

21ST CENTURY CITIES INITIATIVE

WHITE PAPER | AUGUST 2018

FINANCING BALTIMORE'S GROWTH Strengthening Lending to Small Businesses

By Mary Miller, Ben Seigel, and Mac McComas

The authors are, respectively, Senior Fellow, Executive Director, and Program Coordinator of the 21st Century Cities Initiative.

Executive Summary

In 2017, the Johns Hopkins University 21st Century Cities Initiative published a report on the capacity of the financing system to support small businesses and startups in Baltimore City. The report covered both venture capital and loan capital flowing to small firms located in Baltimore, documenting \$500-600 million in annual investments. Loans from banks are the largest source of financing for Baltimore's small businesses, responsible for about half of total investments per year.

As a follow-up to the 2017 report, this paper takes a deeper look into the dynamics of bank lending to small businesses in Baltimore City. Our analysis covers the most recent available 10 years of loan and deposit data that banks are required to report to federal regulators (2007-2016).

Key findings from our analysis are highlighted below.

- **Bank loan transactions and dollar amounts in Baltimore were significantly lower in 2016 than 2007.** Total small business lending fell from 17,084 loans totaling \$457 million in 2007 to 8,274 loans totaling \$307 million in 2016.
- **Bank deposits in Baltimore nearly doubled from 2007 to 2016, reaching \$26.5 billion, while the ratio of small business lending to deposits plummeted.** If banks that take deposits in the city had maintained the same ratio of small business loans to deposits in 2016 as in 2007, an additional \$400 million of loans would have been made in 2016.
- **The average loan size from all depository banks operating in Baltimore shrank dramatically.** The average loan amount to small businesses in Baltimore declined from \$191,819 per loan from all depository banks in 2007 to \$70,877 by 2016.
- **Larger loans are hard to come by.** As more banks gravitated to making smaller credit card and line of credit loans to businesses, a handful of banks from



JOHNS HOPKINS
21ST CENTURY CITIES
INITIATIVE



within and outside Baltimore consistently offered loans of \$200,000 and above, providing meaningful capital for business growth.

- **Outside lenders grew their market share to 15 percent of small business loan capital in Baltimore City in 2016.** These banks provided nearly four times the number of loans and total dollar amount they provided in 2010.
- **Small Business Administration guaranteed loans were under-leveraged in Baltimore.** With the exception of one bank, there is very little SBA lending to Baltimore City businesses. Compared to other similarly sized cities, Baltimore had among the lowest levels of SBA loans.
- **As a “branch town” Baltimore lacks the scale of investment provided by our large banks in their headquarters cities.** A comparison of lending levels in the headquarters city of our largest depository banks shows significantly higher lending activity than in Baltimore.
- **Community Reinvestment Act 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.

Based on our analysis, we make the following recommendations to increase bank lending to small businesses in Baltimore City.

- **Encourage our largest banks to do more.** Given the growing deposit base in Baltimore, there is room for more small business lending. In addition to more direct lending, large banks could develop more capacity to make loans guaranteed by the U.S. Small Business Administration.
- **Develop small business lending capacity at community development financial institutions.** Large banks can help capitalize these institutions that provide financial services to underserved communities. CDFI loan funds can deliver credit on affordable terms to small businesses to help them grow into the banking system.
- **Help new and higher-risk borrowers.** Public resources, such as state and city loan programs, should be used to provide loan loss reserves or guarantees for private bank loans to new and/or higher-risk borrowers.
- **Welcome new entrants to small business lending in Baltimore.** Banks from outside of Baltimore and Maryland, and other types of lenders, have identified market opportunities in Baltimore’s small businesses and startups. We encourage a specific effort focused on bringing more of these lenders into Baltimore.
- **Use Baltimore as an example for Community Reinvestment Act modernization.** Reports like this one, which rely on CRA data focused on a specific market, could be used as a case study for regulators and stakeholders 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.

Introduction

In 2017, the Johns Hopkins University 21st Century Cities Initiative documented financial flows to small businesses in Baltimore. The intent was to measure the capacity of the city to support economic development, grow and sustain jobs, and expand the city's tax base.¹ The report covered both venture capital and loan capital invested in growing and established small companies documenting \$500-600 million in annual investments. On the loan side it showed the decline in the total amount of loans originated in the city over the past decade as a result of bank consolidation, a shift toward smaller business loans, and an emphasis on real estate lending over business lending.

This report represents a deeper dive into the dynamics of bank lending to small businesses in the City of Baltimore. We are particularly interested in bank lending because such loans are the largest single source of capital for small businesses in Baltimore, responsible for about half of all investments annually. While equity capital may establish a business, working capital can sustain the business and help it grow.

We focused our analysis on the most recent 10 years of loan and deposit data that banks are required to report to federal regulators under the Community Reinvestment Act (CRA). The 1977 CRA law was enacted "to encourage banks to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions."² Because this data is collected at the county level – and because Baltimore City is also a county – this gave us a reasonably accurate way to measure lending activity in the city. We also measured bank loans guaranteed by the U.S. Small Business

Administration, some of which are not captured in CRA reports.

There are some important caveats to state at the outset. First, we were only focused on small business lending.³ We know that banks originate mortgage loans, community development loans, and loans to larger commercial entities in Baltimore that also reflect their presence in the city.

Second, while we have full deposit and loan data for all of the FDIC insured banks for the 10-year period that we covered, the composition of the list changes over time with bank mergers and acquisitions. Smaller banks with under \$1.2 billion in assets are not required to report CRA small business loan data, although a few do voluntarily. We know from our earlier report that the missing loan data in the CRA reports from these smaller banks do not change the overall observations here.

Third, it is much easier to measure the supply of loans provided than the demand for loans or the experience of borrowers trying to obtain credit. Further research into the rate of small business formation in the City of Baltimore, loan application approval/rejection rates and demand for credit of varying amounts would be very useful in strengthening the recommendations here. Much of the information we have on loan demand comes from limited surveys and anecdotal reports.

