ending totaled \$14.8 million
<b>Staffing/Operations:</b>	Nine staff, including six loan officers
<b>Notable Features:</b>	Unit of a large bank responsible for implementing bank's community reinvestment agreement with the City of Cleveland; manages economic development finance in modest-income neighborhoods with a specialized unit approach

### History and Description

Society Bank's Community Development Lending Group (SCDLG) is a unit of Cleveland-based Society National Bank that makes community development loans, both for housing and small business projects, in modest-income parts of the Cleveland metropolitan area. Society Bank is a \$22 billion subsidiary of KeyCorp, a \$65 billion bank holding company based in Cleveland, Ohio. Society operates in 42 Ohio counties, most of them in Northern Ohio, and KeyCorp operates in 14 states. SCDLG was established in 1989, subsequent to Society's acquisition of Central National Bank, an active small business lender, and prior to its merger with Ameritrust Corporation. SCDLG is only one unit within Society making small business loans in modest-income parts of the Cleveland area. Other units also serve these markets.

In the early 1990s, the city of Cleveland took an active role in pushing for heightened reinvestment activities on the part of Cleveland's major financial institutions. In December, 1991, Society signed a community reinvestment agreement with the city of Cleveland, pledging to do \$260 million in residential and small business lending in Cleveland neighborhoods within a four year period. The Bank exceeded its lending targets in all four years of the agreement. SCDLG has played a significant role in fulfilling the Bank's commitment under this agreement.

A significant part of SCDLG's responsibility is to serve small businesses that do not meet the traditional requirements of Society's Business Loan Center, which focuses on conventionally bankable customers. SCDLG utilizes credit enhancements where necessary, combined with a more patient and specialized approach to less sophisticated and sometimes less mature businesses. Both the Business Loan Center and SCDLG make loans in modest-income census tracts in the Cleveland area. SCDLG customers tend to be smaller and less established than those of the Business Loan Center, and sometimes need increased attention regarding business records, business plans, and projections. SCDLG is more likely than other units of the Bank to work with customers on these issues and to utilize credit enhancements where appropriate. SCDLG also focuses on minority-owned businesses.

SCDLG is situated within Society Bank's regular management structure as opposed to being structured as a separate entity such as a bank community development corporation. SCDLG is a distinct lending unit, similar to other specialized lending units within Society, such as asset-based lending or middle-market lending. Many districts in the statewide bank have their own community development staff.

The Bank views the type of small business lending done by SCDLG as a demanding task requiring highly skilled and experienced staff committed to development issues. SCDLG also utilizes a distinct loan approval process with its own loan committee. SCDLG staff note that credit administration personnel associated with unconventional lending programs should have some lending background. Otherwise, it is very difficult to maintain the flexibility and creativity needed for this type of lending. SCDLG also has access to Key Community Development Corporation, a bank holding company CDC, which offers additional products and services.

As part of its efforts to serve businesses in Cleveland's neighborhoods and minority-owned businesses, SCDLG utilizes small business development centers in its outreach and marketing work. These organizations also provide potential borrowers with the technical assistance needed to structure business plans and prepare loan packages. The unit relies on relationships with economic development and business people to develop new contacts, and does not need to do extensive direct marketing.

## **Loan Products**

SCDLG provides a range of products to small businesses, including financing for neighborhood commercial real estate, working capital and equipment. Loans range from \$1,000 to over \$1 million, with a focus on smaller loans between \$10,000 and \$100,000. Loans are usually made at market rates, with more flexible terms than those available

through the other parts of the Bank. As an example, SCDLG developed a contract financing program with Cuyahoga County, in which it makes loans to minority- and women-owned contractors doing business with the County. Instead of offering a line of credit based on receivables, which are available only after the contracted work is completed and delivered, SCDLG provided an "advance" line of credit in which it accepts an assignment of a client's contract with the County as collateral, providing the borrower with the funds upfront that he or she needs to finance the project.

Society Bank is a certified lender under the SBA 7(a) guarantee program. SCDLG also utilizes the Ohio Mini Loan program, which combines a 45 percent guarantee with a linked-deposit, and the Business Consortium Fund, which offers loan guarantees and subordinate financing to minority firms contracting with large corporations.

The real difference between SCDLG and other units of the bank lies in the effort made to work with individual businesses, to structure deals, and to try to make projects happen. This increases the costs of the transaction and requires a specialized lender approach to contain these costs.

### **Lending Activity**

Through 1993, SCDLG made almost 250 small business and commercial real estate loans for a total of more than \$33 million in the Cleveland area. The Group also made almost 70 loans to nonprofits and churches. The majority of these were made for projects in the city of Cleveland, with the bulk of all lending going to businesses in modest-income neighborhoods in the metro-area. More than 40 percent of all loans were for amounts of less than \$50,000, and another 20 percent were for amounts between \$50,000 and \$100,000. SCDLG staff estimate that 70 percent of its loans utilize some type of credit enhancement such as a guarantee or subordinate loan.

In 1993, SCDLG made approximately 80 loans totaling almost \$10 million to small businesses and commercial real estate projects, and about 15 loans totaling about \$5 million to churches and nonprofits. Charge-offs for 1994, the first year that the unit handled its own loss accounting, were 0.9 percent of outstandings.

### **Staffing/Operations**

SCDLG had nine staff members serving the Cleveland market in 1993, six of whom were loan officers. These lenders work on small business, housing, and real estate projects, requiring a diverse set of development finance skills. The unit is housed within Society Bank's offices and utilizes its own loan committee.

### **Notable Features**

The SCDLG model is one that appears to be readily replicable for many larger metropolitan banks. It utilizes a relatively straightforward specialized unit approach and recognizes the limitations larger banks face when attempting to use their

conventional commercial lending units to address the markets represented by small businesses in urban, modest-income neighborhoods. The Bank does not use SCDLG as a replacement for its conventional commercial lending activity in the targeted areas. Rather, it recognizes the development obligations and opportunities presented by businesses that are not served by conventional banking approaches and has developed a section of the bank that has the skills and attitude necessary to address such firms.

One difficulty of this approach is that it is sometimes difficult to devise ways of rewarding individual lenders for strong community development lending performance. Traditional incentives based on loan fees are not necessarily sufficient for retaining quality staff. Compliance with the Community Reinvestment Act provides strong motivation for banks such as Society to develop and commit to programs like SCDLG. The challenge is to convert at least some of the rewards for improving CRA performance into rewards for staff.

