“Strengthening Access to Capital for Minority-Owned Small Businesses”

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Written Testimony
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Baltimore is home to more than 50,000 small businesses. Roughly 37,500 of these businesses are sole proprietorships and about 12,500 have at least one employee.[1] Small businesses form the backbone of the local economy, providing jobs for residents, tax revenues for the city, and a sense of identity to neighborhoods and commercial districts. But for new and established small businesses to thrive, the city needs a financing system with capacity to meet their needs. Capital is certainly not the only ingredient necessary for successful business growth, but it is a critical input. If companies lack access to appropriate types of capital at critical stages of growth, they are likely to never take off and achieve scale, or even worse, to go out of business or leave Baltimore and relocate where financial support is more readily available, depriving the local economy of jobs and economic growth.

To better understand whether Baltimore’s financing system and the flow of capital to small businesses is sufficiently expansive and diverse to support the entire landscape of the city’s small businesses and their varying needs, the Johns Hopkins 21st Century Cities Initiative (21CC) has spent the past two years analyzing data, interviewing experts, and convening stakeholders. 21CC has published two reports over the past year presenting a robust set of findings and recommendations relating to the local financing system. These reports are summarized below. The data provided here are drawn from the reports, where all original sourcing is provided.[2]

The first report, published in September 2017 and titled **Financing Baltimore’s Growth: Measuring Small Companies’ Access to Capital** analyzed 40 separate public and private funding programs and data sources to quantify loan, equity, and grant investments in small businesses located in Baltimore City. Over the five-year period from 2011 through 2015 about $560 million per year totaling about 7,000 individual transactions flowed to startups and small businesses in Baltimore City.

Of the total dollar amount invested, 60 percent came in the form of loans, 30 percent in equity investments, and 10 percent in grants. There was significant annual growth in equity investments, increasing from $50 million per year in the mid-2000s to over $200 million per

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[1] Figures from the U.S. Census Bureau’s 2012 Survey of Business Owners and 2016 County Business Patterns.
[2] To view the full reports, visit http://21cc.jhu.edu/wp-content/uploads/2017/09/21cc-financing-baltimores-growth-sept-2017.pdf and http://21cc.jhu.edu/wp-content/uploads/2018/07/financing-baltimores-growth-strengthening-lending-to-small-businesses.pdf.

year a decade later. On the loan side, the report showed declines in the total amount of loans originated to Baltimore City's small firms over the past decade.

Last month, 21CC published the second report, **Financing Baltimore's Growth: Strengthening Lending to Small Businesses**, that takes a deeper look into the dynamics of bank lending to small businesses in Baltimore City. The report covers the period from 2007 to 2016, which is the most recent available 10 years of loan and deposit data that banks are required to report to federal regulators.

The report organized bank lenders into three categories: 1) banks with branches in Baltimore City (referred to as depository banks); 2) banks that have branches elsewhere, but do not have any branches or take deposits in Baltimore City (referred to as non-branch banks); and 3) regulated financial institutions that specialize in credit card loans. Overall, small business bank lending in Baltimore was significantly lower in 2016 than 2007, falling from $457 million in 2007 to $307 million in 2016. Across the board, all three types of institutions were greatly impacted by the Great Recession, with the number and dollar amount of loans both decreasing significantly from 2007 levels and hitting low marks in the 2010 to 2012 period. Since then, all three types of institutions have expanded their activity, but non-branch banks are the only category of lender that has surpassed 2007 levels in total dollar amount loaned.

Depository banks are consistently responsible for about 70 percent of all loan amounts on an annual basis. Their small business lending, however, has not kept pace with their growth in deposits. Over the 10-year period from 2007 to 2016, total outstanding bank deposits among banks with branches in Baltimore nearly doubled (from $13.5 billion to $26.5 billion), while annual small business lending activity for these same types of banks fell 32 percent (from $311 million to $212 million). The top five depository banks in Baltimore City in 2016, based on small business loans originated, were: M&T Bank, PNC Bank, Wells Fargo Bank, Bank of America, and BB&T Bank.

A key data point analyzed in the report was the annual ratio of small business loan amounts to outstanding deposit amounts, or the loan-to-deposit ratio. Among the top 14 depository banks in 2016, annual small business lending data is publicly available for 11. The total loan-to-deposit ratio for these 11 banks was 0.82 percent in 2016. Bank of America had the lowest loan-to-deposit ratio at 0.21 percent, although the bank originated the fourth most loans to Baltimore's small businesses at $22 million. Maryland headquartered Howard Bank and Columbia Bank had the highest loan-to-deposit ratios at 6.3 percent and 8.1 percent, respectively.

Looking back to 2007, the loan-to-deposit ratio was 2.4 percent among the top banks, combined. If the loan-to-deposit ratio for 2016 was the same as in 2007, then the top depository banks would have provided over $600 million in small business loans in 2016, rather than the $203 million in small business loans that were in fact provided. In other words, just by maintaining the 2007 loan-to-deposit ratio, banks would have originated nearly $400 million more in small business loans in 2016 than was actually the case.

