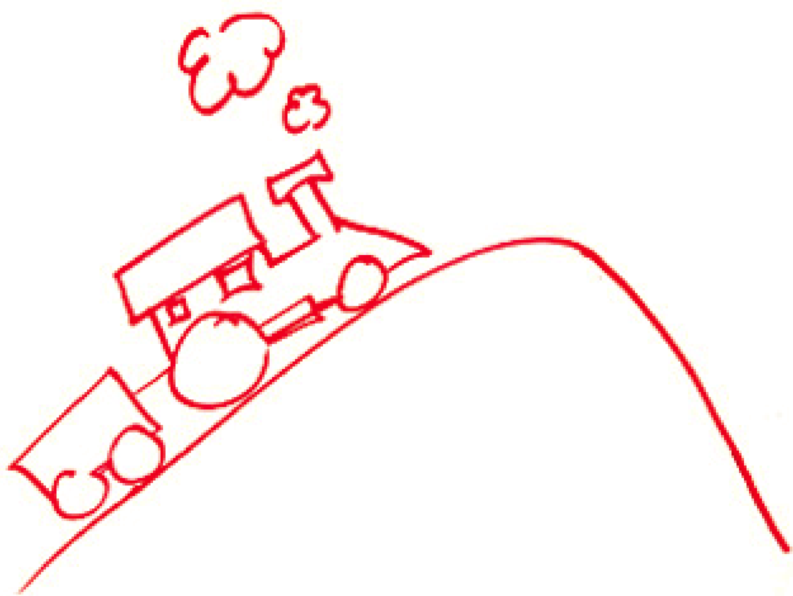
California Reinvestment Coalition

Small Business Access to Credit

The Little Engine that Could



California Reinvestment Coalition

December 2010

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The California Reinvestment Coalition (CRC) is a statewide membership organization of more than 280 nonprofit community-based organizations and public agencies including small business technical assistance providers, small business lenders and community development financial institutions. CRC has advocated for more than two decades with banks and other financial institutions for the needs of lower income communities and communities of color. This report is the third in an occasional series on bank lending to small businesses.

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Executive Summary

The economy is sliding downhill with no immediate end in sight. From all quarters comes the refrain: "we need more jobs!" According to the U.S. Small Business Administration (SBA), sixty-five percent of new jobs are generated by small businesses. Small businesses can be the engine of the economy: the little engine that could. The jobs they create could play a major role in rebuilding the U.S. economy; however, the major banks have stepped away from small business lending and stunted the potential to create jobs.

Most small businesses depend on bank lending for business and professional development. Although consumers are spending less, many small businesses can still survive if they have access to working capital. Without it, California and the nation will continue to lose small businesses and shed these crucial jobs. This story of banks strangling small businesses is being played out across the state of California. This report examines big bank and total lending across the state and in six California counties (Alameda, Fresno, Los Angeles, Sacramento, San Diego and Santa Clara Counties) and finds that this lending has decreased by seventy to seventy-five percent from 2007 to 2009.

Despite a $700 billion bank bailout and strong reported bank profits, the increased levels of bank lending to small businesses promised by former Treasury Secretary Henry Paulson and others has not occurred. Between 2007 and 2009, California small business lending by just three of the major banks– Bank of America, Citibank and Wells Fargo Bank– dropped by nearly two-thirds leading to half a million less small business loans made in California.

A recent national study found that two in five small businesses report their company has not been able to acquire adequate financing.[1] The impact on business districts is clear as businesses shutter and empty store fronts become more common in California and the nation. For example, Los Angeles, the second biggest city in the country, had a 25% drop in the number of business establishments existing in the City between 2007 and 2009.[2]

[1] 2009 year-End Economic Report, National Small Business Administration.

[2] Based on applications for businesses licenses to the City of Los Angeles.

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From 2007 to 2009, SBA lending to California's minority-owned businesses dropped by 81 percent forAfrican American-owned businesses and 84 percent for Latino-owned businesses. Minority-owned businesses are particularly critical to struggling neighborhoods and the recovery of California's economy because they are more likely to hire people of color who are experiencing much higher unemployment rates in this economy.

How has this happened?

- Banks tightened their small business underwriting in 2007 to limit access to a tiny few and have loosened them only slightly since.
- Federal regulators and the U.S. Treasury have been more concerned with propping up financial institutions and Wall Street than ensuring the economic vitality of American small business.