**Contact:** Rosalyn Ciulla, Society Bank Community Development Lending Group

**Interview Date:** March 17, 1995

## **Bankers Small Business Community Development Corporation**

**San Diego, California**

<b>Type of Organization:</b>	For-profit, multibank community development corporation
<b>Program Start Date:</b>	1992
<b>Service Area:</b>	San Diego County
<b>Targeted Markets:</b>	Small and emerging businesses, especially minority- and women-owned, in modest-income census tracts and designated enterprise zones
<b>Loan Products:</b>	Small business loans of up to \$50,000 for a variety of purposes and stand by letters of credit
<b>Lending Activity:</b>	32 loans for a total of \$900,000 in 1994
<b>Staffing/Operations:</b>	Staffed by one person via contract with the CDC Small Business Finance Corporation, an SBA 504 certified development company that serves four southern California counties and has a staff of approximately 22
<b>Notable Features:</b>	Initiated and partially supported by the CDC Small Business Finance Corporation, which in turn generates the bulk of its revenues from its large volume of SBA 504 loan activity

### **History and Description**

Bankers Small Business Community Development Corporation (Bankers CDC) is a multibank community development corporation that targets minority and women-owned businesses, as well as those located in modest-income census tracts in San Diego County. Bankers CDC was organized by the CDC Small Business Finance Corporation (SBFC) in the early 1990s and began lending in late 1992. SBFC is an SBA 504 Certified Development Company that was founded in 1978 and serves four southern California counties: San Diego, Riverside, Imperial, and Orange. The SBA 504 program provides subordinated, long-term, fixed-rate loans as large as \$1 million to small businesses for

real estate and equipment projects. SBFC is a relatively large economic development financing organization, with a strong history of SBA 504 and 7(a) lending activity. It is one of the most active SBA 504 CDCs in the country, originating more than 120 SBA 504 loans and packaging almost 100 SBA 7(a) guarantees in 1994.

While the SBA 504 loan program, or one of its predecessors, has been the primary focus of SBFC, the organization sees itself as a comprehensive economic development financing organization and has sought to develop innovative programs and partnerships to provide financing across a range of small business needs. Operating SBFC on a regional basis allows the lender to take advantage of the significant economies of scale in 504 lending. Packaging and processing 504 loans is somewhat specialized, creating barriers to profitable small-scale operations. Larger scale 504 operations can generate significant net revenue for 504 certified development companies. This has allowed SBFC to invest in the creation and development of Bankers CDC and to focus on underserved markets.

In addition to using the 504 program to serve the fixed-asset (real estate and equipment) needs of well-established, expanding enterprises, SBFC also provides financing assistance to smaller and younger firms and for those needing working capital. One way SBFC has done this is by developing new, innovative programs, customized to the needs of businesses in their area. The 504 loan program is ill-suited for projects of less than \$400,000 or so, and banks had been reluctant to make loans under \$50,000, even with SBA 7(a) guarantees, particularly to younger firms that may not meet conventional underwriting standards. What was needed was a mechanism to provide financing and related assistance to small firms that cannot meet the needs of conventional loan programs, especially for those firms seeking loans of under \$50,000.

Beginning in 1989, the president of SBFC formed a working group to explore the development of a new program for financing young, smaller firms. SBFC recognized that the need for economic development was greater among certain communities within its greater service area, so in setting up Bankers CDC, it targeted modest-income census tracts within San Diego County as well as minority- and women-owned firms.

In 1991, SBFC organized a separate organization, formed as a for-profit multibank community development corporation, staffed via a management contract with SBFC, and on whose board the director of SBFC sits. The multibank organizational structure permits the participating lenders to spread risks and costs, and to step out of the traditional, rigid credit cultures that persist in many banks. The CDC model permits Bankers CDC to utilize flexible underwriting and structure innovative deals, including "equity kickers" and other unconventional features. The for-profit status of the CDC stemmed from a desire to maintain a longer-term profit-making, or at least break-even, objective among participating institutions.

Bankers CDC has a 12 person board, including eight member bank directors and four community members (three small business owners and the director of a local microlending organization). Bankers CDC began with \$75,000 in equity and \$600,000 in

its first loan pool from 20 banks. Financial institutions participate in Bankers CDC both to help meet their CRA obligations, and to support the environment for longer-term business formation in targeted parts of the San Diego community. Bankers CDC boasted 28 member banks as of early 1995, and had recently completed their third loan pool, bringing the cumulative total lending pool to \$2 million.

## **Loan Products**

While SBFC offers a variety of government-enhanced loan products, including SBA 504 and 7(a) loans, Bankers CDC utilizes pooled private capital and debt to provide smaller loans to targeted businesses. Bankers CDC describes itself as offering two different products. The primary loan product is called a microloan. Bankers CDC provides direct financing from \$5,000 to \$50,000 for equipment or working capital, with flexible terms, three year maturities with five year amortizations, and an interest rate fixed at prime plus 3.5 percent. Applicants are expected to show positive cash flow and have a good credit rating. A lack of collateral does not preclude qualification.

A second product is an "equity gap" letter of credit, an innovative tool where Bankers CDC provides a letter of credit of up to \$25,000 to help applicants meet equity requirements for SBA 7(a) guaranteed loans from conventional lenders. Alternate applications of Bankers CDC letters of credit have also been used.

In conjunction with providing credit, Bankers CDC has begun to deal with the need for technical assistance among some of its borrowers. Because the organization has seen some problems with what one loan committee member termed the "shoebox" financial record-keeping practices of some very small firms, it is instituting a technical assistance program in which it makes loans subject to the borrower agreeing to undertake basic financial management training from a qualified CPA, designated by Bankers CDC. The training is paid via an upfront escrow, which varies based on loan size. The fee is then used to retain the accountant for six months to train the businessperson to maintain adequate records and financial systems, and to implement financial planning. Monthly reports are provided to Bankers CDC as a part of this process.

## **Lending Activity**

In its first two years of operation, Bankers CDC had originated 44 loans for \$1.3 million, all of them in low- or moderate-income census tracts within San Diego County, with more than one-half of the loans going to minority-owned businesses. After making 12 loans in 1993, Bankers CDC made 32 loans in 1994 for a total of \$900,000. The typical loan size is \$25,000. Bankers CDC has begun to utilize two loan committees, each meeting once a month, to assure adequate turn around on applications. Each loan committee consists of bankers and one minority business person. While it is still a bit early to judge the performance of Bankers CDC loans, only two loans had been charged off as of mid-1995, with a couple of other borrowers experiencing difficulty due to the

devaluation of the Mexican peso. The organization, however, budgets for a loss rate of 15 percent of outstandings, expecting to remain well under budget in the longer-term.

### **Staffing/Operations**

Until early 1995, Bankers CDC was staffed by one person, an employee of SBFC. In early 1995, an additional staff person was brought on, in part to handle loan servicing. Servicing of loans was initially handled by a member bank, but after experiencing some problems subsequent to an acquisition of this bank, Bankers CDC took over servicing. SBFC, whose main office is co-located with Bankers CDC, has a staff of 22, with eight loan officers and four credit analysts, in addition to Bankers CDC staff. SBFC's annual operating budget is \$1.7 million. In addition to its main location in San Diego, SBFC has offices in Riverside, Imperial, and Orange Counties.