Non-branch banks in Baltimore have grown in both number of loans and total dollar amount, with increased growth over the past six years. In 2016, these banks provided nearly four times the number of loans and loan amounts they provided in 2010. They are the only lender type that is doing more small business lending in total dollar amount compared to 2007. One example is the First National Bank of Pennsylvania, which began originating small business loans in Baltimore in 2012 and steadily increased their lending in the city to 2016 when the bank made 35 loans totaling $8.5 million, for an average of over $240,000 per loan, indicating a focus on larger working capital term loans. In a sign of a long-term commitment to the Baltimore market, in 2016 the bank established its regional headquarters in Baltimore and opened its first branch in the city.

Credit card lenders have made some gains over the past five years, but their activity today is well below what it was prior to the Great Recession. The number of credit card transactions in 2016 was about one-third what it was in 2007, and the total dollar amount was less than half what it was a decade prior. The top lender in terms of number of transactions in Baltimore City for every year from 2007 to 2016 was American Express, although their average loan size was only $12,000 in 2016.

The report also looked closely at U.S. Small Business Administration (SBA) 7(a) loans in Baltimore. In the overall landscape of small business lending by banks in Baltimore, SBA 7(a) loans represent a small portion of loan activity. However, they are an important tool for banks to expand their small business offerings, particularly because they are generally larger loans and a way banks can provide working capital to small businesses through loans that are guaranteed by SBA.

From 2007 to 2016, the total dollar amount of all types of SBA 7(a) loans made to Baltimore City small businesses increased from $19.2 million in 2007 to $28.3 million in 2016, while the number of loans during that same time period decreased from 152 in 2007 to 108 in 2016, resulting in an average loan size that was twice as high. In 2016, 26 banks originated SBA 7(a) loans to Baltimore City small businesses. An important observation in SBA 7(a) lending in Baltimore is the dominance of M&T Bank in the market, which accounted for over half the number of loan transactions and more than one-third of total loan amounts in 2016. Overall, however, SBA loans are under-leveraged in Baltimore compared to their use in cities such as Atlanta, Buffalo, Cleveland, and Pittsburgh.

The decline in overall small business lending over the past decade did not happen by accident. Rather, it largely mirrors changes in the marketplace, some of which are national and some Baltimore specific. The report highlighted three reasons for small business lending declines in Baltimore: bank consolidation, headquarters effect, and shrinking average loan sizes.

The national consolidation of the banking industry hit Baltimore particularly hard. In each case where a locally headquartered bank was acquired by a larger national bank, the amount of combined small business lending dropped. Examples include the acquisition of Mercantile Bank by PNC Bank and Provident Bank by M&T Bank. These four banks were together originating over $130 million in small business loans in 2007. The two acquiring banks originated $98 million in 2016.

For Baltimore, it is challenging to be a branch town and attract the same level of investment as a bank's headquarters city. The report looked at overall loan data and found that the two largest small business lenders in Baltimore, M&T Bank and PNC Bank lend at higher rates in their headquarters communities, when controlled for population. In Buffalo, M&T's small business lending was 2.5 times its Baltimore area activity. In Pittsburgh, PNC's small business lending was three times that of its Baltimore area lending. It's also the case that these banks have much higher deposits in the headquarters communities, which supports higher local lending.

The average loan amount to small businesses by all depository banks has declined from $191,819 per loan in 2007 to $70,877 per loan in 2016. Decreasing average loan amounts appear to be driven by the growth of small business credit cards and smaller lines of credit being offered by some depository banks.

The report also analyzed Community Reinvestment Act (CRA) evaluations for depository banks active in Baltimore. The evaluations shed little insight into small business lending activity in Baltimore. CRA guidelines, with regard to geographic assessment areas and lending criteria, do not capture the decline in small business lending nor recognize the banks that are serving Baltimore City's need for these loans.

In closing, the report offered several recommendations:

- Encourage the largest banks in Baltimore to increase small business lending activity by making more direct loans, becoming more active with SBA loans, and/or capitalizing local small business loan funds, such as community development financial institutions (CDFIs).
- More effectively utilize state and city loan programs to provide loan loss reserves or guarantees for private bank loans targeting new and/or higher-risk borrowers.
- A concerted effort should be made to attract and welcome banks and other types of lenders from outside of Baltimore and Maryland that have identified market opportunities in Baltimore's small businesses and startups.
- Reports like the one developed by 21CC, which rely on CRA data focused on a specific market, could be used as a case study for regulators and stakeholders currently working on modernizing this 40-year-old legislation. Baltimore is an example of how CRA's geographic assessment areas and scoring need improvement to better measure community reinvestment.