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Developing Small Businesses and Leveraging Resources in Detroit: An informed discussion among financial institutions, policymakers, and other stakeholders in Detroit

SSBCI and the Seventh Federal Reserve District

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Community Development and Policy Studies
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230 South LaSalle Street
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We roll out the first 2013 edition with a small business theme and a new look for *ProfitWise News and Views.* In October, we welcomed to the Detroit branch entrepreneurs, bankers, economic development professionals, and an array of organizations and individuals working to improve Detroit's small business lending and development infrastructure. CDPS senior business economists Robin Newberger and Maude Toussaint-Comeau synthesize key themes from the conference, "Developing Small Businesses and Leveraging Resources in Detroit," which featured their related research. Their paper, "Financial Infrastructure and Small Business Funding in Low- and Moderate-Income Neighborhoods in Detroit," is available at chicagofed.org. Also in October, the Fed hosted a U.S. Treasury Department-organized conference on its State Small Business Credit Initiative. Treasury's Cliff Kellogg, the program's director, provides an overview of the SSBCI's significant impact in the five Seventh District states of Illinois, Indiana, Iowa, Michigan, and Wisconsin.

Alicia Williams
Vice President, Community Development and Policy Studies

The Federal Reserve Bank of Chicago

The Federal Reserve Bank of Chicago and its branch in Detroit serve the Seventh Federal Reserve District, which encompasses southern Wisconsin, Iowa, northern Illinois, northern Indiana, and southern Michigan. As a part of the Federal Reserve System, the Bank participates in setting national monetary policy, supervising banks and bank holding companies, and providing check processing and other services to depository institutions.

Developing Small Businesses and Leveraging Resources in Detroit:

An informed discussion among financial institutions, policymakers, and other stakeholders in Detroit

by Robin Newberger and Maude Toussaint-Comeau

Introduction

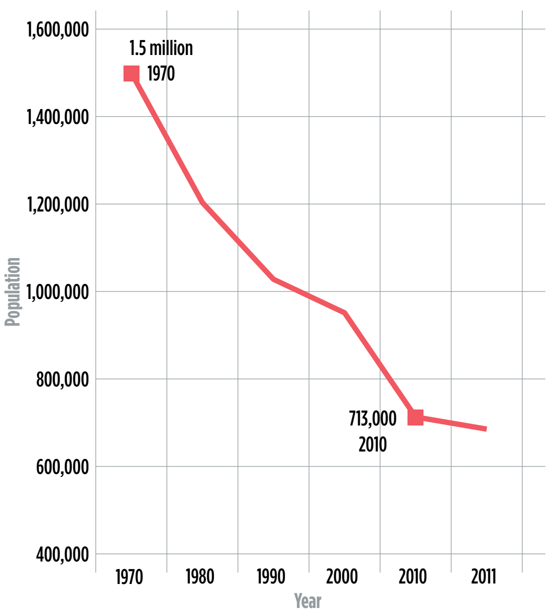
In October 2012, the Federal Reserve Bank of Chicago, the Michigan Bankers Association, and the New Economy Initiative for Southeast Michigan co-sponsored a symposium in Detroit that brought together business experts, business owners, policymakers, funders, and bankers to explore issues around access to small business credit and financing in Detroit. As Alicia Williams, vice president of the Community Development and Policy Studies (CDPS) division, explained in her opening remarks, the symposium was a follow-up to meetings hosted around the country by the Federal Reserve System's Community Development offices, as part of an initiative to address the financing needs of small businesses. During the course of the two-day symposium, presenters discussed the small business landscape in Detroit and made recommendations for increasing the supply and availability of resources to these firms. The symposium also highlighted a study conducted by staff of the Chicago Fed's Community Development and Policy Studies division on the changing financial landscape of Detroit and its implications for access to financial services and for lending to small businesses in the city's low- and moderate-income neighborhoods. Drawing banks more closely into the dialogue about neighborhood revitalization was an important goal for the symposium.

This article summarizes contributions from presenters, focusing on three major themes of the discussion: the opportunities and challenges that characterize the small business environment in Detroit; the implications for small business borrowing given the banking and regulatory climate; and strategies to leverage capital and other resources to support small business in the area. Overall, presenters described a city with formidable challenges, but one that is also rich in resources for small businesses in terms of producing talent, providing technical assistance, and offering both bank and non-bank financing. While lending has been hampered by declining real estate values and a shift in underwriting practices, many banks and community-based funders actively utilize government and foundation programs to deliver capital to small businesses. Presenters also offered a range of strategies, some already in development, for building linkages between banks, small business service providers, and other funders, to maximize their ability to serve small businesses.

Small business opportunities in Detroit and the surrounding counties

Presenters evaluated the entrepreneurial landscape from several vantage points, including demographic trends, the diversity of the business sector, and the local financial climate. Many of the presenters

Figure 1: Demographics – Detroit's population



Source: Lyke Thompson presentation based on data from Southeast Michigan Council of Governments (SEMCOG).

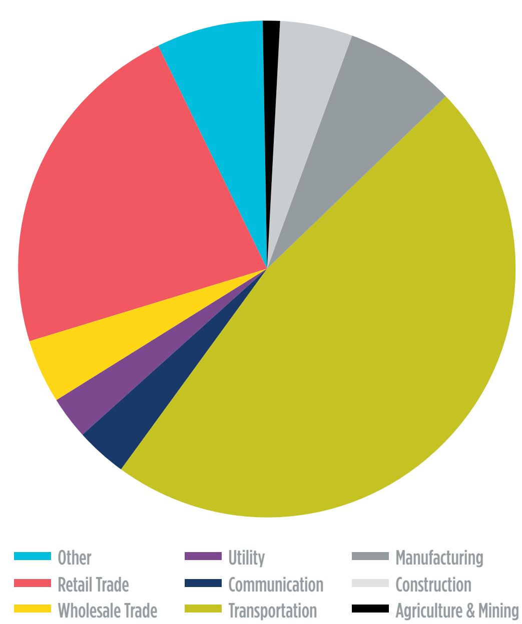
acknowledged that declining population, persistent unemployment, and high crime rates in the city make it a challenging environment for entrepreneurs. Paul Traub, business economist at the Detroit Branch of the Federal Reserve Bank of Chicago, reminded participants that Detroit had a population of almost 1.9 million in 1950, while the U.S. Census recorded about 700,000 residents in 2010. Lyke Thompson, director of the Center for Urban Studies at Wayne State University, reported estimates of an additional population decline in the few years since, suggesting that another 270,000 residents could leave Detroit during the current decade if the long-term trend continues (see figure 1). According to Thompson, high crime rates, the poor quality of the educational system and city services, along with contractions in the job market during the 2000s, have adversely affected population flows and, ultimately, businesses.