### **Notable Features**

Essentially, the income produced by SBFC's SBA 504 lending activity has been reinvested in new and supplemental programs that address a variety of economic development needs. Operating the 504 program at a substantial scale has enabled the development of a targeted program focusing on those firms with the greatest unmet financing needs in the areas most in need of development. This approach is appealing for several reasons:

- It recognizes the differences encountered when attempting to serve a broad range of business size, loan size, risk, and uncertainty.
- It reinvests a portion of retained earnings, provided by the more lucrative activities, into developing and investing in innovative approaches to meeting the financing needs of poorly served credit markets and modest-income communities.
- It has enabled the development of a sizable nonbank, economic development oriented financial institution that is less susceptible to the whim of funding agencies or the credit cultures of banks. While freedom from operating support may not be feasible for most economic development lenders, if practicable, it has many advantages.

**Contacts:** Jeni Burgess, Director, Bankers Small Business CDC  
Kimberly Buttemer, CDC Small Business Finance Corp.  
Lee Fenn, Boardmember, Bankers Small Business CDC  
Art Goodman, President, CDC Small Business Finance Corp.

**Interview Date:** March 10, 1995

# Maryland Small Business Development Financing Authority

## Maryland

<b>Type of Organization:</b>	State economic development finance agency
<b>Program Start Date:</b>	1978
<b>Service Area:</b>	State of Maryland
<b>Targeted Markets:</b>	Minority-owned businesses
<b>Loan Products:</b>	Direct contract financing program; long-term loan guaranty; surety bond guaranty; equity participation
<b>Lending Activity:</b>	22 loans for more than \$2.9 million for the year ending June, 1995
<b>Staffing/Operations:</b>	State now contracts with MSBDFFA Management Group, Inc., a private firm, to improve effectiveness and responsiveness; staff of eight includes five professionals
<b>Notable Features:</b>	Complementary to government procurement programs; has maintained consistent track record in minority business financing, focusing on more established firms and larger loan sizes to impact job creation

### History and Description

The Maryland Small Business Development Financing Authority (MSBDFFA) is a state agency founded in 1978, whose mission is to assist socially or economically disadvantaged businesses, primarily minority-owned firms, in the State of Maryland. MSBDFFA, like many state-level economic development financing agencies, seeks to create and retain jobs and generate tax revenues, as well as to serve its targeted businesses. The agency operates a number of financing programs, including a contract financing program, a long-term loan guaranty, a surety bond guaranty program, and an equity participation program. MSBDFFA was originally capitalized with \$2 million from the State of Maryland budget. As new programs were created, additional capital was set aside for their operation. To date, the State has invested approximately \$20 million in MSBDFFA programs. MSBDFFA does not receive annual state appropriations for operating expenses. Rather, the agency operates on returns from its lending activities and from investments of its capital dollars in various securities.

MSBDFA programs suffered from high losses when they first began. Current management attributes this to excessively concentrating its portfolio in one volatile industry, construction, and serving primarily undereducated, underprepared entrepreneurs, the majority of whom did not have a high school education. Since these early problems, MSBDFA has focused on assisting firms with more educated owners, and has diversified its lending to include firms in a variety of businesses, including higher growth services. Proximity to Washington, D.C., has led MSBDFA to finance many firms with federal contracts.

The most significant development at MSBDFA in recent years is its change from being staffed with State of Maryland employees to operating via contract with a private management company, the MSBDFA Management Group (MMG). MMG was established by MSBDFA senior management in 1994 to contract with the State of Maryland to operate MSBDFA programs more efficiently and effectively. The State of Maryland legislature approved this change, agreeing with the notion that it would help the program achieve its economic development goals.

The motivation for moving operations of the MSBDFA to a private firm were based partly on the grounds of improving efficiency and timeliness. Before this change, the program was required to utilize the State of Maryland Attorney's General Office for all legal work. This could add more than two to four weeks to the loan approval and closing process, which, when dealing with contract financing, can be devastating to a small business. Operating as a state agency also made it difficult to hire and manage staff effectively, and to procure supplies efficiently.

Before the change in management structure, MSBDFA faced the challenge of preserving its working relationship with small businesses and banks despite delays and bureaucratic hassles encountered with the underwriting and loan closing process at MSBDFA. This was due in large part to lack of control over the legal process, a problem which the new management structure promises to resolve. When management proposed moving staff out of state government, they encountered some resistance from the state bureaucracy. Broad support in the legislature, as well as support from organized labor, enabled them to make the change.

## **Loan Products**

MSBDFA offers four primary financing products: a direct loan for financing companies with contracts with government or utilities; a loan guarantee for working capital, equipment and real estate; a surety bond guarantee program for firms contracting with government or utilities, and an equity participation program providing capital to franchises, technology-based firms, and acquisitions. The direct loan program had offered below-market rate lines of credit. Recently, rates were increased to prime plus 1.5 percent to counter falling interest rates and help maintain income for program operations. This increase should not only boost MSBDFA's return on assets, but should help ensure that firms seeking assistance are unable to get financing from conventional

sources, an area of concern when dealing with relatively established firms seeking larger loan amounts. Average loan amounts for direct loans have run slightly less than \$200,000 in recent years, while guarantees tend to be larger. MSBDFA prefers financing more established firms that are poised to create a substantial number of jobs rather than lending to young, very small, lower-growth firms.

Under its long-term loan guarantee program, MSBDFA guarantees up to 80 percent of a bank loan with a maximum guarantee of \$600,000. Unlike the other programs, the loan guarantee is available to all firms owned by disadvantaged persons, not just those contracting with government or utilities. Under the surety bond program, small businesses with government or utility contracts are eligible for 90 percent guarantees of bonds up to \$1 million. The equity participation program can provide debt or equity up to \$100,000 for franchises and up to \$500,000 for technology-based businesses or acquisitions.

While MSBDFA does not offer traditional technical assistance, it works with small business development centers, and federal, state and local development agencies to assist client firms. MSBDFA also performs pre-loan and post-loan financial audits of clients, helping them identify potential problems and stay financially sound.

One unusual feature of MSBDFA is its practice of collecting and analyzing detailed data on its borrowers. Information on business owner traits and business characteristics are collected along with job creation figures. The organization has also utilized econometric tools to project the amount of economic activity resulting indirectly from MSBDFA financed projects. Job creation attributed to the direct loan program for fiscal 1988 through 1993 suggests that the program created approximately one job for every \$11,000 in loan funds. Such records and analyses have enabled the agency to develop a strong and positive relationship with the state legislature.

### **Lending Activity**

Since 1980, MSBDFA has made or guaranteed more than 384 loans totaling more than \$59 million. In fiscal 1995, MSBDFA made or guaranteed 22 loans for more than \$2.9 million. Of these 22 loans, six went to businesses in the city of Baltimore, with most of the others going to firms in Prince George's and Montgomery Counties in the greater Washington, DC area. MMG management indicate that raising interest rates has not had a detrimental effect on loan demand, suggesting that clients have been utilizing the direct loan program based on need and not merely taking advantage of low-interest rates.

Total loan losses have amounted to less than 11 percent of cumulative loans, with recent loss rates running about 4 percent of outstandings. MSBDFA has shifted from doing a large number of smaller loans to high-risk firms predominantly in the construction industry, to making fewer larger loans to more established minority-owned businesses. This appears to have contributed to reduced loan losses in recent years.