Finally, we acknowledge that in measuring the formal financial system's loans to small businesses we are not capturing non-bank lenders or personal credit sources. These are undoubtedly additional sources of capital to small businesses.

TABLE 1: SMALL BUSINESS LOANS BY TYPE OF LENDER, BALTIMORE CITY, 2007-2016

YEAR	DEPOSITORY BANKS			NON-BRANCH BANKS			CREDIT CARD INSTITUTIONS		
	#	\$	AVG	#	\$	AVG	#	\$	AVG
2007	1,602	\$311,013,000	\$194,140	443	\$37,719,000	\$85,144	15,039	\$107,944,000	\$7,178
2008	1,328	\$283,189,000	\$213,245	333	\$30,664,000	\$92,084	11,055	\$75,688,000	\$6,846
2009	982	\$204,315,000	\$208,060	242	\$19,803,000	\$81,831	3,645	\$24,522,000	\$6,728
2010	1,091	\$164,761,000	\$151,018	59	\$11,274,000	\$191,085	3,336	\$20,997,000	\$6,294
2011	1,367	\$183,447,000	\$134,197	63	\$15,560,000	\$246,984	3,920	\$27,615,000	\$7,045
2012	1,683	\$161,584,000	\$96,010	91	\$19,088,000	\$209,758	4,324	\$31,593,000	\$7,306
2013	2,028	\$189,383,000	\$93,384	95	\$24,894,000	\$262,042	4,308	\$34,696,000	\$8,054
2014	1,954	\$193,192,000	\$98,870	220	\$48,768,000	\$221,673	5,040	\$41,718,000	\$8,277
2015	2,810	\$194,786,000	\$69,319	225	\$50,282,000	\$223,476	5,105	\$46,432,000	\$9,095
2016	2,985	\$211,569,000	\$70,877	220	\$44,630,000	\$202,864	5,069	\$51,147,000	\$10,090

Source: Federal Financial Institutions Examination Council (FFIEC) and Federal Deposits Insurance Corporation (FDIC)

Who Lends to Small Businesses in Baltimore?

To get a clear sense of the overall lending trends, we first wanted to better understand the types of institutions providing credit and their lending activities over the past decade. We organized the financial institutions 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) financial institutions that specialize in credit card loans.

Table 1, above, outlines the aggregate lending activity of these three types of institutions from the period 2007 through 2016. Depository banks in Baltimore provided the most capital of the three types of institutions as measured by dollar amount, while credit card companies had the most overall transactions.

Trends across the decade reveal interesting changes in the marketplace. Across the board,

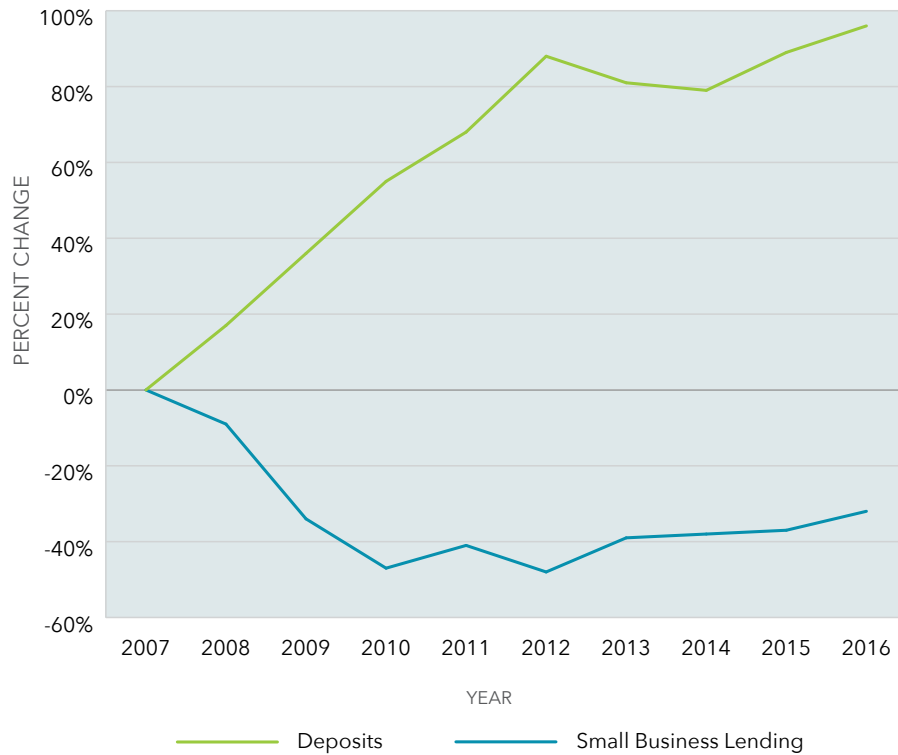
all three types of institutions were greatly impacted by the Great Recession, with the number and dollar amount of loans both decreasing significantly from 2007 levels and hitting low marks in the 2010 to 2012 period. Since then, all three types of institutions have expanded their activity, but non-branch banks are the only category of lender that has surpassed 2007 levels in total dollar amount.

Depository Banks

Depository banks have branches in Baltimore, though they are not necessarily headquartered in the city. We measured these banks' presence in Baltimore by looking at their outstanding bank deposit dollar amounts, which we then compared to their small business lending activity.

Over the 10-year period from 2007 to 2016, total outstanding bank deposits in the City of Baltimore have nearly doubled, while annual small business lending activity of depository banks has fallen 32 percent, as displayed in Chart 1, on page 5.⁴ In dollar terms, total

CHART 1: PERCENT CHANGE OF BANK DEPOSITS AND SMALL BUSINESS LOANS SINCE 2007, BALTIMORE CITY, 2007-2016



Source: FFIEC and FDIC

outstanding deposits grew from \$13.5 billion in 2007 to \$26.5 billion in 2016. During the same period, total reported small business loans fell from \$311 million to \$212 million. Meanwhile, the number of business establishments in Baltimore held relatively constant, with a one percent decline over the 10 year period to 12,555, 99.6% of which are small businesses. In the most recent year available, from 2015 to 2016, there was a gain of 100 business establishments in the city.⁵

Table 2, on page 6, shows deposits and small business lending data for the top depository banks in Baltimore in 2016. Four banks in Baltimore had deposits in excess of \$2 billion: Bank of America at \$10.3 billion, M&T Bank at \$8.3 billion, Wells Fargo Bank at \$2.9 billion, and PNC Bank at \$2.6 billion. There is then a

significant drop off with BB&T at \$507 million, followed by SunTrust Bank (\$354 million), 1st Mariner Bank (\$256 million), Harbor Bank (\$174 million), Northwest Bank (\$147 million), Hamilton Bank (\$112 million), and Howard Bank (\$94 million).