In spite of these challenges, many presenters at the symposium focused on the positive aspects of Detroit's small business environment, including the diversity of business owners and the variety of sectors represented. As part of her presentation, Maude Toussaint-Comeau provided statistics on trends in business growth and location in both low/moderate-income and middle/upper-income census tracts (see table 1, page 3). She noted that the total number of small businesses and start-ups increased in both lower- and higher-income locations in the city, which suggests that businesses are a potential source of economic diversification and revitalization in some communities.

Lyke Thompson saw an opportunity in the large number of minority- and immigrant-owned businesses in Detroit, in that foreign-born residents in Michigan have historically (in the 1990s and 2000s) been more likely to start new businesses and high-tech businesses than the native-born. As Timothy Bates, professor emeritus at Wayne State University, noted, Detroit's small business community differs from the national community of small business owners in that it has a much higher proportion of minority-owned and immigrant-owned businesses.

Teresa Lynch, a principal at Mass Economics and former senior vice president and director of research at the Initiative for a Competitive Inner City, explained that, while dominated by transportation-

Figure 2: Detroit business breakdown (2011)



Source: Lyke Thompson presentation based on data from Esri.

Table 1. Distribution and growth of small businesses in the Detroit area, by annual revenue, 2003–2010

Location/census tract income	Distribution, average over 2003–2010 (percent of total)				Growth, 2003-2010 (percent change)			
	More than $1 million	$500,001 to $1 million	$50,001 to $500,000	$50,000 or less	More than $1 million	$500,001 to $1 million	$50,001 to $500,000	$50,000 or less
City of Detroit	7.9	6.6	59.5	22.5	−12.5	31.5	154.6	62.0
Non-LMI	7.2	5.9	62.6	22.5	−9.9	14.5	162.9	87.3
LMI	7.8	7.3	58.3	19.8	−11.7	35.3	145.4	51.6
Status changed from LMI to non-LMI	4.4	4.1	61.3	26.4	−19.8	35.5	183.4	78.7
Surrounding counties	10.6	7.9	62.9	15.8	−14.6	22.9	146.6	44.3
Non-LMI	8.4	9.3	56.5	15.8	−14.8	22.9	151.3	45.5
LMI	13.7	7.7	64.3	15.5	−14.0	22.2	121.7	36.6
Status changed from LMI to non-LMI	9.9	7.4	61.4	17.1	−13.9	33.0	138.7	29.2
Status changed from non-LMI to LMI	13.5	8.9	57.9	15.1	−15.8	15.7	135.6	59.5

Notes: Small businesses are defined as businesses with 500 employees or fewer. The distribution categories may not add up to 100 percent because revenue data are missing for some businesses. LMI indicates low- to moderate-income census tracts, while non-LMI indicates middle- to upper-income census tracts. A change in the status of census tract income from 2000 to 2007 (if applicable) is identified by HUD. None of the census tracts in the city of Detroit changed in status from non-LMI to LMI. The surrounding counties are Wayne (excluding the city of Detroit), Macomb, and Oakland.

Sources: Authors' calculations based on data from Dun & Bradstreet (D&B) and the U.S. Department of Housing and Urban Development (HUD).

related industries, the economy of Detroit is actually more economically diverse than is commonly believed. She noted that Detroit does have representation in high-tech, higher innovation, and capital-intensive industries. Detroit has a growing digital and creative economy, while universities and hospitals ("eds and meds"), as is true in other cities, have persevered and provided employment for institutional workers, as well as contracted and vendor services. Figure 2 provides a breakdown of business sectors in the city.

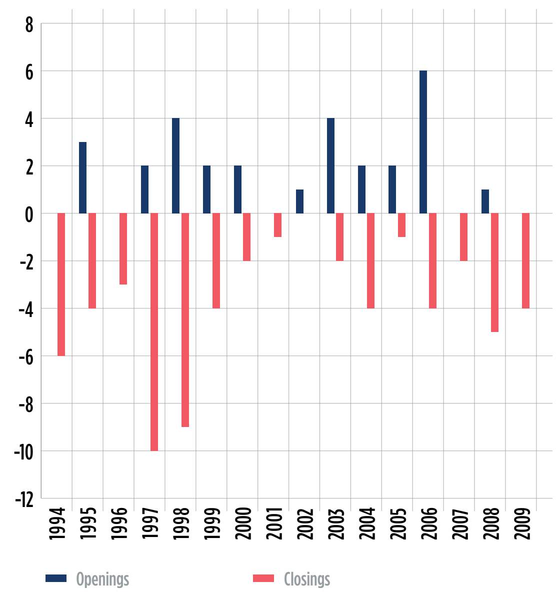
According to Olga Stella, vice president for business development at the Detroit Economic Growth Corporation, the sectors that have shown some of the most potential for business growth are the business-to-business sectors that include local janitorial, landscaping, and waste management companies; the industrial sector that includes metal manufacturing and food processing; the distribution and logistics sector; the construction, demolition, and environmental engineering sector; and the education and medical sectors, which include major institutions such as Wayne State and the Detroit Medical Center. These types of institutions often lead or sustain (local) economic development due to public and philanthropic support, and steady use of contract services. The city also has a range of creative, mostly early stage businesses.

In addition to the small businesses themselves, a variety of organizations operate in Detroit that provide both general advice as well as specific technical assistance for new and existing businesses. Representatives of some of these organizations highlighted the range of services available to Detroit area small businesses. Richard King, regional director of the Michigan Small Business and Technology Development Center (SBTDC), explained that the SBTDCs serving Wayne, Oakland, and Macomb counties have an array of training sessions from half a day to ten weeks that address topics, such as basic market research, business plan development, and training to understand financial statements. Daryl Williams, director of Research and Policy for the Ewing Marion Kauffman Foundation, described the Urban Entrepreneur Partnership Program as a one-to-one coaching model to help minority auto suppliers identify new opportunities to diversify their revenue streams. Dana Thompson, director and a co-professor of the Entrepreneurship Clinic at the University of Michigan, described the pro bono legal assistance provided by the university and others in the area to student-led small businesses. Richmond Hawkins, director of Economic Equity for New Detroit, Inc., talked briefly about seminars organized by New Detroit that help business owners use their financial statements as management tools, and prepare owners for better conversations with lenders. Brian Balasia, founder and president of Digerati and the MORE Program, estimated that more than 26,000 funded programs exist across the state of Michigan to provide services and resources to small businesses and entrepreneurs. They offer many services at no charge, as they receive funding from government sources such as the Small Business Administration, foundations, and universities. Digerati created an online tool called "InsYght" that is one of the richest catalogues of entrepreneurial resources in the country.