### **Staffing/Operations**

The MSBDFA Management Group, which operates MSBDFA under contract with the State of Maryland, employs five professional staff and three support staff. Professional staff include four lenders and one auditor. MMG is based in Baltimore. Most of its staff are former employees of MSBDFA.

### **Notable Features**

MSBDFA is notable for its successful track record in financing minority-owned firms, particularly government and utility contractors. Given the resources and attention many state and local governments place on minority business contracting programs, it is important to recognize the particular obstacles minority-owned firms face in accessing capital and credit as they attempt to take advantage of these new opportunities. With increased access to a comprehensive range of economic development programs, including a solid financing program, minority-owned businesses in Maryland possess a competitive advantage in these emerging markets. On the other hand, MSBDFA will have to keep an eye on federal and state changes to minority business development programs, because roll-backs of such programs could be detrimental to businesses that rely heavily on such programs.

Operationally, MSBDFA's efforts to become more efficient and effective through creating a private management company are significant. This move has enabled MSBDFA to decrease turn-around time on loan applications by at least two to four weeks. The organization is also unusual in its utilization of monitoring and auditing activities, portfolio review, and economic impact analysis.

**Contact:** Stanley Tucker, MSBDFA Management Group

**Interview Date:** May 16, 1995

## Urbank -- Connecticut Small Business Reserve

### Connecticut

<b>Type of Organization:</b>	Urbank is administered by the Connecticut Development Authority, a state government development authority
<b>Program Start Date:</b>	1993
<b>Service Area:</b>	24 Connecticut cities containing distressed areas or enterprise zones and two nonurban counties
<b>Targeted Markets:</b>	Near-bankable small businesses, especially minority- and women-owned
<b>Loan Product:</b>	Capital access portfolio insurance
<b>Lending Activity:</b>	65 loans totaling \$6.9 million in 1993
<b>Staffing/Operations:</b>	One professional and one support staff
<b>Notable Features:</b>	A simple, nonbureaucratic tool for government involvement in increasing small business loans that is easily targeted by varying subsidy rates; provides a means of buffering areas from federal SBA policy changes

### History and Description

The Urbank program is a capital access program designed to assist small businesses that create and retain jobs in designated urban centers across the state and in two nonurban counties. Capital access programs work by creating reserve funds for each bank making loans under the program. Typically, the borrower makes a premium payment, often from 1 to 3 percent of the loan, the bank makes a similar payment (which may be passed on to the borrower), and the capital access program agency matches it. Together, these payments are put into the participating bank's Urbank reserve account. Each participating bank has only one reserve account, which, as loans build, accumulates sizable reserves that can be drawn down to cover charge-offs for loans processed through the program.

The Urbank program was established in 1993 by the Connecticut Development Authority (CDA), a quasi-public economic development authority whose mission is to foster economic development throughout Connecticut. Urbank, unlike most other CDA programs, is geographically targeted, focusing on central cities containing enterprise

zones and distressed nonurban communities, as well as on minority- and women-owned businesses.

CDA was established in 1973 and receives its capital from general obligation bonds backed by the State of Connecticut and its operating revenues from borrower repayments. The Authority is governed by a board appointed by the governor and legislative leaders. Altogether, CDA manages 15 different economic development programs. In 1994, CDA funded 205 firms for projects totaling more than \$335 million, with \$135 million of this coming from CDA programs.

Historically, CDA had focused on assisting relatively established, small and medium-sized industrial firms. However, when the recession of the early 1990s hit several Connecticut cities particularly hard, CDA officials began exploring potential methods of improving access to credit for a broad range of smaller firms in these areas. Around the same time, the Michigan Capital Access Program had begun to gain attention as an innovative approach to improving credit availability for small businesses. Following the Michigan model, CDA established the Urbank capital access program in 1993, with funds of \$5 million targeted to businesses in five distressed central cities. This enabled the agency to target its limited resources where they were most needed and to influence banks to lend where access to credit was a serious problem.

The Urbank program is not unique in the use of the capital access tool. There are at least 18 capital access programs administered by states and localities in the U.S. The difference is that Connecticut has targeted its program to those communities most in need of reinvestment and has used supplemental insurance to induce banks to lend to firms in such areas. Urbank is notable for its success at targeting modest-income areas and minority- and women-owned businesses, while sustaining few losses and requiring minimal staff. This combination of features is uncommon among state-level economic development financing programs.

### **Loan Product**

The Urbank program works by allowing banks access to subsidized portfolio insurance for eligible loans to small businesses. Any business unable to obtain conventional financing for a project in a targeted area is eligible for the program. Uses of funds may include owner-occupied real estate and equipment, lines of credit and working capital, with working capital requests being the most common.

The program works by having the borrower and bank each contribute 2.5 percent of the principal loan amount to an insurance fund established by the bank for all of its loans through the program. (It is common for banks to pass on their fees, so that the borrowers effectively pay 5 percent.) CDA then matches these contributions at a rate between one and two times the borrower amount to increase the available insurance pool. When examining Michigan's capital access program, CDA officials learned that it took considerable time to build up volume because banks were reluctant to lend before they had built up a sizable reserve pool. In order to induce lenders to participate in their program, CDA matched borrower contributions to the insurance pool at a rate of 2-to-1 and offered an additional 30 percent loan guarantee on loans made during the first nine

months of the program. This brought the amount of guarantee plus insurance to 45 percent of the loan for the first origination by a bank under the program.

In the second phase of the program, running roughly during 1994 and 1995, CDA reduced the supplemental guarantee to 20 percent and the insurance match to 1.5-to-1, with the borrower and bank each putting in 2.5 percent and CDA putting in 7.5 percent. This reduced the guarantee plus insurance total to 32.5 percent. This is still a substantial amount of protection when a bank has a significant number of loans enrolled in the program. During this same period, CDA expanded eligibility of the program to include eastern Connecticut nonurban counties, including the New London-Groton area, an area severely impacted by military base closings. The program expanded further to include urban areas either designated by the legislature as distressed or containing state enterprise zones.

In the final phase of program development, CDA officials intend to eliminate supplemental guarantees and reduce the agency's portfolio insurance matching contributions to a 1-to-1 ratio, with 2.5 percent each from the borrower and bank and 5 percent from CDA. With substantial volumes of loans built up in the program and significant diversity among them, lenders should require less insurance and guarantee coverage. CDA plans to implement this final phase in 1996.

CDA staff point out that their biggest challenge is to get banks to view loans from the perspective of portfolios and not individual loans. The program works via pooling divergent risks, and lenders must view the loans as a group if they are to undertake riskier loans, especially as the CDA matching level declines.