The last column in Table 2 shows the ratio of small business loan amounts to outstanding deposits, expressed in percent terms. Bank of America had the lowest small business loans to deposits ratio at just 0.21 percent, while Maryland headquartered Howard Bank and Columbia Bank had the highest at 6.32 percent and 8.07 percent, respectively.

Among the top 14 depository banks in 2016, annual small business lending data is available for 11. The ratio of total small business loans to outstanding deposits for these 11 banks was

TABLE 2: DEPOSITS AND SMALL BUSINESS LOANS, TOP DEPOSIT BANKS, BALTIMORE CITY, 2016

INSTITUTION NAME (RANKED BY DEPOSITS)	DEPOSITS	SMALL BUSINESS LOANS	# OF LOANS	AVG LOAN AMOUNT	LOAN TO DEPOSIT RATIO
Bank of America	\$10,378,396,000	\$21,986,000	969	\$22,689	0.21%
M&T	\$8,302,537,000	\$55,036,000	219	\$251,306	0.66%
Wells Fargo	\$2,940,513,000	\$24,247,000	606	\$40,012	0.82%
PNC Bank	\$2,571,086,000	\$43,213,000	620	\$69,698	1.68%
BB&T	\$507,780,000	\$19,785,000	253	\$78,202	3.90%
SunTrust Bank	\$353,810,000	\$10,016,000	160	\$62,600	2.83%
1st Mariner Bank	\$255,584,000	\$11,657,000	32	\$364,281	4.56%
Harbor Bank	\$173,686,000	NA	NA	NA	NA
Northwest Bank	\$146,632,000	\$679,000	2	\$339,500	0.46%
Hamilton Bank	\$112,195,000	NA	NA	NA	NA
Howard Bank	\$93,919,000	\$5,931,000	21	\$282,429	6.32%
Capital One	\$86,439,000	\$3,624,000	29	\$124,966	4.19%
Bay Bank	\$86,201,000	NA	NA	NA	NA
Columbia Bank	\$82,588,000	\$6,662,000	28	\$237,929	8.07%
Total Top Depository Banks	\$26,091,366,000	\$202,836,000	2,939	\$69,015	0.82%
All Depository Banks	\$26,491,694,000	\$211,569,000	2,985	\$70,877	
Top Bank % Share	98%	96%	98%		

Source: FFIEC and FDIC

0.82 percent in 2016. Looking back at the top banks in 2007, the same ratio was 2.4 percent. **If the ratio of 2.4 percent had remained the same over the decade, 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.**

Non-Branch Banks

Non-branch banks in Baltimore have grown significantly 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 total dollar amount 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. In 2016, the bank had a small business loan to deposit ratio of 25 percent in the city.

As can be seen in Table 3, below, other notable banks active in the non-branch categories are smaller banks headquartered in Maryland, such as Sandy Spring Bank, The Bank of Glen Burnie, and Howard Bank, which as of 2016 moved over to the depository banks column after opening branches in the city. Howard Bank also moved its headquarters to Baltimore in 2018 upon acquiring 1st Mariner Bank.

Credit Card Institutions

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 10 years ago. The number one 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.

These trends are displayed in Chart 2, on page 8. Transactions, (left side), indicate that the share of credit card transactions (in green) has decreased over the 10-year period, from 88 percent of all transactions in 2007 to 61 percent in 2016. Dollar amounts, (right side), show slight dips among both credit cards and depository banks, while the share of non-branch banks had grown significantly, from 8 percent in 2007 to 15 percent in 2016.

Small Business Administration Guaranteed Loans

In addition to the types of loans discussed above, another way banks provide working capital to small businesses is through loans that are guaranteed by the U.S. Small Business

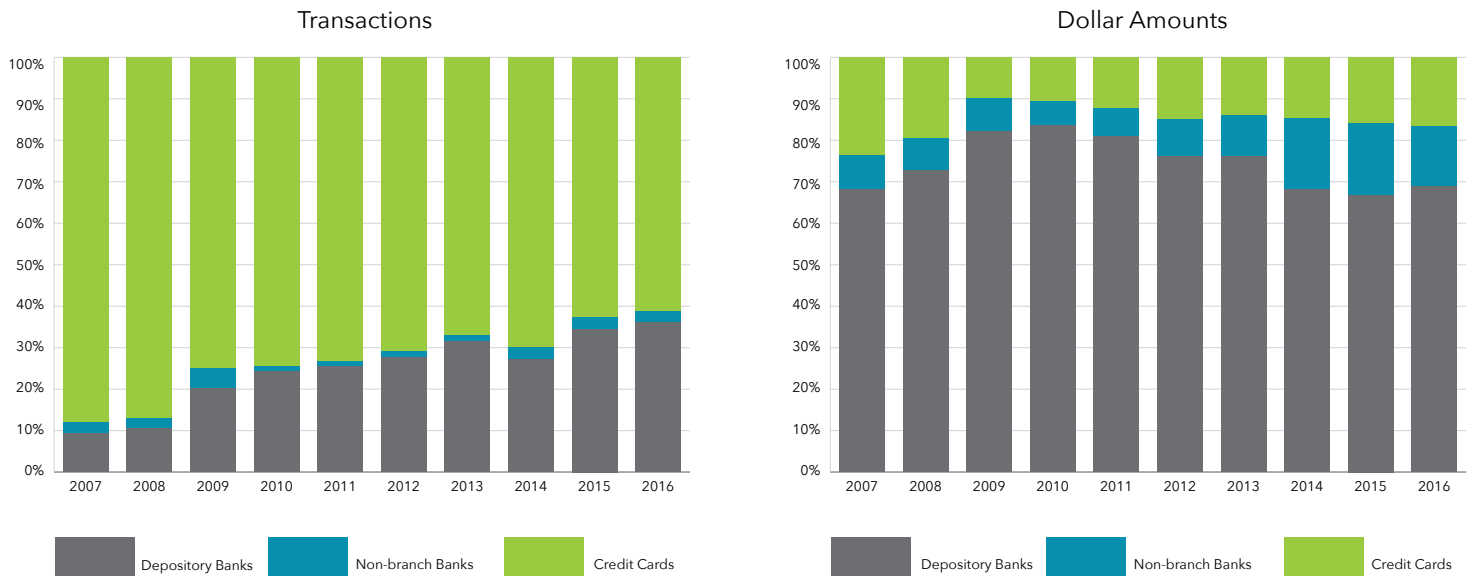
TABLE 3: TOP 5 NON-BRANCH BANKS SMALL BUSINESS LENDING BY TOTAL DOLLAR AMOUNT, BALTIMORE CITY, 2015 AND 2016

