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A Microenterprise Loan Fund Opens Doors in Utah

by Kathy Ricci, *Executive Director, Utah Microenterprise Loan Fund*

Jon Venzia and Joe Ballato formed Greenhouse Effect Coffee Shop and Crepery in April 2001. They received a $3,080 micro-loan in November 2001 from the Utah Microenterprise Loan Fund.

Thirteen years ago the Utah Small Business Development Center (SBDC) and others organized a 21-week business plan training course designed for single mothers living in subsidized housing. Although it was a good course, it raised a disturbing question: "How can you put single parents through 21 weeks of small business training and then offer absolutely no sources of financing for them at the end? It's almost a cruel joke."

This was the impetus for the creation of the Utah Microenterprise Loan Fund (UMLF). We knew that there were significant numbers of low- to moderate-income women and minorities who had the character and determination to succeed at self-employment and microenterprise development. But they lacked access to traditional sources of capital.

At a meeting hosted by the Federal Reserve Bank of San Francisco, senior managers at several Utah financial institutions discussed the prospects for a microenterprise loan fund and the importance of cooperating to fund its loan pool. Management and funding details were gradually worked out, and it was decided that investors, carrying loans to the fund under the category of "other assets," would receive quarterly interest payments based on the federal discount rate on the first day of the quarter plus 50 basis points. Capitalized with approximately $462,000 from a dozen financing institutions and officially incorporated as a 501(c) 3 in 1991, the UMLF made its first loan in 1993.

How our loan fund works

Most small business start-ups are financed from personal savings or investments from friends or family. Once started, small businesses (like larger ones) require a source of credit to sustain them or to finance their growth and development. UMLF clients lack access to conventional sources of start-up capital, and because they typically have neither capital nor collateral — along with poor credit histories in many cases — they are, by conventional standards, poor credit risks.

The UMLF helps to overcome these obstacles by providing modest loans, up to $10,000, for business proposals that demonstrate a sound strategy and the probability that the debt can be repaid from business operations. Applicants personally present their business proposals to a committee of volunteer bankers, small business owners, and community representatives. It's an opportunity for applicants to market their ideas to a tough but supportive audience — and for the committee members to assess applicants' knowledge, integrity, and commitment. In this kind of lending, perhaps even more so than elsewhere, character is key.

Jorge Fierro is a case in point. When he moved to Utah from Mexico, he was unimpressed with the Mexican food he found in local grocery stores. In the summer of 1997 he started selling freshly cooked pinto beans at Salt Lake City's downtown Farmers Market. His business consisted of a card table to display his beans, two coolers to keep them fresh, and some sample recipes. Soon he had a loyal group of customers — and hopes for expansion.

Later that year Jorge and his partner, Karin Palle, secured a $10,000 loan from the UMLF to fund packaging, labeling, and distribution of his Rico's Pinto Beans. Sales financed the start-up of Rico's Mexican Market and Catering. Today Jorge's business employs 14 and earns more than $16,000 per week in sales. He has an extensive product line — all featuring fresh ingredients — and distributes to more than 15 establishments in Salt Lake City and Park City. An active advocate for, and supporter of, small business start-ups, Jorge is quick to acknowledge the UMLF's importance to his own success. "The UMLF," he says, "was the only organization willing to finance our dream."

A growing portfolio

In 10 years of lending, the UMLF has made more than 340 loans totaling just under $3 million. We have 24 participating investors and a loan pool of more than $1.2 million. Starting as a pilot program in Salt Lake County, we have since expanded to serve nine counties that account for about 80 percent of the state's population. Half of our loans have been to home-based businesses; 60 percent to woman-owned businesses (a third of these owners are single mothers); 26 percent to minority-owned businesses; and half to new start-up ventures.

As with our loan to Jorge Fierro, most of our loans have been our original "traditional microloan" of up to $10,000, available to new or existing businesses at a rate of prime plus 5 percent and amortized over 5 years. Working with our clients, we've developed four additional loan products to meet their needs. The "next small step micro-loan" of up to $3,000 is available to existing businesses that need a quick infusion of working capital. A "child care provider micro-loan" offers funding up to $25,000 to child care providers, and the "vocational rehabilitation micro-loan" makes up to $20,000 available to people looking at self-employment as a way to return to the work force. And recently Salt Lake City granted the UMLF $250,000 to underwrite loans of up to $25,000 for entrepreneurs located within the city limits.

It's worth noting that Salt Lake City approached the UMLF about this loan initiative, not the other way around. The concept of microcredit for microenterprises is definitely catching on as an effective community and economic development tool. We've been successful in obtaining Community Development Block Grants (CDBG) from county and local city governments to fund loans and loan loss reserves in their communities.

What about loan performance? Here the UMLF has pleasantly surprised its investors. At the outset, concerned about the viability of the target market, they required a 50-percent loan loss reserve. That has long since been lowered to 20 percent. Losses since inception have ranged between 10 and

15 percent. Losses are shared proportionately among investors and the UMLF. (For example, if a full $10,000 were to be charged off, the UMLF would absorb $2,000 through the reserve, and participating investors would write down the level of their investments by their proportional share of the remaining $8,000.)

As our bank investors' experience demonstrates, there are many advantages to partnering with local microenterprise organizations:

- By pooling financial resources, banks can extend the scope of lending capacity for the benefit of the community.
- The risks of community development lending can be broadly shared.
- Transaction costs can be reduced and managed by using professional expertise and in-kind contributions.
- When a participating bank has to turn down a loan request that doesn't quite meet conventional standards, the bank can make a referral to the microenterprise organization.
- Banks can develop a new source of potential customers, as microloan borrowers establish commercial track records.
- Banks can participate in co-lending opportunities, in which the microenterprise organization makes part of the loan and the bank makes the rest. (For example, if a start-up needs $35,000, we might make a $10,000 loan contingent upon a bank loaning $25,000, with our position subordinated to the bank.)
- Through participation in a microenterprise loan pool, a bank can help underwrite cash flow loans in conjunction with regular commercial and/or SBA loans. (To illustrate: a silk screening company gets an SBA loan to purchase needed equipment and the UMLF makes a $10,000 working capital loan.)

By now it's no secret — at least to us — that many people who may not qualify for conventional loans are worthy candidates for credit nonetheless. Over a 10-year span, we've demonstrated that the Utah Microenterprise Loan Fund can serve as an alternative funding vehicle, focusing on personal character and the capacity of a microbusiness to service its debt. And because the UMLF provides business funding, not grants, our clients can work their own way up the economic ladder with dignity and self-respect.

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Finding a Microenterprise Lending Partner

The SBA's MicroLoan Program provides very small loans to start-up, newly established, or growing small business concerns. Under this program, SBA makes funds available to nonprofit community based lenders (intermediaries) which, in turn, make loans to eligible borrowers in amounts up to a maximum of $35,000. The average loan size is about $10,500. Each intermediary is required to provide business based training and technical assistance to its microborrowers. Individuals and small businesses applying for microloan financing may be required to fulfill training and/or planning requirements before a loan application is considered. There are approximately 179 participating intermediate lenders and non-lending technical assistance providers in the SBA's MicroLoan Program (visit http://www.sba.gov/financing/microparticipants.html for a complete list).