The banking infrastructure and the challenges and opportunities for meeting the credit needs of small businesses

Maude Toussaint-Comeau helped establish the financing context with an overview of the banking landscape in the Detroit area. As she explained, the number of banks, both large and small, has fallen sharply over the past two decades in Detroit (see figure 3). This contrasts with trends across the U.S. that show a decline in smaller banks (less than $1 billion in assets), but an increase in large banks (more than $1 billion in assets) since the Riegle-Neal Interstate Banking and Branching Efficiency Act passed in 1994. Citing findings from the CDPS study, Toussaint-Comeau noted that low- and moderate-income census tracts in Detroit today – the neighborhoods where residents tend to have relatively lower incomes – have even fewer bank branches than would be predicted given the population, median income, and other characteristics of those neighborhoods.

Figure 3: Bank branch openings and closings – city of Detroit



Source: Authors' calculations based on FDIC.

Bankers, bank regulators, and bank consultants elaborated on how the banking climate has presented challenges for small businesses in the city of Detroit, yet offered some reasons for encouragement as well. Jeremiah Boyle, managing director of Economic Development for the Federal Reserve Bank of Chicago's Community Development and Policy Studies division, summarized the situation as being one where the economic and regulatory issues in the current environment are multiplying and overlapping, causing challenges for banks to provide the capital and credit that they want. As

Joseph Turk, regional director for Michigan and Indiana community bank safety and soundness supervision explained, one of the biggest hurdles to small business lending in recent years has been the declining value of real estate. Though Michigan did not benefit from the run up in real estate prices prior to the recession, it was among the top five states in the nation in terms of a decline in value, with 50 percent, 60 percent, and 70 percent declines in some commercial real estate projects. This trend has resulted in negative equity in many commercial real estate holdings, and has influenced many banks to modify their underwriting practices. They have put a new emphasis on cash flow, require more "skin in the game" for borrowers, and rely less on character-based lending when reviewing loan applications.

According to Jeffrey Sugg, chief financial officer of First Independence Bank, banks continue to have a difficult time justifying a purchase price. Appraisers often use comparables on other properties that are themselves distressed sales or have had other issues. Relatedly, borrowing has been affected by the complex process of bankers reviewing a customer's global (i.e., entire) cash flow, as opposed to income from their business alone, according to John Jagels, managing director/group manager of Commercial Banking at Talmer Bank and Trust. As Jeffrey Sugg further explained, a lot of applicants may pass initial underwriting hurdles, but problems on other projects and/or contingent liabilities can undermine the credit application. Concern about net cash flows from multiple properties (or ventures) is often the reason why bankers cannot get comfortable with a particular deal. Lenders more recently tend to favor credit applications that meet, in all respects, "cookie-cutter" underwriting criteria.

In addition to these hurdles, Keith Leggett, senior economist at the American Bankers Association, noted that the recent upheaval in the financial sector has led examiners to take a very risk-averse posture during exams: many examiners, he noted, follow newer, risk-focused guidance procedures as if they are formal rules. Howard Lax, an attorney and consultant on bank compliance and regulatory affairs, issued a further warning that various provisions under the Dodd-Frank Act may make it more difficult for new businesses to get credit. As an example, he noted that the qualified mortgage rule will require the securitizer of commercial loans to retain a 5 percent interest in the pool, which is likely to reduce the availability of capital for commercial loans.

Presenters cited the diminished number of locally-based financial institutions as an additional challenge to small business finance in Detroit. Greg Terrell, founder and CEO of Gregory Terrell & Company, a certified public accounting firm, noted that (post exodus) credit underwriting does not generally take place locally, and loan officers and branch managers have less lending authority. Joseph Turk confirmed that only one community bank remains headquartered in Detroit (First Independence). Michael Berry, director of Policy Studies in the Chicago Fed's Community Development and Policy Studies division, further remarked on the contrast between the number of recent bank regulator actions and closings, and the rarity of these events prior to the financial crisis. Turk noted that since the downturn, 13 banks had failed in Michigan, and 11 of those were located in the auto-related counties of Wayne, Oakland, and Macomb. William Testa, vice president and director of Regional Research at the Federal Reserve Bank of Chicago, probed speakers on how to encourage more de novos and community banks in Detroit, and symposium presenters explained why the current precarious state of many smaller banks makes it unlikely for new banks to get established. One of the biggest obstacles, according to Dennis Koons, president and CEO of the Michigan Bankers Association, is the difficulty of raising the start-up capital needed for a new bank. Given that many of the recently failed banks in Michigan were young institutions opened in the mid-1990s or early 2000s, regulators and investors have become increasingly cautious about the terms for starting a new institution. The trend among Michigan community banks, given the costs of compliance and other pressures, has been toward seeking opportunities to consolidate.

Despite the sober financing climate, several presenters discussed recent commercial lending to small business owners in Detroit, often using government subsidies, guarantees, and other incentives to mitigate risk. Drextel Amy, president of Liberty Bank and Trust for the Michigan Region, described his bank's recent success in the apartment rehab market. Working with a small number of developers, his bank has focused on financing redevelopment of multi-family properties, thereby stabilizing property values on entire neighborhood blocks. (Piecemeal and/or scattered rehab of single-family homes does not have the same effect.) To help mitigate risk and maximize equity in these transactions, his bank has made use of federal tax credits. In addition, Liberty has encouraged nonprofits, when feasible, to buy vacant houses and property en masse in their communities, and to develop their own land banks.

