Mayor’s office of Small, Minority and Women Business

To: Honorable Vice President Sharon Green-Middleton

Honorable Councilwoman Mary Pat Clark, Members

From: Director Paul E. Taylor, Mayor’s Office of Small, Minority and Women Business

Subject: The Decline of Small Business Lending in Baltimore

To better understand the lending environment in Baltimore it is important to understand the context. Most small business lending is based on available equity that can be used as collateral to secure the loan. Where there is no collateral to secure the loan the chances of approval is severely diminished.

In September of 2016 Partnership for Lending in Underserved Markets (PLUM) a project lead by the Milken Institute with SBA and the Small Business Resource Center, was launched to: 1. Identify and analyze root causes affecting lending to minority-owned small businesses. 2. Identify solutions and opportunities for action. 3. Begin to execute the strategic plans and other recommendations developed during Phases 2.

One highlight from this study showed that “while the past three decades have seen the average wealth of Latino and Black households increase from $58,000 and $67,000 in 1983 to $98,000 and $85,000 in 2013, respectively, the trends at the median show Latino and Black wealth moving in the wrong direction. In fact, when consumer durable goods are excluded, medial wealth for Black and Latino families has gone down over the past thirty years from $6,800 and $4,000 in 1983 to $1,700 and $2,000 in 2013, respectively. In current trends continue, Black and Latino families at the median will never reach the levels of wealth of White families today”

Minority –owned small businesses play an important role in Baltimore’s overall economic health, driving job creation, raising wages, and bettering standards of living in our communities. Business ownership is also critical for Blacks and Hispanics to close the racial wealth gap. The Ewing Marion Kaufman Foundation stated that an increase in entrepreneurship among people of color can create income for both the entrepreneur and the people of color who work at these firms.

From the PLUM study some key findings were as follows:

Underwriting – After the great recession, many minority homeowners saw their home values and credit scores wiped out due to the worst financial crisis since the Great Depression. As a common source of collateral used in the traditional underwriting process, the decline in home equity values made it far more difficult for minority small-business owners in particular to secure capital. Alternatives are needed. One example of alternative underwriting practice is the new business lending program started by Baltimore Community Lending. This new program (Baltimore Business Lending) is designed to look more favorable on the business concept rather than a singular focus on the owner credit score and collateral.

Standardization and Best Practices – In the small-business lending space there is a lack of standardization and best practices. In the U.S. 8,000 small and microbusinesses are denied credit each day. Of those declined, roughly one-third are considered creditworthy using currently available underwriting methodologies, proving, once again, the significant product mismatch that occurs between lenders and minority-owned small businesses. In our PLUM meetings we discussed and focused on the development of a loan participation fund, which would provide lenders with balance sheet relief in originating small-business loans and also act as an incentive for lenders to provide standardization across a range of small business products in a responsible and more transparent manner.

Patient Capital – Participants were clearly concerned about the lack of equity available to the city's entrepreneurs. This is not just a local issue, but a national issue as well, as the average amount of new equity investments in minority firms across the U.S. in 2010 was roughly $3,400, or 43 percent the level of non-minority-owned firms. One suggestion from the PLUM study focused on an Intra-state crowd funding vehicle with a portion of the effort would act as collateral for financing from traditional financial institutions.

Financing Education- The lack of understanding and education regarding financing alternatives that go beyond traditional bank loans hinder minority-owned small businesses from accessing the right kind of financing products more tailored to the capital demands of a small business.

Subjects such as credit scores, the underwriting process and necessary documentation needed to gain loan approval are not readily available to minority and small businesses. In addition, many minority businesses are unaware of available financial subsidies for innovation, energy efficiency, and disability access, as well as other financial incentive programs such as tax credits.

Bank Referral Approaches- Many lenders in the Baltimore area do not as a general practice refer borrowers who were declined to alternative programs either sponsored by not for profit resource providers or financing sources. However in recent years as the non-traditional lenders have grown and began marketing their programs there is significant increase in this cross collaboration between traditional and non-traditional lenders.

CDFI – lastly, Baltimore is ripe for greater participation in Business lending by the CDFI community. Because these more flexible lending products are not in the existing market place manner small business borrowers have resorted to selecting products that are ill suited and potentially costlier that products more suited and available from responsible financing providers.

In an effort to provide new lending facilities into Baltimore, this administration has created a Neighborhood Impact Investment Fund to provide high risk, patient investment capital in the market in certain priority areas in Baltimore City. This fund is designed to provide capital not only to real estate markets, but to local businesses as well. While NIIF in many instances will not be a direct lender to businesses, it will make this flexible funding available to fund managers in the market place.