This hidden tragedy for neighborhoods is in stark contrast to the shameless public announcements of bank profits and high executive salaries. The Obama Administration and the U.S. Congress must focus their attention on supporting small businesses. Governor-elect Jerry Brown must do the same for California. It is a key element of reviving the economy and bringing financial opportunity to families and neighborhoods.

Introduction

California and the nation are suffering greatly from an economic crisis that appears to be continuing into an unknown future. California's unemployment rate is in double digits and increases in employment opportunities have been incremental. The economic crisis has struck even more harshly in neighborhoods of color and low income neighborhoods than in the rest of the state. While small business is hailed as the greatest potential engine of the economy and a substantial job creator, those businesses are starving and dying without access to bank lending.

Americans contributed $700 billion to bail out financial institutions. Former Treasury Secretary Henry Paulson reassured the American people that these funds would bring banks surging back as lenders– although the Bush Administration instituted no requirements to that effect. While banks gladly received the funds, they have done almost nothing to extend the same helping hand to small businesses and neighborhoods.

Small businesses are the engines of growth and employment for the U.S. economy. According to the Small Business Administration (SBA), small businesses create 65 percent of the growth in employment in the nation and represent half of all employment. There have been occasional stories in the media and public discourse about the decrease in bank lending to small businesses. This report's goal is to highlight the impact of these stories and document the dramatic decrease in lending to small businesses.

Methodology

This report uses data on small business lending collected from the Federal Financial Institutions Examinations Council (FFIEC) and the U.S. Small Business Administration (SBA). The report looks at conventional lending (reported under the Community Reinvestment Act) and SBA lending by the five major banks in California– Bank of America, CitiBank, US Bank, Union Bank and Wells Fargo. The report also examines overall lending in six key California counties- Alameda, Fresno, Los Angeles, Sacramento, San Diego and Santa Clara counties. Since the housing crisis began in 2007 and the most current data available is for 2009, this report examines the changes in lending from 2007 to 2009.

Background

Financial institutions dramatically tightened their business lending underwriting criteria in 2007 in a knee-jerk reaction to the housing crisis. This action severely restricted access to credit for businesses. Since then, banks have not significantly loosened their purse strings. From 2007 to 2009, California small business lending by just three of the major banks– Bank of America, Citibank and Wells Fargo Bank– dropped by nearly two-thirds leading to half a million less

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small business loans made in California.[3] In addition, regulators are reported to be extremely heavy-handed in restricting bank lending to small businesses. Without the cash flow that they need, businesses are struggling and too many of them are closing their doors.

California has a network of community lenders– mainly nonprofit community development financial institutions (CDFI's)– which offer small business loans and business advisory services. With bank lending at such low levels, these community lenders have tried to fill the lending gap for those who can't get bank loans in the small business lending field. In the last few years, they have been flooded with small businesses who are struggling to keep their doors open and desperately need loans for cash flow. Many of these small businesses are long-term bank customers (with much higher credit scores than usually seen by community lenders) that have been denied new loans by their longtime bankers.

As a result, community lenders are struggling to keep up with the lending demand from these critical small businesses in their communities. This is a difficult position for these community lenders whose design and scope are intended to be complements to bank lending– not substitutes. As a result, community lenders have lent out most of their loan funds and are seeking investments from financial institutions so that they can assist former bank customers. Unfortunately, the response from these banks has been minimal.

U.S. Small Business Administration (SBA) Loans

The SBA was created to aid and protect small business interests and strengthen the overall economy of our nation. SBA plays the unique role of guaranteeing small business loans that banks might otherwise not approve. Although SBA loans are a small portion of overall lending, they collect data on the ethnicity of borrowers that is not otherwise available. With this data, lending activity can be tracked by race and ethnicity– allowing for transparency into lending activities.

Overall, SBA lending by all banks in California dropped 71 percent during this time period– from 14,529 loans in 2007 to 4,343 in 2009. So, there were 10,186 fewer loans made to small businesses or a loss of $1.2 billion in funds for California's small businesses over those two years. (See Appendix A.)

[3] Bank of America, Citibank and Wells Fargo Bank total small business lending in California dropped from 881,129 in 2007 to 315,630 in 2009.