Bankers at both large and small institutions reported using other credit enhancements to expand lending to small businesses as well. For example, Scott Wolffis, senior vice president and business banking market manager for Huntington Bank's East Michigan Region, explained that his institution uses the Small Business Administration (SBA) 7(a) and 504 programs to provide support to more seasoned (small) businesses, and the SBA Quick Express Program to provide up to $50,000 for very small businesses. As Gerald Moore, the Michigan district director of the U.S. Small Business Administration noted, the Michigan SBA insured about 1,700 loans totaling more than $700 million in fiscal year 2012. Wolffis also spoke of his institution using a program from the Michigan Economic Development Corporation (MEDC) to assist borrowers with deficiencies in collateral. Paul Brown, vice president of the Capital Markets group of the MEDC, elaborated on how banks have been great partners in Michigan's Collateral Support Program. The collateral program works by MEDC depositing a small amount of capital with a (lender) bank to act as collateral (but in effect a first loss reserve) for the borrower. He noted that this program has been helpful for small business owners, particularly those in lower income and lower wealth communities, and whose asset values have been harder hit by recent recessions.

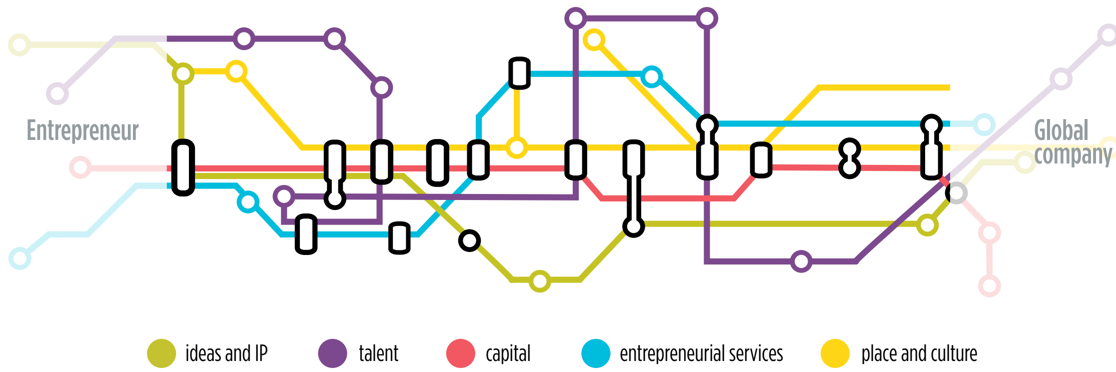
Recommendations for leveraging financial resources for small businesses in Detroit

In addition to assessing the small business credit landscape, presenters were asked to make recommendations on other resources for small businesses in Detroit. Wendy Lewis Jackson, senior program officer for the Community Development and Detroit programs at the Kresge Foundation, highlighted some of work that the New Economy Initiative (NEI) has undertaken to build a broader financial infrastructure for small businesses in the city and surrounding counties. Launched in 2008 as a $100 million collaborative between ten national and local foundations, including the Kresge Foundation, NEI has invested in a range of programs and strategies, such as high-tech incubators and high-growth accelerators, financing pools for graduates of entrepreneurship training programs, and microenterprise funds. The foundation collaborative has also helped develop a procurement initiative (to be launched in 2013) for small and medium-sized businesses to get access to contracts with universities, hospitals, and other large employers that anchor the Midtown neighborhood.

Most recently, NEI has been working to structure existing small business resources into a more cohesive network to in turn help entrepreneurs and all concerned to better understand and navigate the services and capital available to them. According to David Egner, president and CEO of the Hudson-Webber Foundation and executive director of the New Economy Initiative, the next phase of the NEI collaborative is to make a fully functional network that promotes synergies between various business development and entrepreneurship organizations, encouraging the leaders of these institutions to communicate and cooperate more directly. NEI represents this idea in a diagram resembling a subway map. As figure 4 (on page 7) shows, the "subway" lines illustrate the connections between small business and entrepreneurial service providers within a particular area.

As Egner explained, the brown dots in figure 5 (on page 8) represent producers of ideas and intellectual property; the purple dots represent entrepreneurial services; the green dots are funds; the yellow dots are talent producers; the golden dots represent organizations working on culture change through the media; and the red dots are what NEI has not yet funded, but have potential roles in this network. The resources presented on this map exist within a three-and-a-half mile "innovation" corridor in the city of Detroit, making this the densest area of entrepreneurial services and activity in the United

Figure 4: The innovation network – creating connections for entrepreneurs



Source: New Economy Initiative.

States. In his view, getting this amalgam of resources to function as a network would create a unique, unparalleled asset for the local and regional economy.

In her presentation, Susan Mosey, president of Midtown Detroit (formerly known as the University Cultural Center Association), explained that her organization has embraced the network principle for more than 20 years. She described her organization as an intermediary between "many, many forces," which is critical in making the small business environment work in a severely disinvested city. Through a high-touch, holistic service model, her organization connects business owners to technical assistance, including peer-to-peer counseling and customer service training; seeks contracts for services between other businesses in their same network; clusters businesses together on certain blocks to draw "concentrations" of customers; and provides matching grants for safety and security through foundation dollars. Midtown also has roughly $40 million in low-cost capital available for real estate development, and (otherwise) works to connect Midtown businesses to other providers of small business capital in the city. Mosey underscored the value of facilitating these connections between both young and seasoned businesses.

Another set of recommendations, similarly themed around the idea of connecting business owners to local resources, focused on more specific steps that bankers could take to build relationships with business owners throughout the city. Thomas FitzGibbon, managing director for Talmer Bank and Trust, noted that bank branches have traditionally helped bankers to connect to their communities, but bricks and mortar in the current environment are often cost prohibitive, so bankers need to build relationships in other ways. Symposium participants recommended that bankers tour the small business corridors in neighborhoods outside of the more economically vibrant Midtown and Downtown neighborhoods. Widespread vacancies and disaggregation of commercial pockets make it hard for bankers to get first-hand knowledge of the make-up and consumer markets of businesses that remain. If bankers and other lenders could see first-hand the challenges that surviving (but struggling) businesses face, they can begin to understand what gaps they might fill. This step could lead to more lending and investing beyond the Downtown and Midtown areas.

Symposium participants also recommended that banks and other financial institutions develop relationships with community groups and intermediaries that work directly with small businesses. Bankers could thereby refer business owners to support services and other sources of capital if a borrower cannot meet their underwriting standards. Lydia Gutierrez, president of Hacienda Mexican Foods, emphasized the point that banks should inform would-be borrowers about other options rather than issuing a simple decline. Chinwe Onyeagoro, co-founder and CEO of O-H Community Partners, hypothesized that, given data about extant, early stage, or otherwise higher risk small businesses to gauge risk parameters and needs,

Figure 5

non-bank entities (some potentially having bank investors) could create new financial tools and products for businesses unable to meet bank lending criteria. By investing in these resource partnerships, banks could take a more active role in business development and community revitalization, even if they cannot lend directly. Gerald Moore explained that business people are more likely to go to lenders, legal specialists, and insurance brokers before they go to an economic development specialist. Dana Thompson suggested that a referral from these "front line" organizations is the best way for informing small businesses about resources, including technical support, mentors, and financing. As Cathy McClelland, president and CEO of McClelland & Associates, remarked, even people who have begun to operate their business and recognize that they "do not have everything right" are often not aware of what resources are available.