### **Lending Activity**

As of March, 1995, three years after Urbank's inception, 122 loans had been processed through the program for a total of \$10.4 million. Typical loan size is approximately \$50,000. In 1993, the program processed 65 loans totaling \$6.9 million. A relatively high volume in the program's first year is likely due to the aggressive 30 percent supplemental guarantee and 2-to-1 matching of the insurance contribution. Relatively lower volumes in later years were also partially due to the introduction of the SBA LowDoc program, which serves similarly situated companies and offers a larger degree effective guarantee. Also notable during the first nine months of the program is that 40 of the 65 loans went to modest-income urban areas, and 19 went to minority-owned businesses. In total, the program has made 60 loans to modest-income urban areas and 25 to minority-owned businesses. Despite its aggressive start, the program has sustained low losses, amounting to five loans and approximately \$250,000 as of March, 1995, for less than three percent of originations thus far.

### **Staffing/Operations**

CDA staffs the Urbank program with one professional and one support staff person. The program has over 20 participating banks, and continues to add new lenders.

## **Notable Features**

The Urbank program is not a comprehensive business financing program like many of the others described in this report. It is a relatively efficient credit enhancement tool that state and local governments can use to target businesses in greatest need. The program offers several key advantages to government agencies interested in developing programs for addressing economic development and small business finance needs in a targeted fashion:

- It is a low-cost, responsive program that is relatively simple to implement, making it a good model for government-administered programs, especially for state and large municipal governments.
- Because businesses contribute to the insurance pool, they pay higher than conventional fees for their financing, which, to some degree, guards against the use of state dollars for loans that could have been made conventionally. Of course, this assumes a relatively competitive banking environment and businesses that are willing to shop around for their financing.
- It can be targeted via differential subsidy rates on matching contributions or supplemental guarantees. Such targeting can be politically difficult to maintain, however, especially at the state level.

It can absorb the impact of fluctuating policies of the U.S. SBA. As SBA programs are geared up or scaled back, the capital access model offers states and localities a way of providing an alternative credit enhancement with relatively low fixed costs to start-up or scale-up.

Unfortunately, governmental agencies like CDA are often politically hard-pressed to maintain geographic targeting of successful programs. Constituent politics pushes development finance agencies to offer products in all types of areas and to all types of businesses, regardless of economic development needs. Initially, Connecticut successfully targeted areas and borrowers most in need of development support. The challenge will be to maintain this focus in the face of success.

**Contact:** Thomas D'Avanzo, Connecticut Development Authority

**Interview Date:** May 23, 1995

## Center for Community Self-Help

### North Carolina

<b>Type of Organization:</b>	Nonprofit 501(c)3 with affiliated lending units: Self-Help Credit Union and Self-Help Ventures Fund
<b>Program Start Date:</b>	1984
<b>Service Area:</b>	State of North Carolina
<b>Targeted Markets:</b>	Minority- and women-owned businesses in urban areas; rural enterprises
<b>Loan Products:</b>	Loans from \$500 to \$750,000 for various purposes
<b>Lending Activity:</b>	144 small business loans totaling \$5,285,000 in 1993
<b>Staffing/Operations:</b>	Self-Help employs 35 staff
<b>Notable Features:</b>	Has developed a niche by lending to daycare providers; uses its lending activities to influence development and social policy

### History and Description

The Center for Community Self-Help was founded in 1980 to increase economic opportunity for financially disadvantaged North Carolinians. Started with initial capitalization of \$77 raised at a bake sale, Self-Help has grown to more than \$75 million in assets. Self-Help began by offering technical assistance to struggling businesses, but within a few years, the organization decided it needed to provide access to capital. In 1984, Self-Help created the Self-Help Ventures Fund (SHVF) and the Self-Help Credit Union (SHCU) to provide financing to underbanked businesses in the rural areas and modest-income urban neighborhoods of North Carolina. The Center for Community Self-Help, a nonprofit organization, serves as the umbrella for these financing affiliates by providing technical assistance, developing new programs, and performing policy analysis.

SHCU is a federally designated community development credit union chartered by the State of North Carolina and insured by the National Credit Union Administration. Like other credit unions, SHCU accepts deposits and offers some financial services. However, SHCU does not try to remain fully competitive with aggressive retail banks or other credit unions on retail services, because its focus is on financing community development.

SHCU, due to its state charter, is able to offer membership to any interested parties. The Credit Union receives deposits from individuals and institutions nationwide and not just from its borrowers. Individuals and corporations that become members of the Center for Community Self-Help are eligible to use the services of SHCU.

The Self-Help Ventures Fund is a revolving loan fund, making investments in businesses in the state of North Carolina. The SHVF receives program-related investments, long-term, low-interest loans from foundations and other investors, that Self-Help uses as risk capital. SHVF, as a 501(c)(3) nonprofit, receives tax-deductible contributions from individuals, religious organization, foundations, public sector agencies, small businesses, and corporations. These moneys are used to support operations, to develop new programs, to cover costs of technical assistance, and to make loans. Self-Help has also received a capital infusion of \$2 million from the state of North Carolina for small business lending.

Self-Help chooses to originate particular loans in either the Credit Union or Ventures Fund in part to satisfy credit union regulators. SHCU cannot make a loan unless it is fully secured. Consequently, many small business loans must be made by the SHVF. However, loans guaranteed under the SBA 7(a) program must be made by the Credit Union. While a majority of Self-Help's business loans are made by the Ventures Fund, the dollar amount of small business lending is evenly split between SHCU and SHVF.

Because Self-Help's objective is to serve low wealth communities, the organization targets its lending toward particular areas and populations. Conventional financial institutions do not sufficiently serve the capital needs of businesses owned by minorities and women and firms located in rural areas. For this reason, Self-Help has designated small women- or minority-owned businesses and rural enterprises as its targets.

In addition to its business lending, Self-Help provides a number of other financial and non-financial services. It makes home mortgages and loans to nonprofit organizations. Self-Help complements its financing with technical assistance programs for small businesses, organizations, and individuals. Loan officers provide general technical assistance to borrowers, primarily in the areas of financial management, cash flow, and basic business startup needs. Self-Help offers some more specialized services for childcare, food-related, and cooperative firms.

## **Loan Products**

Self-Help lends between \$500 and \$750,000 to small businesses, with an average loan amount of \$36,500. The types of businesses and the purposes for the loans vary greatly. Self-Help utilizes SBA 7(a) guarantees and the SBA Microloan Program. Self-Help also participates in the SBA 504 program, as a Certified Development Company, making larger, fixed-asset loans to more established businesses. This program provides subordinate loans in conjunction with senior debt from conventional financial institutions.

Self-Help makes microloans through a system of peer lending and through direct lending. The microloans are financed primarily through the SBA Microloan

Demonstration Project. Their peer lending is structured such that groups of five to eight prospective borrowers form business loan groups and approve loans, initially up to \$500 per borrower, for members of their group. The SBA Microloan Demonstration provides technical assistance and loans up to \$25,000 to self-employed and very small businesses.

In addition to its general lending activities, Self-Help has developed a specialized daycare focus as a part of its products and services. This has enabled Self-Help to contribute to daycare policy, as well as to the development of women-owned businesses and overall economic development. Self-Help discovered an unmet need for capital in the rapidly expanding daycare industry. Childcare is a crucial need for most parents and a promising business prospect in many communities. However, it is a complex area due, in part, to the presence of many government regulations and subsidies.