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Minority-owned businesses had an even greater drop in access to SBA loans in this time period. African American-owned businesses experienced an 81 percent decrease and Latino-owned businesses experienced an 84 percent decrease. Lending by Asian American- owned businesses was more consistent with the overall drop in lending– they experienced a 73 percent decrease in lending. Figure 1 (and Appendix A) shows the decreases in access to credit for minority-owned businesses. Minority-owned businesses are in danger of closing their doors because of the lack of access to SBA and conventional small business loans. These businesses are particularly critical because they are more likely to be in neighborhoods with fewer businesses and are more likely to hire people of color who experience much higher unemployment rates.

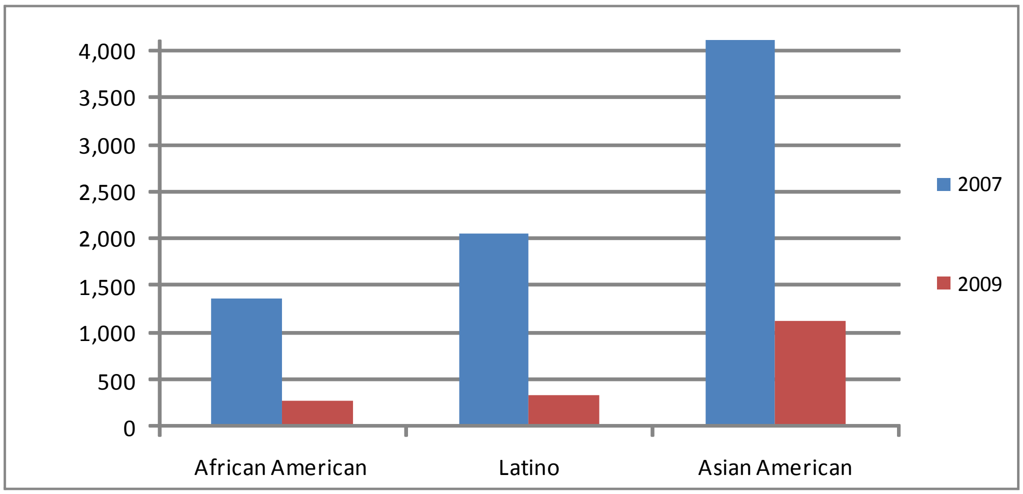

Figure 1: SBA Loans to Minority-Owned Businesses, 2007 to 2009

The five major banks– Bank of America, CitiBank, US Bank, Union Bank, and Wells Fargo--have also dramatically decreased their SBA lending. Bank of America (BofA) and Citi's SBA lending have dropped the most among the major banks between 2007 and 2009– decreasing their lending by 97 percent and 99 percent, respectively. In real numbers, this difference is incredibly stark; for example, Bank of America provided 2,304 SBA loans in California in 2007, but only provided 74 in 2009. Citi made 906 SBA loans in 2007 but only 10 in 2009. Wells Fargo's SBA lending had the smallest decrease with its 2009 lending at approximately 50% of its 2007 level.

When looked at collectively, these five banks decreased their lending to minority-owned businesses at an even more dramatic rate. Where overall SBA lending by the five major banks dropped by 77 percent, their lending to Latino-owned, African American-owned, and Asian-owned businesses dropped much more dramatically– at 89 percent, 86 percent, and 88 percent, respectively. Figure 2 below (and Appendix A) shows the changes in lending to minority-owned businesses by each of the five major banks.

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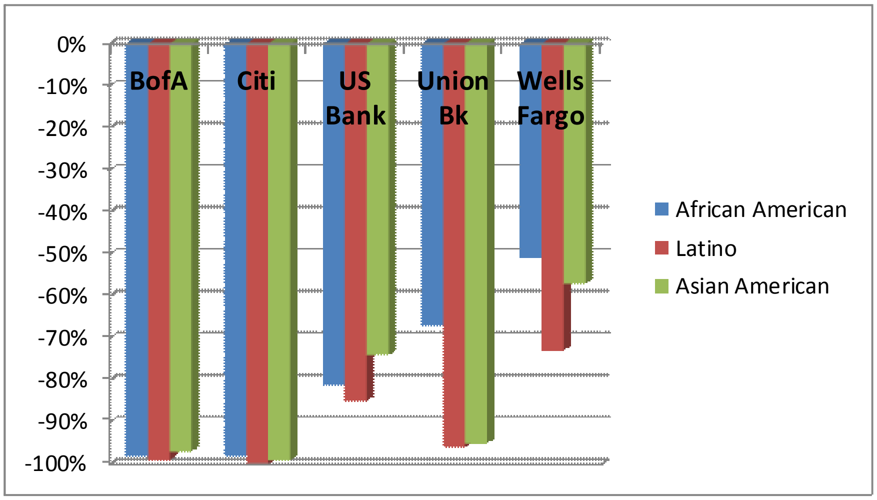

Figure 2: Percent Decrease in Bank SBA Lending by Race 2007-09

Conventional Lending

Conventional small business lending in California by all banks dropped by 1.46 million loans and $20.6 billion between 2007 and 2009. In 2007, there were a total of 2.3 million loans.[4] In 2009, only 816,000 loans were made or roughly one-third as many loans.