Presenters provided several examples of how bankers already work with community organizations. For example, Michelle Richards, executive director of the Center for Empowerment and Economic Development (CEED), underscored that success at her group depends on collaboration and partnerships between banks, nonprofits, the government, and foundations. She described how her organization not only receives referrals from bankers, but several bankers sit on her board of directors and loan review committee. Louise Guyton, vice president of Public Affairs at Comerica Bank, listed the various small business activities that Comerica supports, including microenterprise organizations, small business competitions, resource forums, and incubators. William Beardsley, president and chief lending officer of Michigan Business Connection, LLC, added that credit unions in Michigan, which currently have more than $1 billion in small business loans, participate in various programs to support Michigan-owned small businesses. He gave one example with "CU Soup," a convening that brings together entrepreneurs every few months and provides thousands of dollars to the person with the best business plan and presentation. As Lydia Gutierrez noted, banks should not think solely in terms of "doing it conventionally." Sometimes there have to be other programs that partner and collaborate with the bank in order for small businesses to accelerate.

In addition, presenters explained why developing these relationships would be beneficial to the financial institutions themselves. Brian Balasia noted that partnerships between banks and community-based resources, such as incubators and SBTDC programs, provide an opportunity to de-risk the borrower pool. Through these relationships, bankers might also learn about opportunities for serving customers with non-traditional products. For example, Drextel Amy spoke about his bank developing microlending products for which borrowers apply on the telephone. Timothy Bates explained why banks could both make a profit and serve local economic development interests by providing working capital to companies that have reached the cash flow positive phase. He described the common situation where young firms that have been in business for a few years, and are either seasonable businesses or are gearing up for a big contract, get marginalized or simply go out of business because they are unable to secure $150,000 to $250,000 in working capital. Frequently these business owners, particularly minorities and immigrants, turn to informal lenders as they tend to have weaker ties with banks. He proposed that bankers enter this market by pricing working capital loans – loans that exceed the amount available through credit cards – somewhat below the rates charged by the informal lenders, but still in line with associated risk. He acknowledged that many banks already provide working capital lines of credit, but more institutions could.

Along with these ideas, presenters mentioned additional steps funders – particularly foundations – might take to leverage bank resources. Since foundations tend to be asset rich, Bates suggested that they adopt a linked deposit strategy. By opting to do business with banks that are most aggressive in small business lending, foundations can create subtle pressure on other lending institutions. Mosey also proposed that foundations become more active in providing credit enhancements, guarantees, and other tools to improve the terms of small business loans. As Egner remarked, the role of philanthropy is to subsidize failing markets or to create new markets that have not yet been developed by traditional thinking. In addition, philanthropy must make sure that minorities who are concentrated in cities get connected to the marketplace and have opportunities to become entrepreneurs.

Perhaps the most ambitious recommendation from speakers was for banks to re-evaluate their role as institutions, and to do more than approve or deny loan applications. As FitzGibbon remarked, financial institutions should lead in innovative thinking to address some of the biggest challenges in the city. As a start, this leadership and innovation includes gaining fluency with small business resources, including alternative financing options, more neighborhood contact, and re-envisioning their role in general. In a related formulation of this idea, Bruce Pietrykowski, director of urban and regional studies and director of the Center for Labor and Community Studies at the University-Dearborn, suggested that banks be a source of social capital, particularly in low-income communities. In other words, local banks should help bring together diverse people for the benefit of the community. In this way, banks would be more tied to the neighborhoods they serve, they could reorient to focus more on opportunities for entrepreneurs, networks, and making connections, and could therefore increase their economic multiplier effect. As FitzGibbon noted, the leadership of financial institutions who also commit to goals around social capital can better participate in civic decisions, assess and develop future directions for the entrepreneurial ecosystem, and raise the potential for success in business development.

Conclusion

Overall, speakers representing a diverse set of institutions coalesced around the idea that strategies to leverage and connect resources are important to ensuring that adequate capital is available to small businesses in Detroit. They tended to share the perspective that improving coordination between small business-related institutions and organizations could enhance their impact and help improve the function of the entrepreneurial "ecosystem." Of concern is the also commonly shared perception that collaboration is not the natural state of organizations with diverse goals and agendas. As Dave Egner noted, institutions do not naturally commit resources to benefit other organizations or a collective goal with no obvious or near term return. To change course, bankers need to appreciate that the entrepreneurial and small business network has value to them. They need to see that the resource pipeline can ultimately lead customers back to the bank, and that this pipeline may lead to future business and credit relationships. Presenters with some of the most experience in leveraging resources acknowledged that identifying mutually re-enforcing interests is difficult. Institutions need to engage with each other, identify common interests, and discuss how to pursue common strategies with specific tasks. Many of the presenters who have already invested in building the ecosystem agreed that if cooperation is not attainable, at least coordination might be, and banks are critical in either case. In a capital-constrained environment, the best that can be done is to make sure investments actually help each other in the places with the best prospects for growth, and banks can take a greater role in facilitating that outcome.

Gary Peters – Day one keynote

In his keynote speech on the first day of the symposium, Congressman Gary Peters discussed a series of federal initiatives that were developed to support small businesses in Detroit during the financial crisis. As part of his remarks, Congressman Peters, who serves on both the Financial Services Committee and Small Business Committee, explained how members of the Financial Services committee came to Detroit in 2009 to hear directly from small businesses, particularly auto suppliers, regarding their inability to get credit. At that time, credit from large banks was highly restricted because of the high unemployment rate in the Detroit area and the troubled nature of the auto industry. The value of facilities and equipment at many companies had dropped significantly and left these firms with insufficient capital to qualify for loans. Another tool to assess business credit worthiness, the three-year cash flow, also showed poor projections among tier 1 auto suppliers given that many companies were cutting to avoid liquidation. Still, the congressman noted that some community banks and credit unions said they were willing to make loans to these companies based on longstanding relationships and a well-developed understanding of the local economy, but they found it difficult to raise the capital to support that lending.