Many daycare operators are in need of technical, as well as financial assistance. In order to lend to these facilities, Self-Help needed to develop an expertise in daycare regulations. Consequently, Self-Help created a special loan program that fosters the startup, expansion, and improvement of childcare facilities. A Self-Help staff person specializes in childcare regulations and lending. Self-Help has found niche lending to be a way of surviving financially in an industry that is heavily regulated and subsidized.

As an active player in the daycare financing market since 1991, Self-Help has become a credible voice that can influence policy. They support daycare trade associations by advocating for quality as a financial concern. High quality centers are more sustainable, and, therefore, a safer investment. Self-Help has also supported government involvement in childcare to benefit modest-income populations.

### **Lending Activity**

In 1993, Self-Help made 144 business loans totaling \$5.2 million. About 60 percent of these loans were in cities with populations larger than 50,000. Approximately 85 percent went to minority- and women-owned firms. While the cities in North Carolina are relatively well banked, Self-Help has found there is still a need for small loans. For this reason, the average loan made to an urban enterprise was \$40,000, although the loan size can range from \$4,000 to over \$750,000. Self-Help made about 48 loans to businesses in modest-income parts of relatively larger cities most of which were owned by minorities and women. Despite its focus on higher-risk markets, Self-Help has kept its loan losses well below industry averages, at 1.4 percent. Flexibility, technical assistance, and close monitoring of slow-paying loans have been the keys to this strong lending performance. Self-Help prefers to work hard to collect on loans rather than write delinquencies off quickly.

### **Staffing/Operations**

Self-Help operates out of a main office in Durham and regional offices in Asheville, Greensboro, Charlotte, and Greenville. Staffing consists of 45 people. The commercial lending team is made up of six loan officers and administrative staff. The Center for Community Self-Help, the Self-Help Credit Union, and the Self-Help Ventures Fund

each has its own board of directors, and Self-Help utilizes additional advisory boards. These boards include representatives from North Carolina financial institutions, community organizations, businesspeople, chambers of commerce, educators, and other community members.

### **Notable Features**

The Center for Community Self-Help has a unique organizational structure enabling it to be involved in comprehensive community development. With assets of \$75 million, Self-Help has extensive institutional resources and functions. However, it has less restrictions than a conventional bank. Like a bank, the Credit Union takes deposits and offers retail financial services. Self-Help also provides direct technical assistance, which banks have difficulty doing. The loan portfolio is balanced between the Credit Union and the Ventures Fund. Self-Help has branch offices in four cities, permitting it to lend throughout North Carolina. Overall, the Self-Help model exhibits several advantages:

- Having two lending arms allows Self-Help greater flexibility and creativity in lending.
- Self-Help can make riskier loans through the Self-Help Ventures Fund.
- Staff can spend more time working with borrowers and provide direct technical assistance to businesses.
- By working closely with borrowers, Self-Help has maintained low loan losses.
- Self-Help has developed a niche in childcare, enabling it to affect an entire industry.

**Contact:** Robert Schall, Self-Help Ventures Fund

**Interview Date:** March 7, 1995

## Cooperative Business Assistance Corporation

### Camden, New Jersey

<b>Type of Organization:</b>	Nonprofit 501(c)(3) economic development financing organization
<b>Program Start Date:</b>	1987
<b>Service Area:</b>	Camden, New Jersey
<b>Targeted Markets:</b>	Small businesses located in or moving to the city of Camden
<b>Loan Products:</b>	Micro-business development loans up to \$20,000; commercial loans between \$20,000 and \$100,000 for equipment, leasehold improvements, working capital; fixed-asset loans from \$100,000 to \$750,000
<b>Lending Activity:</b>	21 loans totaling approximately \$990,000 in the year-ending June, 1994
<b>Staffing/Operations:</b>	5 staff includes 2-1/2 lenders
<b>Notable Features:</b>	An innovative, community-based partnership that blends public, bank, and foundation funds to provide business financing in a difficult economic environment



## **History and Description**

The Cooperative Business Assistance Corporation (CBAC) provides business loans and management and technical assistance to Camden businesses in an effort to stimulate economic development and job creation in the City of Camden. A city of 90,000 people in the Philadelphia metropolitan area, Camden has experienced massive disinvestment. While the city's population declined through the 1960s and 1970s, it remained essentially constant from the 1980 to 1990 census. Still, all of Camden's census tracts are at or below 80 percent of the area median income, and the city had a 1992 jobless rate exceeding 20 percent when the New Jersey average was 8.4 percent.

In an attempt to increase economic activity in Camden, the City used a United States Economic Development Administration (EDA) planning grant to examine the needs of local small businesses. This research yielded the conclusion that the primary obstacle confronting Camden businesses and entrepreneurs was access to credit. Consequently, CBAC was created in 1987 to make loans to small businesses. A grant from the Fund for New Jersey provided operating funds, and investments by the City and participating financial institutions provided loan capital. Community Development Block Grant (CDBG) funding of \$150,000 was matched 3:1 by three banks. In this way, the organization was created as a cooperative effort, aiming to bring conventional financial institutions back into Camden.

CBAC started out, in 1987, offering loans in the range of \$20,000 to \$60,000. Deals were structured as two loans: CBAC made a subordinated loan for 50 percent of a project, or up to \$30,000, and the three banks split the other 50 percent. While two notes are written, the credit approval process is one decision. A lead bank fronts the money, houses the documents, and services the two loans. This bank then sells participations to the other two banks.

This loan structure has remained essentially unchanged despite the loss of one investor financial institution and the addition of four others. In 1989, one of the participating financial institutions, an S&L, went bankrupt, and four other banks have since joined in. After these banks joined the pool, the maximum loan amount increased to \$100,000, with CBAC's maximum participation remaining at \$30,000. The six banks cover the remaining portion.

To supplement the existing commercial loan product, CBAC began making loans for construction, acquisition, and renovation of commercial real estate in 1989. Funding for this product came from City CDBG money.

In September 1992, CBAC took over the portfolio of another economic development financing organization that had ceased operations, assuming its seven performing loans and \$1.7 million in cash and loan assets. The cash came from the U.S. EDA Revolving Loan Fund program and from a repaid Urban Development Action Grant. Receiving these funds allowed CBAC to restart its Real Estate Loan Program, now called a Fixed-Asset Loan Program, which provides financing primarily for real estate and equipment.

In 1993, CBAC received a grant from the EDA to capitalize a Micro Loan Fund. These loans of \$1,000 to \$20,000 are for startup and very small businesses with under five employees. This was the first EDA Title IX grant made for micro loans.

CBAC receives an annual grant from the City's CDBG funds. In its first seven years of operation, CBAC's investments led to the creation of 186 new jobs and retention of 300 other positions.

## **Loan Products**

CBAC offers three loan products to new and existing businesses in the City of Camden. The commercial lending program provides financing between \$20,000 and \$100,000. Under the Micro Lending Program, CBAC lends amounts up to \$20,000. The Fixed Asset Loan Program offers large loans in the range of \$100,000 to \$750,000 for equipment and real estate.