This drop in conventional small business lending is also witnessed at the national level. The Federal Reserve recently published a report stating that loans to small businesses in the U.S. dropped by more than fifty percent from 2007-2009– from 5.2 to 1.6 million loans.[5] The report also states that "low and moderate income neighborhoods saw the number of small business loans from large banks drop from 395,000 to 44,000 resulting in $7.6 billion fewer dollars flowing to these communities in just over a two-year period."[6] So, while overall lending dropped by 70 percent, lending to small businesses in lower income neighborhoods decreased by almost 90 percent.

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[4] These are loans publicly reported under the Community Reinvestment Act. They were loans that are less than $1 million or to businesses with revenues of less than $1 million annually.

[5] "Community Reinvestment Act and Small Business Lending in Low- and Moderate-Income Neighborhoods during the Financial Crisis," Elizabeth Laderman and Carolina Reid, Federal Reserve Bank of San Francisco, October 2010.

[6] Ibid.

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Among the major banks, Bank of America and CitiBank's lending to small businesses decreased by more than 80 percent in six California counties– Alameda, Fresno, Los Angeles, Sacramento, San Diego, and Santa Clara. Bank of America's total lending to businesses with revenues of less than $1 million decreased by 59,384 loans in those counties between 2007 and 2009.[7] Citi's overall lending decreased by 79,510 loans. Although not the biggest small business lender, US Bank increased its overall small business lending during this time frame– increasing its loan volume by 1,855 loans in these counties. Figure 3 below (and Appendix B) shows the average percentage change in each bank's lending from 2007-2009 in the six California counties.

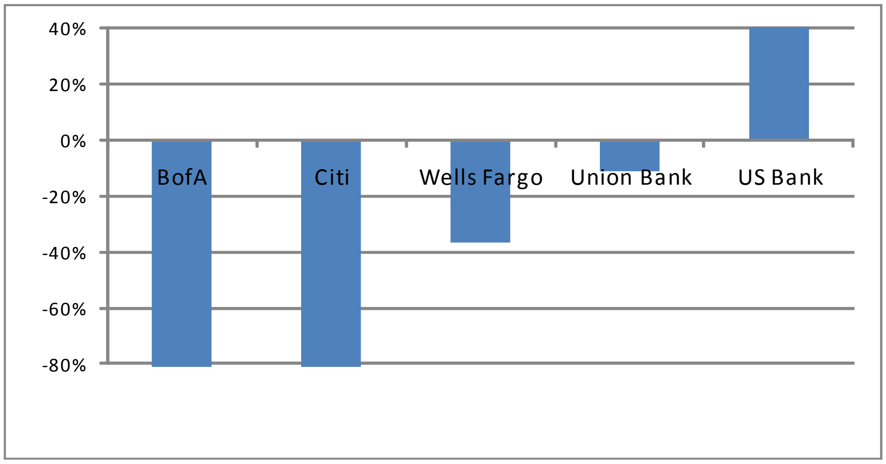

Figure 3: Percent Change in Lending by Five Banks in Six CA Counties, 2007 to 2009

JP Morgan Chase, now a major California bank, was not included in this review of small business lending because they did not have a significant presence in California until their purchase of Washington Mutual Bank in 2008. However, in 2009 in the six counties reviewed, Chase only made 172 conventional loans to businesses with revenues of less than $1 million. In contrast, they did make 38,968 business loans of less than $100,000 of which only 6,250 or 16 percent were in lower income neighborhoods. These numbers show that Chase was not serving very small businesses or those in lower income neighborhoods in 2009.