2015			2016		
INSTITUTION NAME	# OF LOANS	TOTAL \$ AMOUNT	INSTITUTION NAME	# OF LOANS	TOTAL \$ AMOUNT
Sandy Spring Bank	44	\$13,384,000	Sandy Spring Bank	41	\$11,146,000
Howard Bank*	21	\$8,365,000	Silicon Valley Bank	15	\$4,305,000
First National Bank of PA*	32	\$8,293,000	EagleBank	8	\$3,000,000
Silicon Valley Bank	7	\$1,858,000	Old Line Bank	4	\$2,098,000
The Bank of Glen Burnie	6	\$1,858,000	BMO Harris Bank N.A.	21	\$1,685,000

*Both Howard Bank and First National Bank of PA opened branches in Baltimore City in 2016.

Source: FFIEC and FDIC

CHART 2: SHARE OF SMALL BUSINESS TRANSACTIONS AND DOLLAR AMOUNTS BY TYPE OF LENDER, BALTIMORE CITY, 2007-2016



Source: FFIEC and FDIC

Administration (SBA). Known as the 7(a) program, the SBA reduces the risk for banks to lend to small businesses that otherwise might not qualify for traditional bank loans by guaranteeing up to 85 percent of the loan principal in the case of a default. Some SBA loans are reported as small business loans for CRA purposes, but this is at the bank's discretion and not all are captured in the CRA data, including SBA loans that are \$1 million and over.

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. There are also a number of different types of SBA 7(a) loans, including Express and Community Advantage loans that can be used as revolving lines of credit and turned around more quickly than standard 7(a) loans, providing banks a flexible menu of options for capitalizing small business clients.

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. See Table 4, on page 9. The increased average loan amount was partly due to the Small Business Jobs Act of 2010, which increased allowable maximum loan amounts for 7(a) regular loans permanently and Express loans temporarily.

In 2016, 26 banks made SBA 7(a) loans to Baltimore City small businesses, six of which were depository banks and 20 of which were non-branch banks. Many of these are the same banks discussed above that are active in Baltimore, with some key differences. The most important observation in SBA 7(a) lending in Baltimore is the dominance of M&T Bank in the market.

As can be seen in Table 5, on page 9, M&T accounted for over half of the total number

TABLE 4: SBA 7(A) LENDING BY DEPOSITORY AND NON-BRANCH BANKS, BALTIMORE CITY, 2007-2016

YEAR	# OF LOANS	TOTAL \$ AMOUNT	AVG	# OF DEPOSITORY BANKS LENDING	# OF NON-BRANCH BANKS LENDING
2007	152	\$19,195,666	\$126,287	5	10
2008	71	\$13,022,500	\$183,415	3	10
2009	60	\$6,823,500	\$113,725	7	5
2010	73	\$22,683,800	\$310,737	6	13
2011	65	\$21,896,415	\$336,868	8	10
2012	67	\$26,019,100	\$388,345	6	9
2013	64	\$36,264,600	\$566,634	7	11
2014	82	\$30,170,500	\$367,933	7	12
2015	95	\$25,830,400	\$271,899	7	14
2016	108	\$28,347,300	\$262,475	6	20

Source: SBA and FDIC

TABLE 5: TOP 10 SBA 7(A) LENDERS RANKED BY NUMBER OF LOANS, BALTIMORE CITY, 2016

BANK NAME	BRANCH IN BALTIMORE?	TOTAL \$	# OF LOANS	AVG
M&T Bank	Yes	\$10,487,100	58	\$180,812
Wells Fargo	Yes	\$1,203,800	14	\$85,986
SunTrust Bank	Yes	\$4,282,600	4	\$1,070,650
Hanmi Bank	No	\$1,861,400	3	\$620,467
PNC Bank	Yes	\$220,000	3	\$73,333
Capital Bank	No	\$500,000	2	\$250,000
First Home Bank	No	\$435,000	2	\$217,500
BankUnited	No	\$197,000	2	\$98,500
Independence Bank	No	\$170,000	2	\$85,000
BB&T Bank	Yes	\$95,000	2	\$47,500
All Depository Banks		\$16,635,500	82	\$202,909
All Non-branch Banks		\$11,708,800	26	\$450,338
All Banks		\$28,347,300	108	\$262,475

Source: SBA and FDIC

of SBA 7(a) loans in Baltimore in 2016, a share that has been consistent since 2009. In addition, M&T accounted for over one-third of the total loan amount. While Bank of America is notably missing from this list, several non-branch banks are active in Baltimore, led by Hanmi Bank, which is a bank based in Los Angeles that focuses on the Korean-American community.