Commercial loans, typically used for equipment, minor leasehold improvements, and working capital, are available in amounts ranging from \$20,000 to \$100,000. The loan is funded by CBAC and investor banks, with CBAC in a subordinate position. While the bank's portion is priced at prime plus 1.5 points, CBAC's is priced at prime. The term is set at five years.

The Microloan Program was begun in 1993 with a grant from the EDA to serve an unmet need for very small loan amounts. These loans, which can amount to up to \$20,000 and carry terms of up to five years, typically go to businesses less than two years old. CBAC makes these loans directly, using funds borrowed against two lines of credit from participating banks, totaling up to \$150,000.

The Fixed Asset program was begun on a trial basis in an attempt to stimulate job creation on a larger scale. These loans of \$100,000 to \$750,000 can be used to buy, repair, or build commercial real estate, as well as to purchase equipment. The maximum term is 15 years. The borrower is expected to invest 10 percent of the cost of the project, and CBAC will loan up to one-third of the project cost. In addition, CBAC will assist in packaging the application for the bank portion. In this way, CBAC works toward a key objective--leveraging additional capital from the private market.

## **Lending Activity**

CBAC's activity has increased steadily over its seven years of existence, to the point where it made more than 20 loans totaling approximately \$990,000 in fiscal 1994 (ending June 30, 1994). Lending in 1994 includes ten micro loans, totaling approximately \$150,000, six commercial loans for \$262,000, and five fixed asset loans totaling \$568,000. Since 1987, CBAC has made 68 loans, amounting to \$3.9 million. Half of the loans have gone to minority-owned businesses. A total of 495 jobs have been created or retained, including 186 new jobs for Camden residents. Close contact with borrowers has helped CBAC keep its losses thus far to approximately 2 percent of total originations.

## **Staffing/Operations**

CBAC is run by five full-time staff. Two serve as loan officers aided by an additional part time lender. The second loan officer has been hired very recently, and they hope to increase loan volume with another person working full time on deals. The three loan officers and the loan administrator provide ad hoc technical assistance to borrowers.

CBAC has an 18-person Board of Directors composed of representatives from the city, participating banks, businesspeople, and the community. The board brings together people from the city and from the community, permitting these groups to share information from different perspectives. City representatives keep the board apprised of city activities and plans for development, while community members keep the board in tune with street activity (such as gang problems). CBAC can use this information in deciding whether or not to approve loans.

A loan committee, made up of a subset of the board of directors, reviews requests for commercial and fixed-asset loans. A separate committee approves loans for under \$20,000. Loans recommended by staff must be approved by these committees except in the case of a loan for under \$10,000 to a repeat borrower. In such a case, CBAC staff can make the credit decision.

## **Notable Features**

The structure of CBAC as a cooperative enterprise involving the city, several banks, and members of the community has a number of benefits. First, the organization can access the financial resources of both the City and independent financial institutions. CBAC's capacity even has the potential to expand by simply adding more banks to the loan pool. The organization also benefits from its diverse board which brings together representatives from the City and from the community, providing information about community needs, street activity, and the City's plans for development.

While financial institutions consider Camden businesses to be risky borrowers, CBAC loans demand only very small investments from each participating institution for each loan. In this way, CBAC has been successful in directing financial markets back into

Camden. Although in 1987 banks did not want to participate in this project, banks have now begun encouraging CBAC to direct borrowers to them. The loan pool has allowed banks to combine funds and share risk to begin to reinvest in Camden.

**Contact:** Adina Abramowitz, Cooperative Business Assistance Corporation

**Interview Date:** March 15, 1995

## Southern Dallas Development Corporation

Dallas, Texas

<b>Type of Organization:</b>	Nonprofit, 501(c)(3) economic development lender with affiliated organizations, including a multibank community development corporation and an SBA 504 certified development company
<b>Program Start Date:</b>	1989
<b>Service Areas:</b>	Southern Dallas, with SBA-affiliated programs serving all of Dallas
<b>Targeted Markets:</b>	Small and minority-owned businesses
<b>Loan Products:</b>	CDBG-funded loans for a variety of purposes; SBA microloans to \$25,000; direct multibank loans; SBA 504 loans for fixed assets
<b>Lending Activity:</b>	73 loans for a total of \$3.8 million for year ending September, 1994
<b>Staffing/Operations:</b>	12 staff, including 5 professionals working directly on reviewing and processing loans
<b>Notable Features:</b>	Provides a comprehensive set of small business financing tools, working with relatively larger firms expanding and creating jobs to small, young firms unable to obtain bank financing

### History and Description

The Southern Dallas Development Corporation (SDDC) is a nonprofit, 501(c)(3) organization whose mission is the economic development of southern Dallas and the creation of jobs for the modest-income residents of the target area. Southern Dallas is the predominantly modest-income segment of Dallas, with a population of 450,000, of which approximately 75 percent is African-American and Latino. SDDC's primary activities include four business financing programs that address various small business needs and focus on firms owned by African-Americans and Latinos. In addition to business financing, SDDC also conducts other economic development activities including mixed-use real estate development projects, entrepreneurial seminars and networking functions. Initiated by City of Dallas management, SDDC is governed by a board of 25 directors composed of approximately one-third neighborhood organizations, one-third

chamber of commerce and business groups, and one-third individuals appointed by the Mayor or city councilpersons from southern Dallas.

SDDC was established in 1989, two years after a predecessor organization, the Housing and Economic Development Corporation (HEDCO) of Dallas had ceased operating. Established in the middle 1980s by the City of Dallas, HEDCO saw very little activity. In 1989, senior city management staff reestablished and renamed the organization the Southern Dallas Development Corporation. SDDC, unlike HEDCO, was given a mission to focus exclusively on economic development and job creation and was relieved of housing development responsibilities. It was felt that the organization needed to maintain this narrower focus in order to overcome formidable obstacles and make significant progress.

The City committed to a multiyear contract with SDDC, which included provision of a loaned executive to direct the organization, \$800,000 over three years in Community Development Block Grant (CDBG) funds for operating support, and \$3 million for loan capital. The organization began by focusing on lending from its CDBG revolving fund. In its first three years, the organization made loans from this fund at a rate of just over \$1 million per year.

In 1990, SDDC began exploring the potential of a multibank CDC, and, in 1991, 18 financial institutions pledged \$3.7 million of capital to the Southern Dallas Development Fund (SDDF). SDDF was set up as a separate organization, a for-profit multibank CDC chartered under the Office of the Comptroller of the Currency. SDDF contracts with SDDC, however, for management and staffing. SDDF's board includes representatives of 17 participating banks, with some representatives from the SDDC board.

SDDC further expanded its operations by setting up an SBA 504 Certified Development Company, the Dallas Business Finance Corporation (DBFC) in 1992. The City of Dallas had managed an SBA 504 certified development company, but it had become inactive, so it transferred its 504 authority to SDDC. The 504 program was the first SDDC-affiliated program that targeted the entire city of Dallas. The 504 program is a somewhat specialized program for subordinate loans for larger, fixed-asset projects, and requires a significant geographic scale to achieve cost-effective operations. The program also has the potential to generate substantial net income for SDDC once a substantial volume of loans have been originated. While DBFC serves the entire city of Dallas, it target markets southern Dallas communities.