CRC reviewed conventional small business lending to businesses with revenues of $1 million or less annually in the six key counties. Overall, lending to these businesses decreased by roughly 75 percent. Across the six counties, 343,055 fewer loans were made by lenders just across this

[7]This paper, and many federal data sources, define small business as a business with revenues of $1million or less annually.

two-year period. Figure 4 (also see Appendix B) shows 2007 and 2009 lending to businesses with annual revenues of $1 million or less in the six counties studied.

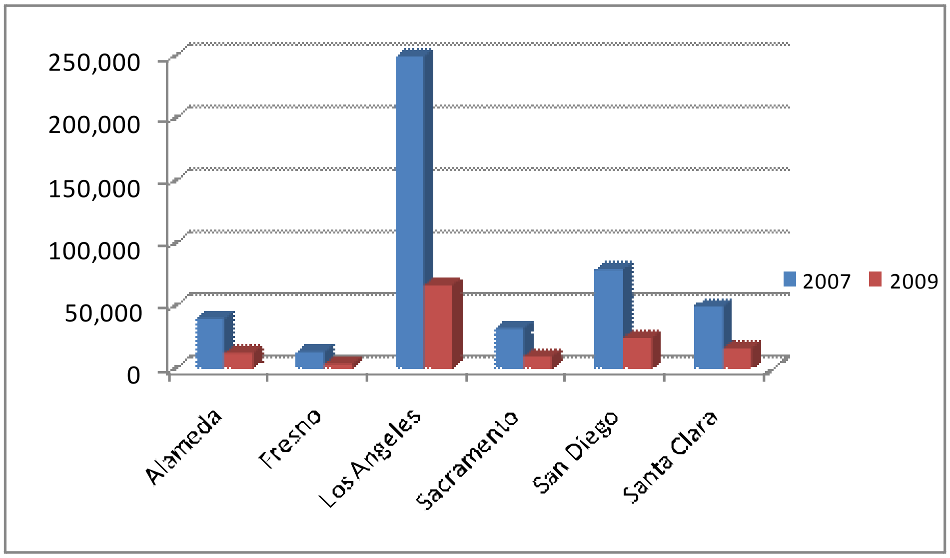

Figure 4: Small Business Lending by County 2007-2009

In Alameda County, overall lending to small businesses dropped from 2007 to 2009 by 68 percent, from 40,254 loans to 12,852. The decline in lending in lower income neighborhoods was slightly higher at 70 percent, from 10,206 to 3,093.

In Fresno County, overall lending to small businesses dropped from 2007 to 2009 by 70 percent, from 13,486 loans to 3,993. The decline in lending in lower income neighborhoods was also significant at 70 percent, from 3,083 to 911.

In Los Angeles County, overall lending to small businesses dropped from 2007 to 2009 by 75 percent of the 2007 level, from 262,595 loans to 66,721. The decline in lending in lower income neighborhoods was higher at 79 percent, from 62,397 to 13,299.

In Sacramento County, overall lending to small businesses dropped from 2007 to 2009 by 70 percent, from 32,280 loans to 9,790. The decline in lending in lower income neighborhoods was slightly higher at 71 percent, from 8,991 to 2,608.

In San Diego County, overall lending to small businesses dropped from 2007 to 2009 by 69 percent, from 79,400 loans to 25,016. The decline in lending in lower income neighborhoods was higher at 73 percent, from 16,140 to 4,413.

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In Santa Clara County, overall lending to small businesses dropped from 2007 to 2009 by 67 percent, from 49,891 loans to 16,479. The decline in lending in lower income neighborhoods was higher at 73 percent, from 10,403 to 2,865.

Between a Rock and a Hard Place

In good economic times, small businesses are beacons of pride for their neighborhood– offering services and economic opportunity to their community members. Today, small businesses, particularly those in lower income neighborhoods, are struggling just to keep their doors open and their staff employed. They are caught in a tight squeeze between decreased consumer demand and lack of cash flow.

