

# MICRO ENTERPRISE LENDING

Community Equity Investments, Inc.

## PARTICIPANT PROFILES

**Community Equity Investments, Inc.** ("Equity Investments") is a Community Development Corporation ("CDC") that was incorporated in 1974 as a federally funded CDC. A grant from the Office of Economic Opportunity, part of the "War on Poverty" initiative by the Johnson Administration, provided Equity Investments' initial funding. Equity Investments is a community-controlled, non-profit organization. The Board of Directors is composed of 21 members, 11 of whom are elected by the residents of Escambia County, Florida.<sup>1</sup> Equity Investments operates on an annual budget of \$800,000 and has a 13-member salaried staff that includes a Vice President of Lending Operations, two Loan Officers and a Technical Assistance Specialist.

One of Equity Investments' principal products and the subject of this best practice review is its microlending program, undertaken with the help of a program sponsored by the Small Business Administration ("SBA"). Discussed in greater detail below, microlending is generally defined as the making of small business loans under \$25,000 to help stimulate the creation of jobs and promote business ownership opportunities for low-income borrowers. Equity Investments operates a very successful Revolving Loan Fund, established with funding from the Florida Department of Community Affairs, an

Intermediary Re-lending Program (USDA Rural Development), and an affordable Home Ownership and Housing Rental Program. Equity Investments spearheaded a 1992 initiative to enhance minority business opportunities in the region through the development and support of the Northwest Florida Black Business Investment Corporation.

Funding is derived primarily from earnings generated by its programs, including the Revolving Loan Fund outlined above and the Micro Enterprise Loan Program described below, rental income and the sale of single family units. A small annual grant is received from the Florida Department of Community Affairs for general administration. A larger annual grant is received from the SBA for training and technical assistance services to the SBA's Micro Enterprise Loan Program ("Microloan Program").<sup>2</sup>

<sup>1</sup> Horvath, R. Daniel. "Partners in Community and Economic Development: CEII." Federal Reserve Bank of Atlanta. 1997. P. 6.

<sup>2</sup> Ibid.

## COMMUNITY BACKGROUND

Over the years, Equity Investments has grown from a neighborhood based CDC in Escambia County to a regional CDC. Currently, Equity Investments has a lending territory that covers the 15 county area of the Florida Panhandle. Bordered by Alabama in the northwest and the Gulf of Mexico in the south, the area includes a mixture of urban and rural communities. The area's largest urban centers are Pensacola, Tallahassee, and Panama City. The 1990 Census indicates that the population of the region at that time was 992,903. As of July 1, 1997, the U.S. Census Bureau estimates that the population of this area had increased to 1,155,993. In 1989, per capita income for the 15 county region was \$10,828. This amount rose to \$13,157 in 1993 and, as of 1997, is estimated to be \$17,264.

The majority of the region's housing stock consists of single family detached units. According to the 1990 Census data, eighteen percent of the 106,174 county households were single-parent families and more than one-fourth had incomes below \$24,999. The

primary area of housing growth is in the new construction sector where homes are moderately priced between \$60,000 and \$80,000. Only minimal building activity has taken place in the \$25,000 to \$50,000 price range.

The region is largely dependent upon employment opportunities in tourism, retail and the government sectors. For example, the Pensacola Naval Air Station is heavily dependent on a civilian workforce, but the federal government's closing of the Naval Aviation Depot in Pensacola has resulted in the elimination of 3,500 technical civilian jobs and the loss of almost \$150 million annually to the local economy. Efforts to attract new businesses to the area or to encourage existing businesses to expand their operations in the region have met with some success and have helped offset some of the loss of jobs that occurred as a result of the Naval Aviation Depot closing.



## COMMUNITY NEEDS

Equity Investments' microloan program is aimed at creating small business growth and new job opportunities for residents of its

lending territory. The term "microloan" refers to business loans with principal amounts between \$500 and \$25,000. SBA

sponsored microlending programs are only available to non-profit organizations and are used as a vehicle to stimulate low-income entrepreneurial business opportunities by providing specialized funding for these businesses. For example, Equity Investments' borrowers have opened day care centers, hair salons, restaurants, and travel agencies. Many state governments have implemented strategies to ensure that microloans and small business lending are tied to economic growth. For example, Florida has enacted legislation to tie job creation to state-funded initiatives. Therefore, Equity Investments carefully tracks job creation in order to make sure it complies with the Florida statutory requirement that at least one new job be created for every \$10,000 in loans.<sup>3</sup>

In rural communities, microlenders fill a void because of the lack of conventional lenders willing and able to make these small loans. Some small rural areas have only one or two lenders that service their community. Additionally, banks with branches in rural communities often do not have the products, expertise, or service capacity needed to address the microloan borrower. Furthermore, rural communities are generally perceived to lack the population density needed to support the start-up or expansion of microloan businesses. This factor has caused conventional lenders to view the microloan

business as an extremely risky venture.

