



MAIN STREET

SBA Revamps Lending for Underserved Markets

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By Steve Garmhausen

Small-business owners complain that it's tougher to get loans from banks these days. But now, thanks to a new Small Business Administration program, some won't need banks at all. They will be able to get government-guaranteed loans directly from nonprofits that specialize in economic development.

"Banks have really tightened their credit standards to the point where it is virtually impossible for small businesses to get a loan unless their principles have a high net worth or a lot of home equity," says Calvin Holmes, president of the Chicago Community Loan Fund, a community development organization. "This is definitely a move in the right direction."

The new program, called Community Advantage, targets what the SBA considers underserved markets—inner cities, rural areas and female entrepreneurs.

Advantage replaces the 12-year-old Community Express program, which the SBA scrapped citing poor performance on the loans. The main difference between the two programs is that Advantage cuts out banks entirely. Instead, only nonbank lenders such as community development financial institutions, community development corporations and microlenders can participate.

The change is an acknowledgement that the federal government's efforts to steer commercial credit to underserved communities wasn't working well, says Grady Hedgespeth, director of the SBA's office of financial assistance.

Under the Express program, lenders were required to arrange management and technical assistance for borrowers. But they proved unable to do so, Hedgespeth says. "We basically learned our lesson that you can't teach an ostrich to fly. Getting commercial lenders to accept technical assistance programs just did not work for us."

So Advantage puts loan-marketing power in the hands of lenders that are well-versed in providing technical assistance to entrepreneurs.

The only way for banks to participate in Advantage would be through investments in nonprofit community-based lenders.

Of course, banks will continue to be able to offer other types of SBA loans, but too little of that lending is happening in areas like inner cities, according to the SBA and others.

In the SBA's 2010 fiscal year, which ended Sept. 30, lending in underserved markets was 5 percent less than in fiscal 2008. The 5 percent drop is roughly in tandem with the decline in overall SBA lending during the same period.

(Loans through the Express program have also dropped steadily over the last three years, shrinking by more than 53 percent, to \$91.8 million in 2010.)

A high rate of default on loans made through the Express program was a critical factor in deciding to scrap it, says SBA spokesman David Hall. "The SBA does not believe it is helpful to offer entrepreneurs and small-business owners loans through a program that has shown a greater than one-in-three chance that the borrower will default."

Previously, the SBA only worked with lenders that had FDIC insurance or were overseen by a bank regulator. That has forced community development financial institutions to go to extraordinary lengths to qualify to make SBA-backed loans.

The Reinvestment Fund, in Philadelphia, has been an approved SBA lender since the late 1990s, but to get that status it had to navigate what Donald R. Hinkle-Brown, the organization's president of community investment and capital markets, calls a "cumbersome and complicated process." It partnered with three other nonprofit lenders to create an affiliate that's regulated by the Pennsylvania Banking Commission.

Community Advantage does away with the regulatory hoops, and even allows stronger nonbank lenders to sell their loans on the secondary market, according to the SBA.

The change appears to be "an acknowledgement that the field of nonbank lenders has matured," says Hinkle-Brown.

Not everyone agrees with the SBA's rationale. Bruce Lammers, chief executive of Ridgestone Financial Services in Brookfield, Wis., says he worries that such lenders lack underwriting experience. He says this could lead to increased credit risk that might ultimately be reflected in higher charges for all SBA borrowers. Ridgestone did \$95 million worth of SBA-backed loans in the year that ended Sept. 30.

Still, Lammers doesn't see the Advantage program as a serious challenge to banks. He even acknowledges that it might help businesses grow into good future loan prospects.

And that is exactly what the SBA and community development organizations are hoping for. They want to see borrowers who prove their creditworthiness through SBA loans from community-based nonbank lenders graduate to regular banking relationships, says the SBA's Hedgespeth.

Holmes, for his part, says he hopes to see these SBA-backed loans performing well enough that commercial lenders are drawn back to inner-city markets.

"If, over a three-, four- or five-year period, CDFI loans have seasoned well," he says, "that might educate banks to come back downstream."

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