The Federal Reserve held more than forty meetings in 2010 as part of their "Addressing the Financing Needs of Small Businesses" initiative. The summary of key problem areas from these meetings fall into four categories: tighter underwriting standards, resource constraints on lending, impact of regulatory guidance, and utilization of alternative funding sources. The summary notes that "both small businesses and banks acknowledged that underwriting standards had tightened."[8] Some banks cited "examination-related concerns" (e.g. pressure to keep underwriting restrictive) and conflicting messages from regulators as contributing to the restricted flow of credit to small businesses.[9] The report states that "banks [were] feeling the pressure to lend but [were being] encouraged to apply stricter credit standards. The result is a more cautious approach to lending."[10] In fact, according to the October 2008 Federal Reserve Board Senior Loan Officer Survey, 75 percent of U.S. banks have tightened their lending standards on small business loans.[11]

Small businesses are much more dependent on bank lending than larger businesses who have a range of financing options open to them. In early 2008, 78 percent of small businesses reported being able to obtain financing. This number has been steadily decreasing in the last few years. A recent national study found that only 61 percent of small businesses report that their company has been able to obtain adequate financing.[12]

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[8] Addressing the Financing Needs of Small Businesses: Summary of Key Themes from the Federal Reserve System's Small Business Meeting Series, July 12, 2010.

[9] Ibid.

[10] Ibid.

[11] October 2008 Federal Reserve Board Senior Loan Officer Survey

[12]2009 year-End Economic Report, National Small Business Administration.

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Due to the lack of broadly available public data, it is not clear how deeply the lack of access to credit has affected small businesses but it is clear that it has had a major impact across California. It is hard to visit a business district where there are not empty store fronts or businesses having desperate reductions in prices to keep their heads above water.

One possible way to detect the rate by which businesses are shuttering is to look at the changes in business license fees. Cities collect license fees from the businesses that operate in their jurisdiction. CRC obtained data on the number of business licenses in California's largest city, Los Angeles. In 2007, there were 589,316 businesses paid for licenses to operate in LA. In 2009, there were 438,725. In other words, Los Angeles lost 150,951 businesses in the two years between 2007 and 2009. This is a tremendous loss for the city's economic vitality and a loss of unknown proportions for the employees of these businesses and their families.

Financial institutions have taken the public stance that small business lending has fallen because of a drop in demand. While it is clear that some businesses have closed, it is unclear how much is due to the economic crisis and how much is due to lack of access to working capital from banks. Small businesses are most likely to turn to banks for credit and those banks have tightened loan underwriting so severely that few small businesses can get loans.

There is an old saying that a banker will only give you an umbrella on a sunny day. It appears that this is their approach today: only those who do not really need loans are able to obtain them. Small businesses have learned through experience or word of mouth that banks will not lend to them. That is the "drop in demand" that is the reality for small businesses and their neighborhoods.

Summary

It is clear from the data available that small and minority-owned businesses are experiencing great difficulties accessing credit. These difficulties translate into enormous impediments to the economic and social vitality of lower income and indeed all communities. Lack of access to bank credit presents a tremendous barrier to this key engine of the economy and prevents progress in rebuilding California's economy.

Since small businesses are crucial to economic growth and prosperity in lower income communities, this report reveals that barriers for minority business owners and small businesses in lower income neighborhoods damage and circumscribe these neighborhoods. The dismal failure of these major financial institutions to meet community needs exposes enormous holes in the American ideal of equal opportunity. This gap is likely understated because many small business owners fund their businesses using home equity lines of credit. Unfortunately, this data is not readily available and has not been reflected in the analysis of this report.

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This critical engine of economic recovery is severely hindered by these unequal barriers to credit. The failure of these financial institutions to reach parity in every county illustrates that small businesses in low income areas or those owned by entrepreneurs of color still do not have an even playing field.

CRC hopes that this report will prompt policy makers and lenders to focus more on small business lending in lower income neighborhoods. It is not enough to simply acknowledge the issue. Policymakers and financial institutions must act in the public interest. CRC has recommendations for each of these parties in the section below.

Recommendations

Immediate remedies to these inequities should be offered by these major financial institutions. CRC makes the following recommendations based on this study. These recommendations are a few steps toward assisting the recovery of California and the U.S. economy.

- The U.S. Congress should hold oversight hearings to scrutinize lenders and the federal regulators who are responsible for overseeing them. Their agreement on tightening small business loan underwriting goes beyond the needs of fiscal soundness and is impeding the recovery of the economy.

- CRC's study of small business lending clearly indicates that the major business lenders are not doing an adequate job of meeting the needs of small businesses, minority-owned businesses and business in lower income neighborhoods. Each and every one of these financial institutions reviewed and those not included in this study need to revamp their marketing and underwriting to reach out to small businesses and fully meet their credit needs.

- Federal financial regulators are not doing an adequate job scrutinizing the small business lending of major financial institutions to ensure that there is an even playing field for entrepreneurs of color and small business owners in lower income communities. They need to ensure banks make good small business loans at the level needed.