Historically, small business loans under \$25,000 have not been profitable for banks because of the originating, processing and servicing costs associated with such loans. The small size of microloans means that bank fees, typically based upon a percentage of the loan amount, do not provide sufficient profit to justify making these loans. Additionally, many microloan applicants need considerable training and technical assistance. These ancillary costs further reduce the attractiveness of such programs to traditional financial institutions.

As a microlender, the operating objective of Equity Investments is to develop this crucial niche market with the overall social goal of providing financing, technical assistance and opportunities to unserved and under served customers. Through microlending initiatives such as that undertaken by Equity Investments, low-income borrowers obtain financing that enables them to start up their businesses, gain experience, and establish a demonstrable track record. For successful microloan businesses, this translates into larger loans for conventional lenders in the future.

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<sup>3</sup> Ibid. P. 7.

## **BEST PRACTICE PROGRAM OR PRODUCT**

Equity Investments became one of the first 35 intermediaries selected to participate in a new SBA Micro Enterprise pilot program to provide small business loans of under \$25,000. Equity Investments established its Microloan Program to stimulate job creation and promote business ownership opportunities

to low-income borrowers in the Florida Panhandle. To this end, Equity Investments' Microloan Program sought to provide technical assistance and business training to help low-income borrowers establish and maintain self-sustaining businesses.

Under the agreement executed with the SBA, Equity Investments received an initial \$500,000 loan to provide microloan financing. The SBA loan is for 10 years at 5 percent interest. Equity Investments has closed two additional SBA loans totaling \$1.5 million. A fourth loan for \$500,000 has been approved and will be used by Equity Investments to begin making microloans in the Southern Alabama market. These funds are utilized by Equity Investments to fund microloans to individual borrowers. The individual microloans are not guaranteed by the SBA.

Equity Investments also receives an annual SBA grant, the amount of which is usually set at 20 percent of the cumulative loan balance due to the SBA. The grant covers program marketing up-front technical assistance such as business strategy development market analysis, and post loan counseling. Another condition of the Microloan Program is that all applicants must reside in Equity Investments' designated service area.

Equity Investments conducts an extensive marketing effort to reach potential borrowers. Equity Investments advertises the Microloan Program through the local municipalities, non-profit organizations, radio stations and newspapers. However, 80 percent of the referrals to Equity Investments come from the area's financial institutions. Often local banks cannot make these type of loans profitably, but they want to keep their existing customers. Having an organization like Equity Investments available to refer customers to is beneficial for the banks. Equity Investments' President has indicated his belief that because of the specialized nature of the Microloan Program, a bank's referral of its customer to Equity Investments

does not result in a lost customer. Further, he believes that helping customers find specialized credit that is not available from the bank likely improves the customer's relationship with the bank. Finally, the Microloan Program serves as an entrepreneurial incubator for unproved small businesses that may develop into future customers for conventional lenders.

Equity Investments provides potential applicants with a package that describes the program and contains a loan application form, credit release form and other materials relevant to the program and application process. If necessary, Equity Investments also supplies technical assistance to applicants seeking help in completing their application or assembling necessary documentation. Equity Investments loan officers pre-screen potential borrowers for compliance with product requirements and to ensure that the applicant resides in Equity Investments' service area.

Once the application is complete, the loan officer packages, underwrites and prepares the loan for the Loan Review Committee (the "Committee"). The Committee consists of representatives from financial institutions, private industry, and community residents. The borrower's capital, collateral, capacity, and credit are evaluated by the Committee, which then makes its recommendations to the Board of Directors. The Committee and the full Equity Investments Board of Directors must approve all loans. If a loan is denied, Equity Investments has an appeal process that affords the applicant himself or herself the opportunity to present the loan to the Board of Directors.