The final addition of SDDC's financing programs also came in 1992, when SDDC became a U.S. SBA microlending intermediary, gaining the ability to make loans of under \$25,000. SDDC received the full \$750,000 in capital in the first round of the SBA microlending initiative. As with the 504 program, SDDC serves the entire city of Dallas with its microlending initiative. This is partly to obtain the economies of scale needed to make microlending more cost effective. While the program is available throughout Dallas, SDDC again targets this program to firms in southern Dallas and to minority-owned businesses.

The combination of these four lending programs provides SDDC with the ability to serve a broad array of economic development financing needs in its target area. CDBG funds

provide a flexible source of funding for higher risk projects that may have considerable employment potential for the community. SBA microloans provide firms with small loan amounts that are not well served by the banking community. SDDF provides subordinate, pooled private financing to near-bankable firms. DBFC provides long-term, fixed-rate financing for the expansion projects of more established, relatively larger small businesses, which are creating jobs. SDDC has identified goals for each of these programs over a five-year period through a formal strategic planning process.

## **Loan Products**

SDDC makes direct community development business loans from its CDBG funds in amounts of up to \$300,000 to small businesses creating or retaining jobs primarily for modest-income individuals. Businesses must be located in modest-income areas, including southern Dallas and Enterprise Zones. Loan purposes include a wide variety of uses, including working capital, equipment, and real estate. SDDC can cover up to 90 percent of project costs, and interest rates are fixed at below market rates.

As an SBA microlending intermediary, SDDC also makes microloans from \$5,000 to \$25,000 to new and existing firms at an interest rate of prime plus 4 percent. Eligible uses of financing include working capital and equipment. The microloan program is offered throughout the city of Dallas, but SDDC targets southern Dallas and minority-owned firms.

SDDF, the multibank CDC, makes loans from \$25,000 to \$100,000 for working capital and equipment to firms located in southern Dallas and Enterprise Zones. Typically, these loans are made in conjunction with senior loans from an SDDF participating bank. This product is intended for more stable firms with stronger operating histories. SDDF can make equity investments or may require a sales royalty in lieu of equity. Interest rates are generally market rate, with higher risk loans priced at higher rates.

The last product, offered through DBFC, is the SBA 504 program for long-term, fixed-rate financing of expansion projects of well established firms. This product, like the SBA microloan, is made available throughout the city of Dallas, but is marketed to modest-income areas and minority-owned businesses.

## **Lending Activity**

As of March, 1995, SDDC and its affiliates had made 204 loans totaling more than \$14.6 million since inception. This includes: 73 CDBG loans for \$5.6 million; 72 microloans for \$922,000; 50 SDDF loans for \$2.8 million; and nine SBA 504 loans for \$5.3 million. Approximately 80 percent of these loans went to firms located in modest-income neighborhoods, primarily southern Dallas. Of the 204 loans, 149 went to minority-owned businesses, including 107 to firms owned by African-Americans, and 35 to firms owned by Latinos. SDDC borrowers represent a fairly diverse industrial mix, consisting of 22 percent manufacturing, 10 percent distribution, 21 percent retail, and 48 percent

service. In total, SDDC-funded projects have totaled approximately \$52 million, and are projected to create more than 1,600 jobs.

In fiscal 1994, a year in which all programs were in operation, SDDC and its affiliates made 73 loans totaling \$3.8 million. Of these, CDBG accounted for 32 loans, SDDF for 21, microloans for 16 and SBA 504 loans for four. In terms of loan losses, as of September 1994, SDDC had charged off 18 loans for a total of \$779,900 since inception and had recovered \$175,500, bringing net losses to \$504,400, or just over 5 percent of total originations of just over \$10 million. SDDC staff have clear maximum loan loss expectations for each program, with higher loss expectations for CDBG and microloan programs than for SDDF and DBFC programs.

### **Staffing/Operations**

SDDC staffs all four loan programs, in addition to staffing nonfinancial economic development activities. Regular SDDC staff total 12 and include five professionals working directly on lending activities. SDDF and DBFC are staffed via contract with SDDC. SDDF and DBFC each have separate boards of directors and separate loan committees. SDDC has an additional two staff assigned to a special project, not part of its regular development finance activities.

SDDC works with neighborhood-based Business Assistance Centers (BACs), typically housed at community development corporations, who do outreach and marketing work to local businesses and screen potential loan applicants. SDDC utilizes a circuit-rider concept, in which an SDDC loan officer will spend time at BACs to assist in supporting screening and business assistance functions. SDDC itself is located in a community-college business development facility, which also houses a small business development center, a business incubator, and a private industry council training facility.

Funding for SDDC activities include City of Dallas Community Development Block Grant funds, corporate and foundation support, fees and interest. It hopes to reduce its significant reliance on CDBG funding over the next few years through increased fees and interest, as well as foundation and corporate support. Approximately 20 percent of the organization's \$1 million budget comes from non-CDBG lending-based fees, approximately 45 percent comes from its CDBG contract with the City and the rest comes primarily from corporations and foundations.

### **Notable Features**

SDDC is notable for its relatively rapid development of a comprehensive business financing program and detailed strategic plan with performance targets, including both lending activity and job creation. Particular advantages of SDDC's approach include:

- Its ability to serve a wide variety of business development financing needs, from start-up to established, expanding business

- Its effective mix of geographic and minority business targeting
- Substantial support and participation from local government as well as from private financial institutions, local chambers of commerce, and community development corporations

**Contact:** Jim Reid, President, Southern Dallas Development Corporation  
Charles English, Southern Dallas Development Corporation

**Interview Date:** June 6, 1995

## **Appendix: Contact Phone Numbers for Model Programs**

<b>Organization</b>	<b>Principal Contact</b>	<b>Phone</b>
Bankers Small Business CDC	Jeni Burgess	619-291-3594
Center for Community Self-Help	Robert Schall	919-683-3016
Cooperative Business Assistance Corporation	Adina Abramowitz	609-966-8181
Delaware Community Reinvestment Action Council	Rashmi Rangan	302-654-5024
Delaware Trust Company	Michael Skipper	302-421-7554
First Community Bank (Bank of Boston)	Jeffrey Zinsmeyer	617-434-1440
Maryland Alliance for Responsible Investment	Thomas Chalkley	410-467-5042
Maryland Small Business Development Finance Authority	Stanley Tucker	410-333-4270
Mellon Bank CDC	William Whitfield	412-234-1059
NationsBank	Barry Blumberg	410-547-4880
Society National Bank Community Development Lending Group	Rosalyn Ciulla	216-689-4472
Southern Dallas Development Corporation	Jim Reid	214-428-7332
Urbank (Connecticut Development Authority)	Thomas D'Avanzo	203-258-7872