This situation led to two main responses on the part of federal lawmakers. To help local community banks make more small business loans, a Small Business Lending Fund was created as part of the Small Business Jobs Act in September 2010. The fund provided money that these banks could tap into to increase the scale of their small business lending. As Congressman Peters noted, a recent report issued by the U.S. Department of Treasury showed that Michigan banks that received capital from this fund increased small business lending by $216 million over their baseline (see http://peters.house.gov/index.cfm?sectionid=22&itemid=573). A second response from the federal government was to provide support for innovative state lending programs, like the Michigan Supplier Diversification Fund and the Capital Access Program, through the State Small Business Credit Initiative. These programs were designed to address the reasons why businesses were having trouble qualifying for loans, such as collateral and cash flow shortfalls. These programs allowed the state to top off collateral or invest in a portion of the loan, and permit borrowers to defer interest or capital payments. These programs acted as portfolio insurance, with the lender, borrower, and state, each contributing a portion of the total loan value towards a loan loss reserve. Through the State Small Business Credit Initiative, the Michigan Economic Development Corporation obligated $39 million of the $79 million in 14 months. More than 300 businesses received loans, and the program saved more than 4,000 jobs in Detroit and around the state.

In addition to lending and access to capital issues, Congressman Peters spoke about some work that has been done to expand government contracting for small businesses, especially for minority-owned firms. As he explained, the federal government spends half a trillion dollars per year to procure goods and services through contracts. He advocated for helping more small businesses to also compete for these contracts. As he noted, government contracting provides an opportunity to invest in small businesses owned by women, minorities, and veterans, and build the local economy. While the current government goal for contracts to small disadvantaged businesses is 5 percent, Congressman Peters recommended increasing the goal to 6 percent. See http://peters.house.gov/news-releases/us-rep-gary-peters-announces-bill-to-create-new-local-jobs-by-increasing-government-contracting-to-small-businesses-and-minority-owned-businesses. This would increase the amount of government contracts to disadvantaged businesses by more $5 billion.

Michael Barr – Day two keynote

With his keynote speech on the second day of the symposium, Michael Barr, former deputy treasury secretary and currently a professor of law at the University of Michigan, introduced another set of considerations around ways banks can serve their communities. He focused on the importance of designing banking and financial products that conform to ways people actually use these products. His recommendations related mainly to consumer banking.

Barr based his talk on research he conducted with the Survey Research Center at the University of Michigan, interviewing thousands of low- and moderate-income families in the Detroit metropolitan area in the lead-up to the financial crisis. The findings of this work were published in his book, *No Slack: The Financial Lives of Low-Income Americans.* In these interviews, low- and moderate-income families reported that they had little ability to access the mainstream banking sector to adjust to financial shocks they experience, whether from reduced income or increased expenses. Many had no savings to weather costs linked to unfortunate but common life events such as illness of a family member or divorce.

These findings led him to think about ways in which financial products and services can better meet the needs of low-income consumers and help them build a measure of financial stability. As Barr noted, advances in psychology and work in behavioral economics over the past 30 years have led to a richer understanding of the way that people actually carry out financial decisions, and therefore can inform how financial products should be designed. For example, consumer behavior is shaped by institutional constructs in our daily lives, and this is true of both market-based and non-market-based transactions. In the financial marketplace, the way in which consumers access even mundane information about mortgage contracts or credit card late fees help to shape decision-making. The bundling of certain products and services can lead to efficiencies, but can also conceal or obscure hidden costs. Behaviors of third party agents, such as mortgage brokers, also can influence consumer actions.

In thinking about the ways in which financial products and services can better meet the needs of lower-income consumers, Barr offered the example of debit-card-based banking accounts and prepaid cards. His interview subjects had identified desired features of these cards that would better serve their needs. With varying levels of fees charged, these cards could: offer FDIC protection, be free of overdraft fees, be protected against loss or theft, not require a credit check (for issuance), and include things like automatic savings and bill payment features. Based on his interview findings, Barr suggested that a financial institution could expect a high take-up rate if such a card had no monthly fee in exchange for the user agreeing to direct deposit, even if users incurred transaction fees. Institutions are already testing cards with similar choices of features. Barr suggested that more financial institutions could develop innovative products that offer consumer protection and enhance the financial capability of low- and moderate-income consumers.

Biographies

Robin Newberger is a senior business economist in the Community Development and Policy Studies division at the Federal Reserve Bank of Chicago.

Maude Toussaint-Comeau is a senior business economist in the Community Development and Policy Studies division at the Federal Reserve Bank of Chicago.

SSBCI and the Seventh Federal Reserve District:

An account of the second annual SSBCI conference and jurisdictional state profiles

by Clifton Kellogg

In October 2012, the Federal Reserve Bank of Chicago hosted a U.S. Department of the Treasury's State Small Business Credit Initiative (SSBCI) conference, which brought together over 150 representatives from states, territories, and the District of Columbia, to discuss best practices in the rollout of the SSBCI state programs. This article describes the SSBCI and how financial institutions and small businesses can benefit by expanding access to capital.

To support and improve access to credit for small businesses, Congress passed and the president signed the Small Business Jobs Act of 2010, creating the SSBCI and appropriating $1.5 billion for the program. The United States Treasury Department administers the SSBCI, which provides direct funding to states for programs that expand access to credit for small businesses. The program aims to leverage $10 in private lending and investing in small business for every $1 in public funds. This article highlights the approved SSBCI programs in the five states in the Seventh Federal Reserve District to inform lenders and investors about how to obtain credit support from their respective state programs for eligible small business transactions.

SSBCI program launch

To help position SSBCI programs to address local economic and market conditions, states tailor their programs to work best in their communities. Based on a review of applications to date, SSBCI program staff at the Treasury Department have approved more than 140 state programs, including loan guarantee programs, loan participation programs, collateral support programs, and Capital Access Programs (CAP).

The programs offer another tool to lenders looking for ways to serve creditworthy small businesses not covered by other programs. For example, SSBCI funding can be useful in SBA 504 transactions for bridge financing during the construction phase before the SBA 504 debenture is in place. SSBCI financing is also available for loans to nonprofits, such as day care centers, medical centers, and charter schools. States can use SSBCI funds to cover collateral shortfalls and therefore bring a loan into compliance with the financial institutions' lending policies.

The law sets forth a funding formula for the allocation of SSBCI funds to states based on population and job losses. Every state was allocated at least $13 million, and the largest allocation was $168 million. SSBCI funds remain with the state in perpetuity; as funds are repaid to a state, they can be used to support other state small business lending programs.