The Committee generally sets the loan terms and conditions, particularly with regard to

*Pictured is Doug's Bar BQ which was financed with a \$25,000 micro-loan from CEII. The restaurant, which opened its doors for business in 1994, is located in Santa Rose County, FL*



collateral requirements. For example, one Equity Investments microloan and extensive technical assistance enabled a disabled veteran to establish a dine-in restaurant and catering business in Milton, FL. The entire project required \$90,000 in financing. Equity Investments was able to loan the borrower \$25,000 based on his overall application, credit history and collateral. One strong consideration in making this loan was the fact that the borrower was able to pool together other resources, including \$30, 000 from his personal savings, to come up the remaining funds. The terms of this microloan were 5 years at 8 percent interest. Generally, microloans are made for up to five years at 8 to 12 percent interest. However, the smaller loans, those between \$5,000 and \$10,000, typically have repayment terms of 2 or 3 years, depending on the borrower's financial capacity. Loan approval normally takes about four weeks.

All approved loans are closed in-house by Equity Investments and there are no closing fees. If a loan contains a real estate component, an Equity Investments approved attorney or title company closes it. The SBA does not permit the sale of microloans,

therefore, microloan lenders are required to handle all loan servicing in-house. This requirement forced Equity Investments to develop an in-house loan servicing capacity.

Currently, the success rate on all outstanding Equity Investments microloans is about 93 percent. A number of factors combine to keep the default rate so low. The 20% grant provided by the SBA described above offsets the considerable cost incurred in providing up-front training, technical assistance and post loan counseling for microloan borrowers. Most Equity Investments applicants have limited expertise in business financing and operational management. Thus, the level of one-on-one technical assistance provided to a typical borrower by Equity Investments loan officers, both before and after the loan is closed, far exceeds the technical assistance provided by a conventional bank loan officer to one of their clients. Further, 50 percent of the technical assistance provided by Equity Investments is done after the loan is closed. Providing all of these perpetual services contributes to the Microloan Program's minimal loan defaults.

## EXPERIENCES AND OBSTACLES

Non-profit organizations such as Equity Investments may be the only entities capable of making significant numbers of microloans. As discussed briefly above, traditionally, conventional financial institutions have not shown a significant interest in providing microloans because of their high maintenance cost and the small loan balances that many believe make them unprofitable. The small size of microloans means that bank fees based on a percentage of the loan amount simply don't provide sufficient profit to justify offering these type of loans. For example, a \$25,000 loan with a 2 percent origination fee would only yield \$500. Finally, microloan borrowers typically have a limited amount of collateral available, which makes these loans riskier.

However, the new Community Reinvestment Act ("CRA") regulations have placed a greater emphasis on lender investments that encourage community economic development. Through the new CRA regulations federally insured depository

institutions are able to receive full CRA credit for microloan investments if the loan is made to a Community Development Financial Institution (CDFI) and the lender is a participant in the Bank Enterprise Award (BEA) Program.

The emerging market for microloans has created potential partnerships for Equity Investments with conventional lenders like banks and thrifts. In 1997, Equity Investments received grants from the following banks: First Union National Bank (\$7,500), SunTrust Bank (\$5,000), Chase Manhattan Bank (\$5,000), and Compass Bank (\$2,500). In 1998, SunTrust also authorized a \$50,000 low-interest loan for Equity Investments to use in funding microloans. Further, these financial institution loans and grants to microlenders like Equity Investments are given strong consideration by regulators when evaluating financial institution performance under the CRA lending and investment tests.

## CURRENT STATUS

Equity Investments made its first micro enterprise loans in 1992. Since then the Microloan Program has grown to its present loan portfolio level of 105 loans totaling \$1.6 million. The Microloan Program's lending profile includes 41 percent start-up companies and 59 percent expansion of existing businesses. Further, 40 percent of the borrowers are minorities and 35 percent are women. The average loan size is approximately \$16,000 and through its

Microloan Program Equity Investments has created or maintained a total of 210 jobs.

After six years of dispersing microloans to Northwest Floridians, Equity Investments was ready to expand the product into Alabama. In November 1997, Equity Investments received permission from the SBA to make the product available to a 13-county area in southern Alabama.

## PARTNERSHIPS

Equity Investments is able to engage in microlending because of the program implemented by the SBA. In addition, Equity Investments obtains strong support from the

region's financial institutions, local and state governments and the citizens of the area.

## ADDITIONAL INFORMATION CONTACTS

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### **ADDITIONAL RESOURCES**

**Karen Prentiss, Executive Director**  
**Florida State Rural Development Council**  
The Atrium Building  
325 John Knox Road, Suite 201  
Tallahassee, Florida 32303  
Phone: (850) 921-0123  
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[www.dos.state.fl.us/fgils/fsrdc](http://www.dos.state.fl.us/fgils/fsrdc)