While it is promising to see Hanmi and several other non-branch banks making SBA loans in Baltimore, their penetration in the market is extremely small, with just a couple loans per year. Overall, compared to cities such as Atlanta, Buffalo, Cleveland, Pittsburgh, and Salt Lake City, Baltimore consistently ranks at or near the bottom in total SBA 7(a) lending.⁶

Other Lenders

In addition to the three types of lenders discussed above, emerging financial technology companies, along with community banks and credit unions are in the small business lending market. As noted in our earlier report, companies such as Lending Club, On Deck Capital, Kabbage, and Kiva offer point-and-click access to needed capital for small businesses. There is no public data on these companies' loans specifically to Baltimore-based businesses, but one company confidentially reported that in 2016 they had roughly 150 active accounts in the City of Baltimore, with 362 loans totaling \$2.5 million, for an average loan size of just over \$6,900.

Another source of capital is smaller banks and credit unions that are not subject to annual small business loan transaction reporting. We identified eight such institutions headquartered in Baltimore City that had small business loans on their balance sheets, which declined by 70 percent from \$326 million in outstanding business loans in 2012 to \$96 million in outstanding business loans in 2016.⁷ However, as we noted in our last report, some of these institutions, such as MECU and SecurityPlus, are actively seeking opportunities to expand their small business lending portfolios to Baltimore companies.

What's Driving These Changes in Baltimore?

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. National data show a drop of 30.4 percent in small business dollars lent from 2007 to 2016, versus 32.7 percent in Baltimore.⁸ For Baltimore, we focused on three drivers that are clear to us from the data: bank consolidation, headquarters effect, and shrinking average loan sizes.

Bank Consolidation

The 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 and Provident Bank by M&T. The four acquiring and target banks were together originating over \$130 million in small business loans in 2007. The two acquiring banks originated \$98 million in 2016.

This is also evident in bank consolidation of non-local banks. Before Wells Fargo's acquisition of Wachovia Bank in 2010, the combined small business lending of the two banks was \$43 million in Baltimore. In 2016, Wells Fargo originated \$24 million in small business loans in Baltimore. Chart 3, on page 11, illustrates the decline in small business lending for these three acquisition examples.

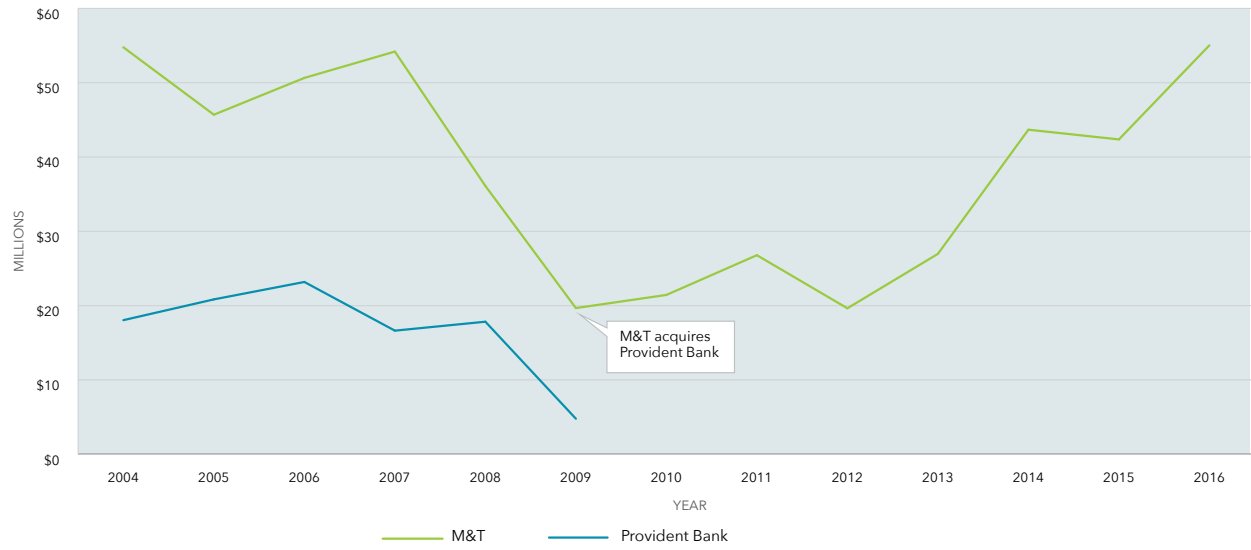
On the opposite end of the spectrum Howard Bank, a locally headquartered bank that acquired 1st Mariner Bank earlier this year, showed an overall increase in small business loans in Baltimore since 2010, while 1st Mariner's lending held fairly steady over the 2007 to 2016 period. In the next few years, it will be important to monitor whether the combined small business lending of the new single entity will equal or even exceed the sum of the two separate banks; or if the

CHART 3: ACQUISITION AND TARGET BANKS SMALL BUSINESS LENDING, BALTIMORE CITY, 2004-2016

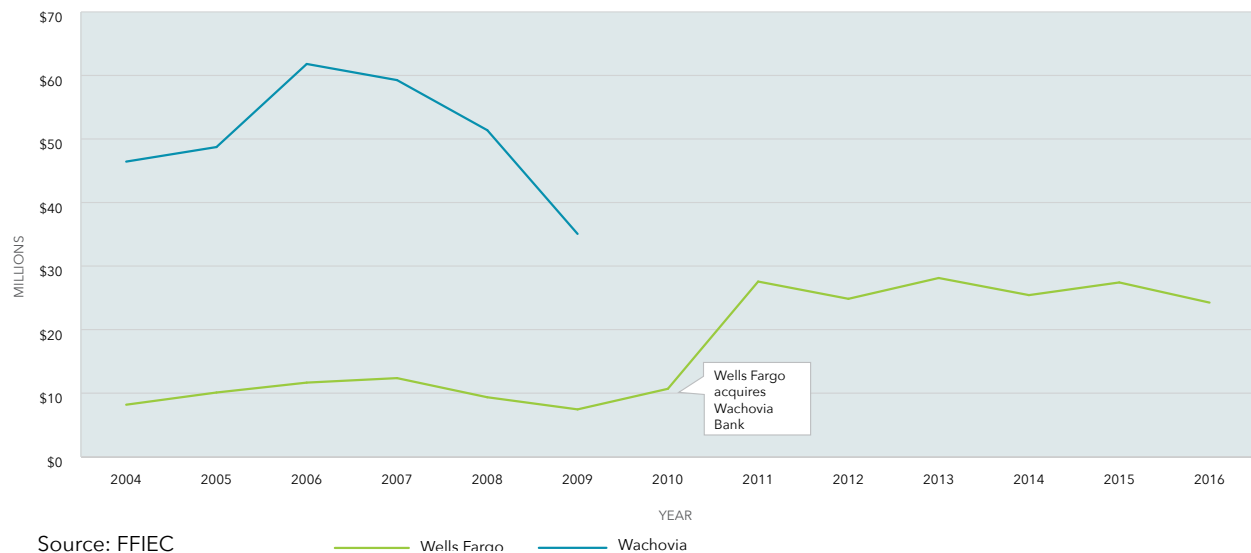
Mercantile Bank and PNC Bank CRA Small Business Lending, Baltimore City, 2004-2016