The Office of the Comptroller of the Currency (OCC) has created a page on its Web site dedicated to the SSBCI, containing an overview of the program and an FAQ. The FAQ addresses many pertinent issues, such as how certain small business loans made

SSBCI state programs for District Seven, Federal Reserve Bank of Chicago

State	Capital Access Program (CAP)	Loan Participation	Loan Guarantee	Venture Capital	Collateral Support	Contact Information
Illinois	X	X		X	X	Illinois Department of Commerce and Economic Opportunity Contact: (800) 252-2923
Indiana	X			X		Indiana Economic Development Corporation Contact: (317) 232-8800 Indiana Economic Development Corporation: CAP Contact: (317) 233-9138
Iowa	X	X		X		Iowa Economic Development Authority Contact: (515) 725-3133
Michigan	X	X		X	X	Michigan Economic Development Corporation Contact: (888) 522-0103
Wisconsin	X		X	X		Wisconsin Home and Economic Development Authority Contact: (800) 334-6873

under this program can qualify for Community Reinvestment Act (CRA) credit. You can also learn more about SSBCI at www.treasury.gov/ssbci.

SSBCI state programs

Above is a chart summarizing the SSBCI programs of states in the Seventh Federal Reserve District (Chicago). It includes information about which type of programs are available and is accompanied by each state's respective contact information.

Illinois

Illinois established four SSBCI programs under the auspices of the Illinois Department of Commerce and Economic Opportunity (DCEO). With an allocation of over $78 million, Illinois operates a multi-faceted Loan Participation Program, a Capital Access Program, a Collateral Support Program, and a Venture Capital Program.

SSBCI funds proved particularly timely for Illinois' existing CAP, the future of which had been uncertain after its small business lending funds were allocated to other budgetary commitments. The state used SSBCI funding to infuse $6.4 million into the 15-year old program to leverage a projected $129 million of newly enrolled loans through December 2016. Under Illinois' program, the lender and borrower each contribute between 1 percent and 2.5 percent for a maximum 5 percent combined contribution to the lender's reserve account. Illinois then matches this contribution using SSBCI funds to yield an individual loan reserve between 4 percent and 10 percent. One of the strengths of Illinois' CAP is its outreach to small businesses in underserved communities.

There are five components to Illinois' Loan Participation Program (LPP), including one targeted to businesses owned by Minority Persons, Women, Disabled Persons, and Veterans (MWDV). The five loan programs are:

- **The Standard Participation Loan Program (PLP) –** Illinois purchases term loans for up to 25 percent of an overall project, or 50 percent of medium- to long-term financing, whichever is less. DCEO participation is subordinated to the lender at a "below market" interest rate.

- **Minority/Women/Disabled/Veteran-Owned Businesses –** This program is similar to the Standard PLP, with a maximum of 40 percent of an overall project, or 50 percent of a medium- to long-term loan, whichever is less. However, the amount of financial support varies, depending on loan term and MWDV majority control/ownership.

- **Revolving Line of Credit (RLOC) PLP –** Similar to the Standard PLP, with up to 25 percent of an overall project, or 50 percent of a revolving line of credit, whichever is less. Maximum term is two years before reapplication is required.

- **PLP Support of Small Business Administration SBA 7(a) Activity –** This program allows the lender to structure a transaction with a senior SBA 7(a) guaranteed loan and a subordinate loan to the same borrower, which is purchased by Illinois. The lender must always retain at least 20 percent risk of loss in the overall transaction.

- **PLP Support of Small Business Administration SBA 504 Activity –** This program allows the lender to secure DCEO's support of the borrower's equity portion in the overall transaction, as specified by the SBA within its approval of an SBA 504-supported loan project. DCEO's support is subordinated to both the lender's and SBA's respective positions.

Illinois' new Collateral Support Program (CSP) provides cash deposits of up to 20 percent of the loan being issued by the lender. The CSP is designed to provide critical support in bridging the shortfalls in collateral value necessary to meet the loan-to-value requirements of lenders.

Illinois also operates a venture capital fund that includes a senior management team with over 30 combined years of industry and venture fund experience. Illinois projects to support up to 40 promising, early-stage, high-tech companies by averaging 20 percent of total financing in each investment.

Indiana

Indiana is deploying its $34.3 million allocation to an existing CAP and an existing venture capital program. Indiana's long-standing CAP has supported over 3,700 loans in excess of $188 million since its inception in 1993. The maximum loan that can be enrolled under Indiana's CAP is $5 million; the average size loan is approximately $50,000. Borrower and lender contributions to the lender's reserve account may be no less than 2 percent and no greater than 7 percent, and the state matches this contribution for a total lender reserve of 4 percent to 14 percent of loan value. As the lender originates more CAP loans, the loan loss reserve account grows as well.

Indiana allocated $32.8 million to its Indiana 21st Century Research and Technology Fund (21 Fund), an existing venture capital fund. The 21 Fund offers SSBCI-sourced investment support under various initiatives: direct co-investments through the 21 Fund and within an angel network initiative and fund-of-funds co-investments within a high growth initiative and a seed fund initiative. The average investment size differs per initiative. Indiana has contracted with private, nonprofit venture development fund manager, Elevate Ventures, Inc., to provide business development assistance programs to high potential Indiana businesses, while also providing investment assessment, due diligence, decision, and management services to the SSBCI initiatives, and to the Indiana-based businesses in which investments are made. The Indiana Economic Development Corporation retains final authority over the direct investment policy and fund-of-fund commitment approval decisions.

Iowa

Under the management of the Iowa Economic Development Authority (IEDA), the SSBCI allocation of $14 million funds the new Iowa Capital Access Program (ICAP) and two existing programs: the Iowa Demonstration Fund Program, a venture capital program; and the Iowa Small Business Loan Program, a microloan program.

ICAP is a new program – similar to other states' CAPs – that provides portfolio insurance for small business loans based on separate loan loss reserve funds for each financial institution lender. Borrower and lender contribute between 1.5 percent and 3.5 percent to the loan loss reserve, and IEDA matches the combined lender/borrower contribution for a total of 6 percent to 14 percent of the loan principal. As the lender originates more CAP loans, the reserve account grows to absorb more potential loan losses.

IEDA administers the Small Business Loan Program in conjunction with the Iowa Foundation for Microfinance and Community Vitality (IFMCV).