- The U.S. Small Business Administration should authorize participation for nonprofit community lenders and Community Development Financial Institutions (CDFI's) as SBA originators in the SBA 7(a) and 504 programs.

- The SBA Community Express pilot should become a full-fledged program and the program requirements that were in place before 2008 should be reinstated. More than half of its loans have gone to minority-owned businesses and this proportion was higher prior to these program changes in 2008.

- Congress should immediately approve funding for nonprofit California CDFI's and Community Development Corporation's which currently provide 1) small business loans or venture capital and 2) critical advisory services directly or in collaboration with nonprofit technical assistance providers. They are more than capable of meeting the needs of small businesses but are limited by resources.

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Appendix A
The data below is SBA 7(a) loan data from federal fiscal years 2007 and 2009 obtained from the U.S. Small Business Administration.

Small Business Administration Lending in California

2007				
	Total	African American	Latino	Asian American
BofA	**2,304**	176	408	680
Chase				
Citi	**906**	48	156	282
US Bank	**910**	31	138	158
Union Bk	**309**	15	53	43
Wells Fargo	**1,274**	70	225	210
California	**14,529**	1,355	2,061	4,123

2009				
	Total	African American	Latino	Asian American
BofA	**74**	3	6	22
Chase	**77**	0	16	12
Citi	**10**	1	0	2
US Bank	**274**	6	21	41
Union Bk	**41**	5	2	2
Wells Fargo	**641**	34	60	91
California	**4,343**	278	332	1,134

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Appendix B

The data below shows loans to businesses with revenues of less than $1 million annually in six California counties. All loans made to business in low income areas are separated from the total number of loans that were made to small businesses. This data is from the Federal Financial Institutions Examinations Council.

Alameda County

	2007 Loans	2007 LMI Loans	2009 Loans	2009 LMI Loans
Bank of America	5,522	1,582	941	211
JP Morgan Chase			5	1
Citibank	7,693	1,902	1,110	263
US Bank	622	126	866	211
Union Bank	238	88	221	75
Wells Fargo Bank	13,757	3,409	8,737	2,035
All Banks	**40,254**	**10,206**	**12,852**	**3,093**

Fresno County

	2007 Loans	2007 LMI Loans	2009 Loans	2009 LMI Loans
Bank of America	1,864	563	271	96
JP Morgan Chase			3	0
Citibank	2,620	587	575	121
US Bank	33	8	80	18
Union Bank	428	118	354	92
Wells Fargo Bank	3,378	873	2,173	483
All Banks	**13,486**	**3,083**	**3,993**	**911**

Los Angeles County

	2007 Loans	2007 LMI Loans	2009 Loans	2009 LMI Loans
Bank of America	41,808	12,981	5,056	1,048
JP Morgan Chase			104	19
Citibank	54,699	12,350	9,531	2,170
US Bank	2,772	889	3,763	997
Union Bank	2,519	629	2,969	599
Wells Fargo Bank	66,618	13,327	39,497	6,913
All Banks	**262,595**	**62,397**	**66,721**	**13,299**

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Sacramento County

	2007 Loans	2007 LMI Loans	2009 Loans	2009 LMI Loans
Bank of America	4,887	2,957	622	161
JP Morgan Chase			10	2
Citibank	4,920	1,354	958	286
US Bank	836	296	656	172
Union Bank	152	57	117	45
Wells Fargo Bank	10,786	2,868	6,609	1,684
All Banks	**32,280**	**8,991**	**9,790**	**2,608**

San Diego County

	2007 Loans	2007 LMI Loans	2009 Loans	2009 LMI Loans
Bank of America	8,440	2,227	1,752	339
JP Morgan Chase			39	6
Citibank	15,470	2,972	2,822	512
US Bank	996	213	1,488	279
Union Bank	3,267	847	2,391	617
Wells Fargo Bank	22,733	4,031	15,045	2,350
All Banks	**79,400**	**16,140**	**25,016**	**4,413**

Santa Clara County

	2007 Loans	2007 LMI Loans	2009 Loans	2009 LMI Loans
Bank of America	7,009	1,715	1,494	270
JP Morgan Chase			11	1
Citibank	10,599	2,066	1,495	276
US Bank	569	140	830	121
Union Bank	339	88	297	69
Wells Fargo Bank	16,788	3,218	11,179	1,861
All Banks	**49,891**	**10,403**	**16,479**	**2,865**