M&T and Provident Bank CRA Small Business Lending, Baltimore City, 2004-2016



Wells Fargo and Wachovia CRA Small Business Lending, Baltimore City, 2004-2016



Source: FFIEC

Wells Fargo Wachovia

The point for Baltimore is that it is hard to be a branch town and attract the same level of investment as a bank's headquarters city.

single entity will follow in the footsteps of national banks that acquired local banks and do less combined small business lending post-acquisition.

Headquarters Effect

Next, we looked at the top four banks in Baltimore as measured by outstanding deposits in 2016: Bank of America, M&T, Wells Fargo, and PNC. We analyzed the small business lending activity of these banks in Baltimore compared to the small business lending activity in these banks' headquarters cities, Charlotte, Buffalo, San Francisco, and Pittsburgh, respectively. This exercise had to be performed at the metropolitan area level because not all of these cities are contiguous with one county, as is the case with Baltimore City.

We looked at overall loan data adjusted for population and found that these banks lend at higher rates in their headquarters communities. PNC and M&T had especially higher levels of small business lending in their home metro areas when controlled for population. In Pittsburgh, PNC's small business lending was three times that of its Baltimore area lending. In Buffalo, M&T's small business lending was 2.5 times its Baltimore area activity. It's also the case that these banks have much higher deposits in the headquarters communities, which supports higher local lending.

The point for Baltimore is that it is hard to be a branch town and attract the same level of investment as a bank's headquarters city.

Shrinking Loan Size

The average loan amount to small businesses by all depository banks has declined from an average of \$191,819 per loan in 2007 to \$70,877 in 2016. In 2007, Bank of America's average loan size was \$190,000, but by 2016 it had fallen to just \$22,000. Similarly, in 2008, PNC Bank's average loan size was over \$290,000, but by 2016 it had fallen to just under \$70,000.

Decreasing average loan amounts appear to be driven by the growth of small business credit cards and lines of credit being offered by depository banks. Credit cards tend to have terms of about three years with no interest payments for an initial period of time and low limits, such as \$5,000 or \$10,000. Lines of credit for small businesses are typically in the \$20,000 to \$100,000 range and may not require collateral. For banks, these types of loans generally require less due diligence and expense from a loan application and servicing standpoint.

There are some important exceptions to this trend. Notably, M&T Bank was the second largest bank in Baltimore by deposit market share (behind Bank of America) and had the highest annual loan amount among CRA reporting banks with \$55 million in small business loans and an average loan size of just over \$250,000 in 2016. Maryland headquartered banks like Howard Bank, 1st Mariner, Sandy Spring, and The Columbia Bank also had higher average loan sizes, all over \$200,000.

The time is ripe to modernize the CRA regulations to make them more effective in making credit available in low- and moderate-income areas.

There are undoubtedly other factors driving the decline in small business lending in Baltimore, but these are the most obvious ones. While there is some evidence of new entrants and lending activity, the overall picture is one of disinvestment in small business, an important source of job creation and economic development. Without a more vibrant financial system to provide critical working capital to these employers, Baltimore will struggle to prosper. The broad trends in small business lending that we have identified bring us back to the question of how well our banks are serving Baltimore's small businesses.

The Community Reinvestment Act & Small Business Lending in Baltimore

The Community Reinvestment Act is currently receiving significant attention in the banking and finance sector as a range of stakeholders seek to modernize the 40-plus-year-old law and its regulations. As Federal Reserve Board Governor Lael Brainard noted in a speech in Baltimore this past April: "The time is ripe to modernize the CRA regulations to make them more effective in making credit available in low- and moderate-income areas at a time when technological and structural changes in the banking industry allow banks to serve customers outside of the areas with branches that have traditionally defined a bank's community."⁹

Table 6, on page 14, provides information on CRA reporting requirements for the top depository banks in Baltimore, including the regulatory agency assessing the institution,

year of the most recent report,¹⁰ the bank's primary rating area and score, and their rating area and score for Baltimore, or closest geography.

CRA evaluations allow banks to identify "primary rating areas" and "other rating areas."¹¹ Areas can be defined as counties, metropolitan regions, or states. Banks receive a composite rating and individual ratings in up to three categories - lending, investment, and service.¹² The lending category is inclusive of home, small business, small farm, community development, and consumer loans. While the lending test is the most important of the three categories, a separate score is not given for just small business lending, only a brief discussion of the bank's small business lending activity. Overall ratings are weighted towards primary service areas although banks may receive ratings for each identified service area, primary and other.¹³

One of the most notable observations in Table 6 is that none of the top six banks include the Baltimore Metropolitan Statistical Area (MSA) or the city as a primary rating area. For three of these banks the state of Maryland is listed as a "primary" rating areas. The other three banks list Maryland as an "other" rating area.

For banks that do have a more local focus, their primary assessment area is always broader than Baltimore City and inclusive of the entire MSA.¹⁴ Given this broader assessment area even for the local banks, it is useful to compare small business lending in Baltimore City to the larger MSA.