It is designed to be a hybrid program combining loan loss reserve and loan participation. The IFMCV has administered the Iowa Small Business Loan Program under contract with IEDA since July 2010. In the first nine months since the conclusion of their contract with IEDA, IFMCV lent $1.6 million to 42 businesses. Program loans leveraged private financing of $1.7 million, for approximately a 1:1 ratio of public to private lending. Community Investment's team leader within the IEDA, Derek Lord, underscores the ongoing, growing interest in Iowa's lending programs: "Our small business development centers are driving businesses to our small business loan support programs in order to better assist their customers. The program is now gaining momentum."

An additional $5 million is apportioned to the Demonstration Fund Program (the Fund), an existing venture capital program. To assist in the management of the Fund, VentureNet Iowa, a for-profit company, performs underwriting and makes investment recommendations to IEDA. Approximately $11 million was invested through the Fund since 2007 in 107 projects. On average, the Fund invested just under $2 million in 25 projects per year.

Michigan

The Michigan Economic Development Corporation (MEDC) administers a long-running, small business loan program that served as one of the models for the creation of the SSBCI. MEDC uses SSBCI funds for three programs: to purchase loan participations, to provide cash collateral, and for a CAP.

- MEDC purchases up to 49.9 percent of a loan and may consider providing interest rate grace periods. Loan participation loan size averages approximately $1-2 million.

- Under MEDC's cash collateral program, the lender calculates the collateral shortfall and requests MEDC to post a cash deposit of up to 49.9 percent of the total loan size. The small business borrower pays an annual fee, which encourages the firm to repay the deposit as early as possible. Collateral loan size averages $1-2 million.

- Michigan's CAP operates similar to many other state programs in which the borrower, lender, and bank contribute to a funded pooled reserve account held at each bank. Michigan's CAP generally enrolls loans under $100,000.

For an example of SSBCI funds at work, consider the case of Livonia, Michigan based PEP (Plug-in Electric Power) Stations. After a successful series of sales of charging stations for electric vehicles to select customers during their test marketing, this start-up had ambitions to launch their product to key markets throughout the U.S. To facilitate the launch, PEP Stations needed additional working capital of about $750,000. Through SSBCI's Loan Participation Program, MEDC was able to help PEP Stations achieve their goal by purchasing 49.9 percent of the loan. PEP Stations is now installing their charging stations across the nation, from Amherst College in Massachusetts to Dallas/Ft. Worth Airport in Texas. This brings real benefits to a region in Michigan hard-hit by the recession. PEP Stations is projected to add an estimated 40 IT professionals to the company's workforce over the next five years.

Wisconsin's NeuWave Medical, Inc., is another great example of SSBCI's ability to leverage private financing. NeuWave develops medical devices designed to deliver high-power microwave energy as a major tool for coagulation of cancerous lesions. The Wisconsin Housing and Economic Development Authority (WHEDA) partnered with Madison Development Corporation (MDC) and other local investors to provide $300,000 of support. Since receiving these funds, NeuWave has raised over $14 million in additional financing to continue its mission of providing minimally invasive surgical tools.

Paul Brown, vice president of MEDC, notes "the Michigan Bankers Association (MBA) was absolutely critical to the successful development and implementation of this program. The bankers' involvement helped us develop a program they would use." Over 100 Michigan banks use the program today. Working with the MBA, the MEDC has trained scores of bankers in how to use the program. At the conclusion of each training session, Paul asks the bankers "to pledge not to say 'no' to a borrower until they have considered the SSBCI programs." To date, the MEDC has participated in over 300 loans, leveraging the $40 million the state received into $300 million in bank loans, without a single default. "This is a program that works for the banks, the borrowers, and for Michigan," Paul concludes.

Wisconsin

With its $22 million SSBCI allocation, Wisconsin expanded its existing CAP, announced the creation of the Wisconsin Housing and Economic Development Authority (WHEDA) Guarantee Program for loan guarantees, and launched the Wisconsin Equity Fund (WEF), a fund-of-funds venture capital program.

Wisconsin's CAP had been limited to four counties in the southeastern part of the state. With SSBCI assistance, the program now covers the entire state under the administration of Milwaukee Economic Development Corporation. Over its 19-year history, Wisconsin's CAP has enrolled 942 loans totaling $52.6 million at an average of $56,000 each. The expanded CAP with SSBCI expects to enroll 160 loans per year at an average of $101,000.

WHEDA employs $3.4 million in SSBCI funding to consolidate two existing loan guarantee programs: the Neighborhood Business Revitalization Guarantee (NBRG) and the Small Business Guarantee (SBG). Specifically, these funds increase the availability of high loan-to-value financing to small businesses by providing a 10 percent first loss on senior debt secured by real property. Each lender has 90 percent of its own capital at risk in each transaction and loans will be targeted to borrowers with an average of 100 employees (maximum 750) and to loans of less than $10 million. Under the NBRG and the SBG, WHEDA has guaranteed over 500 loans totaling $50 million since 2000.

WHEDA is currently proposing changes to its existing program by moving the CAP allocation to WEF, and to expand the use of the loan guarantees beyond a 10 percent first loss product and include a 50 percent pro-rata (or shared) guarantee product. It also requests to add mezzanine and other subordinate debt structures as an allowed SSBCI investment for its Wisconsin Equity Investment Fund (WEIF), one of WEF's two programs.

SSBCI Conference

At the conference held at the Chicago Federal Reserve in October, sessions focused on how to rollout the SSBCI programs to the banking and lending community. Many participants commented on the usefulness of involving state bankers' associations in the marketing of the programs to help increase the awareness and usage of the loan programs.

Experienced participants concurred that the most important consideration for a successful loan program is to keep it simple. Complicated, bureaucratic programs have less appeal and ultimately less participation. Ease of use and speed of program implementation are crucial for success.

For bankers that use the SBA's programs, SSBCI programs may serve as a useful complement. For instance, SSBCI funds can be used for bridge loans during the construction phase of a 504 transaction until take-out by the SBA debenture. Loans that need credit enhancement but do not justify the cost of securing the 75 percent SBA 7(a) guarantee may also be a good fit for SSBCI programs.

The SSBCI program offers an opportunity for financial institutions to serve small business borrowers in their states that they could not have otherwise. Increased lending to creditworthy small businesses will lead to jobs and more stable communities. To learn more about the SSBCI and state-specific programs offered, please visit www.treasury.gov/ssbci.

Biography

Cliff Kellogg is the program director for the State Small Business Credit Initiative (SSBCI) at the U.S. Treasury Department.

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