TABLE 6: CRA REPORT RATING AREAS AND RATINGS, TOP DEPOSITORY BANKS, BALTIMORE, 2016

BANK	REGULATORY AGENCY	YEAR OF REPORT	PRIMARY RATING AREAS	OVERALL CRA RATING FOR LENDING	OTHER RATING AREAS	CRA RATING FOR MARYLAND
Bank of America	OCC	2011	Boston MSA, Charlotte MSA, New York MSA, CA, FL, TX	High Satisfactory	10 MSAs and 31 states including MD	High Satisfactory
M&T	FRB	2014	19 MSAs and 8 states including MD	High Satisfactory	26 MSAs	High Satisfactory
Wells Fargo	OCC	2012	Minneapolis MSA, New York MSA, Washington DC MSA, AZ, CA, CO, FL, GA, NV, NJ, NC, PA, TX, VA	Outstanding	12 MSAs and 28 states including MD	Outstanding
PNC Bank	OCC	2012	Chicago MSA, New York MSA, Philadelphia MSA, PA, MI, OH	Outstanding	7 MSAs and 10 states including MD	High Satisfactory
BB&T	FDIC	2016	51 MSAs and 13 states including MD	High Satisfactory	93 MSAs	High Satisfactory
SunTrust Bank	FRB	2013	25 MSAs and 9 states including MD	High Satisfactory	17 MSAs	High Satisfactory
1 st Mariner Bank	FDIC	2015	Baltimore MSA, Washington DC MSA, CA, MD MSA	Low Satisfactory	Not Applicable	Not Applicable
Harbor Bank	FDIC	2010	Baltimore City, Baltimore County, Prince George's County	Satisfactory	Not Applicable	Not Applicable
Northwest Bank	FDIC	2016	6 MSAs and 4 states including MD	High Satisfactory	10 MSAs	Low Satisfactory
Hamilton Bank	OCC	2015	Baltimore MSA	Satisfactory	Not Applicable	Not Applicable
Howard Bank	FDIC	2015	MD, PA	Satisfactory	Not Applicable	Not Applicable
Capital One	OCC	2013	New York MSA, Washington DC MSA, LA	Outstanding	6 states including MD	Outstanding
Bay Bank	OCC	2016	Baltimore MSA	Outstanding	Not Applicable	Not Applicable
The Columbia Bank	FDIC	2017	Washington-Baltimore-Arlington CSA, Philadelphia MSA	Low Satisfactory	Not Applicable	Not Applicable

Source: FFIEC, FDIC, Federal Reserve Bank (FRB), and Office of the Comptroller of the Currency (OCC).

Chart 4, below, shows the city contributed 38 percent of the MSA's deposits in 2016, but received only 16 percent of small business loans for the area. In 2007, the city contributed 29 percent of the MSA's deposits and also received 16 percent of small business loans, demonstrating that while the city's share of deposits increased during the decade, its share of small business lending was unchanged.

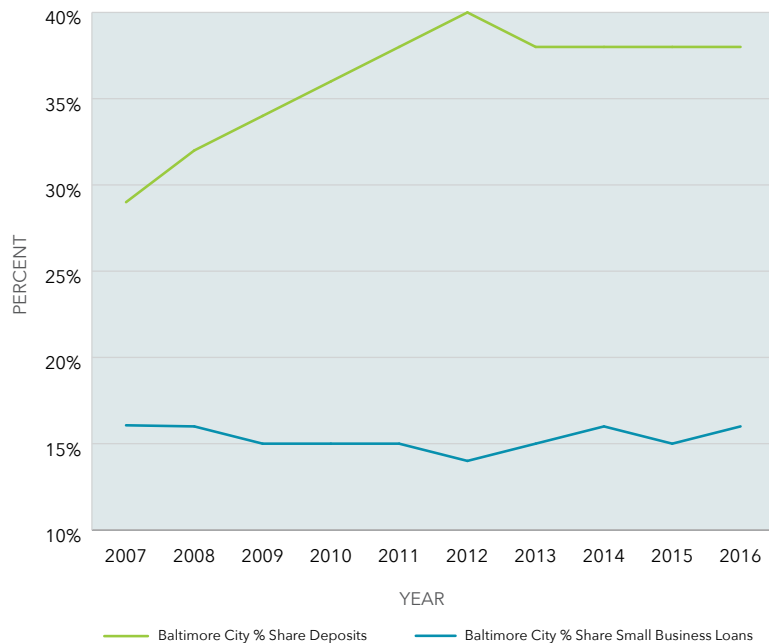
The geographic focus of current CRA lending evaluations at the MSA and state level sheds little light on small business lending in Baltimore City. Looking at the ratings overall, the banks with the highest loan to deposit ratios in the city tend to have lower CRA ratings than the banks with smaller loan to deposit ratios, the opposite of what one might expect if just measuring small business lending activity. The reports as currently constituted would appear to have very limited impact in encouraging banks to do more small business lending.

What Can be Done?

It's important to recognize that Baltimore is not alone in experiencing big shifts in banking trends, but the impact here has certainly been more negative than in some other cities. The recent banking regulation legislation passed in Washington may only encourage large banks to grow larger as the threshold for heightened regulation has been raised to \$250 billion in assets from \$50 billion. While the largest banks all show growth in business lending overall, loans for under \$1 million have declined in terms of both total dollars and share of loan book since 2007.¹⁵

The lending capacity for growth in Baltimore is diminished for a host of reasons, both demand and supply related. Loan demand surveys indicate unmet need, but also a discouraged borrower base with low expectations of finding credit. The availability of technical assistance to ready small borrowers for credit is also hard to navigate in Baltimore. Reports

CHART 4: SHARE OF DEPOSITS AND SMALL BUSINESS LOANS BY DOLLAR AMOUNT, BALTIMORE CITY COMPARED TO BALTIMORE MSA, 2007 TO 2016



Source: FFIEC and FDIC

and stories of businesses failing to find local credit around.¹⁶

On the supply side, the poor economics of large banks engaging in small business lending in the traditional way are often cited, with the costs and inefficiencies of underwriting small loans too high. In addition, a focus on real estate secured lending has led to insufficient resources devoted to small business loans and the experience to underwrite these loans.

This would be a much longer report if we tried to analyze all the reasons why small business lending has dropped in Baltimore, and it wouldn't change the facts. Nevertheless, there are some steps that could be deployed to attract more lending to businesses in Baltimore.

Encourage Top Depository Banks to Do More

As our analysis above has shown, the top depository banks are doing significantly less small business lending in Baltimore today than 10 years ago, especially as the list of top banks has changed. If these banks had maintained the same small business lending ratio to deposits, an additional \$400 million would be available today. We would encourage the large banks that populate Baltimore's landscape to devote more resources to small business lending.

Even if these banks are not in a position to increase their lending directly, we would recommend that they help capitalize smaller institutions that can lend in this space. An example of such institutions is community development financial institutions (CDFIs), organizations that provide financial services to underserved communities. We need to develop strong CDFI loan funds in Baltimore to deliver credit on affordable terms to small businesses that can grow into the banking system. The top depository banks can play a

key role in helping to capitalize funds for small business lending CDFIs. PNC Bank has recently made such a commitment in Baltimore.

We also encourage large banks to devote more resources to underwriting federally guaranteed SBA loans. The largest SBA lender in Baltimore, M&T Bank, has demonstrated that the SBA loan model can work in Baltimore. If other top banks in Baltimore issued even half the number of SBA loans as M&T, small business lending in the city would grow significantly.

Help New Borrowers

We recommend using public resources, such as Maryland Department of Commerce and Baltimore Development Corporation programs and revolving loan funds to provide loan loss reserves or guarantees for private bank loans. In our 2017 report, "Financing Baltimore's Growth," we discussed the leverage that could be attained by using the small amounts of public dollars involved in direct lending to instead leverage more private sector loans. This could be particularly valuable to new businesses without a credit history and a higher risk profile.

Welcome New Entrants to Small Business Lending in Baltimore

A key finding from this report is the growth of non-branch banks in Baltimore's small business lending market. Banks from outside of Baltimore and Maryland have identified market opportunities in Baltimore. A recent example of this is JPMorgan Chase's announcement earlier this year of plans to move into the Baltimore market.¹⁷ We encourage a specific effort focused on bringing more lenders into the small business marketplace in Baltimore.

We should measure the penetration of non-bank lenders into Baltimore to understand how much credit they are actually providing. It would also be helpful to understand the loan

terms and credit models used to see whether technological solutions can reduce barriers to finding credit, lower borrowing costs, and provide more capital in the city.

Use Baltimore as an Example for CRA Modernization

As our analysis of CRA evaluations has illustrated, the broad geographic assessment area and rating methodologies for most banks that operate in Baltimore don't provide much insight into the lending shortfall for small businesses. Reports like this one, which relies on the same data but focused on a specific market, could be used as a case study for regulators and stakeholders working on reforming and modernizing the CRA. Baltimore is a prime example of how CRA's geographic assessment areas and lending scoring need improvement to better measure community reinvestment.

ENDNOTES

1 "Financing Baltimore's Growth: Measuring Small Companies' Access to Capital," Johns Hopkins University 21st Century Cities Initiative, September 2017.

2 US Code 2011, title 12, chapter 30, section 2901.

3 CRA data contains loans under \$1 million dollars to businesses, with the majority going to businesses with under \$1 million in annual revenue.

4 While we have counted deposit levels of all banks in Baltimore, we are only counting small business lending data among banks that are required to report these data, as well as those voluntarily reporting such data. This means that some of the small banks that are not required to report small business loans, such as Harbor Bank, Hamilton Bank, and Bay Bank are not included in the small business loan tabulations. We know from prior analysis of the loan balance sheets for these smaller banks that their activity would not materially change the overall totals.

5 County Business Patterns, US Census Bureau

6 "Financing Baltimore's Growth: Measuring Small Companies' Access to Capital."

7 These figures represent all outstanding business loans under \$1 million on the banks' balance sheet; and all business loans on the credit unions' balance sheets. The figures also represent loans made to all businesses, not just those located in Baltimore.

8 Federal Financial Institutions Examination Council (FFIEC).

9 <https://www.federalreserve.gov/newsevents/speech/brainard20180417a.htm>

10 CRA reports evaluate data from the most recent two to three years, e.g. a report released in 2011 would usually look at lending data from 2009 and 2010.

11 Alternatively referred to as "Full Scope" and "Limited Scope" assessment areas depending on the year of the report and the regulatory agency completing the evaluation.

12 Small banks are only evaluated on lending, while intermediate banks are also evaluated on investments, and large banks are evaluated across all three categories.

13 On June 15, 2018, the Office of the Comptroller of the Currency (OCC) released new guidelines on the selection of "Full Scope" and "Limited Scope" assessment areas. These guidelines serve as a placeholder as the OCC works to modernize the CRA.

14 The exception is Harbor Bank, which treats Baltimore City, Baltimore County, and Prince

George's County as a single assessment area, still broader than Baltimore City.

15 "How Did Bank Lending to Small Business in the United States Fare After the Financial Crises?" Rebel Cole, Krahenbuhl Global Consulting, January 2018.

16 The SBA and Milken Institute's Partnership for Lending in Underserved Markets (PLUM); Association for Enterprise Opportunity's "The Tapestry of Black Business Ownership in America: Untapped Opportunities for Success"; and the Small Business Credit Survey, Federal Reserve Banks.

17 <http://www.baltimoresun.com/business/bs-hs-jpmorgan-chase-investment-20180419-story.html>

21ST CENTURY CITIES INITIATIVE

The 21st Century Cities Initiative (21CC) at Johns Hopkins University is a new source of research, convening, and action on the most pressing challenges facing urban communities. Bringing together diverse stakeholders, performing applied research, and providing policymakers and practitioners with problem-solving ideas and tools, 21CC supports cities committed to opportunity, inclusion, and innovation.

21st Century Cities Initiative
3213 N. Charles Street
Baltimore, MD 21218

Contact us: 21CC@jhu.edu

www.21cc.jhu.edu



JOHNS HOPKINS

21ST CENTURY CITIES
INITIATIVE