Montana Legislative Audit Division
Performance Audit Summary

Microbusiness Finance Program

November 2000

Introduction

The Legislative Audit Committee requested a performance audit of the Microbusiness Finance Program administered by the Department of Commerce. The Montana Legislature created the program in 1991 through passage of the Microbusiness Development Act (Title 17, chapter 6, MCA). The legislature approved an initial appropriation of $3.25 million from the state's Coal Tax Trust Fund and an additional $3.25 million from the trust fund in 1995 to make loans to microbusinesses.

Microbusinesses are defined as those having fewer than 10 employees and less than $500,000 in annual gross revenues. The program: "Is intended to provide … small loans for economically sound and feasible microbusiness projects that because of the high costs and diseconomies of scale of small lending or unconventional collateral are unlikely to receive financing from conventional public or private sources."

The Microbusiness Finance Program is administered by three types of entities. Certified Microbusiness Development Corporations make loans to businesses at the local level. The Department of Commerce is responsible for program oversight on a statewide level. The department provides the money (through development loans) to the Microbusiness Development Corporations who make loans to local businesses. The third entity, the Microbusiness Advisory Council, advises the department regarding overall program operations.

Loan Portfolio is at Risk

We reviewed the status of the loan portfolio for the Microbusiness Finance Program. Several conclusions were made related to the program's loan portfolio.

The program has a weak loan portfolio; most MBDCs are not financially self-sustaining; loan activity is dropping in some areas; and the program has difficulty maintaining/attracting qualified staff. It is not clear whether the program has performed at a level that is acceptable to the Legislature.

High Delinquency Rates

Delinquency rates are one way to measure the percentage of a loan portfolio at risk. They are calculated by comparing the outstanding balance of loans with past due payments to the outstanding balance of the entire portfolio. For the quarter ending March 31, 2000 the microloan portfolios for most local MBDCs had high levels of delinquent loans. Six of the nine funded local MBDCs have delinquent rates over 20 percent and one was over 45 percent. The statewide loan delinquency rate was 20 percent. For most MBDCs there was a general trend for loans with payments one to thirty days late to become delinquent (over 30 days late). Documentation in loan files indicated loans were rewritten to change a loan's past due status. This gives the loan portfolio the appearance that it is stronger than it really is. Therefore, the program's overall delinquency rate would be higher if some loans had not been rewritten.

Once delinquent loans become 90 days or more past due, collection of the loan is doubtful. Department records indicate this is a common scenario for most local MBDCs around the state. We found the total value of loans 90 days or more past due was approximately $405,000. This is more than half the dollar value of the delinquent loans and just under 12 percent of the current loan balance. In addition, there is an outstanding balance of another $143,000 which could become 90 days past due because borrowers have not made their last two payments.

Microloan Late and Delinquent Payments by Local MBDCs
(Quarter Ending 3/31/00)

MBDC	Outstanding Balance	1 – 30 Days	Percent	Over 30 Days	Percent
Billings	$ 320,106	$ 68,628	21%	$ 68,849	22%
Butte	257,405	18,825	7%	57,970	23%
Colstrip	138,674	9,954	7%	33,376	24%
Great Falls	171,386	17,857	10%	76,542	45%
Havre	1,021,631	27,756	3%	209,570	21%
Helena	341,119	8,892	3%	39,901	12%
Kalispell	249,032	85,916	34%	65,698	26%
Missoula	535,197	0	0%	31,415	6%
Wolf Point	370,859	23,184	6%	99,146	27%
Total	$ 3,405,409	$261,012	8%	$682,467	20%

Number of Loans Varies

The total number of loans made since program inception varies widely from region-to-region. Numbers range from 10 loans in Colstrip to 110 loans in Helena. We also noted some local MBDCs have made very few loans in the last two years of the program. For example, one MBDC made two loans in calendar year 1998 and one loan in calendar year 1999.

Need for Umbrella Organizations

Local MBDCs need to be located within a financially sound "umbrella" organization that can subsidize the operating costs of the MBDC. Financial information reported by the MBDCs for fiscal year 1999-00 shows a total statewide net loss (expenses exceeding revenues) for all the MBDCs of $342,921. Only one of the active MBDCs showed a positive change in net assets.

The umbrella organization covers the losses, not the State of Montana. Two local MBDCs (Bozeman and Glendive) chose to leave the program because the entities where they were located no longer wanted to risk the net assets of their organizations on additional loan losses.

Weaknesses Identified in Lending Practices

Lending procedures used by local staff displayed several weaknesses. Examples of weakness found included:

- Business plans were not always obtained or lacked sufficient detail to allow some MBDCs to evaluate a new business proposal.
- Financial/credit analysis of microloan proposals was limited or nonexistent at some MBDCs.
- Financial information was not always obtained when loans were made.
- Liens were not always filed on collateral.
- Some MBDCs made loans to applicants with poor credit histories (bankruptcies, unpaid collections).

Legislative Determination of Program's Future

In 1994, a private consulting firm hired by the department determined the majority of businesses receiving loans were already in operation. Most businesses said they would not have been able to stay in business without the loans. The consultant also found that about 75 percent of microbusinesses cater mainly to residents and businesses in their immediate area. Therefore, they make a limited contribution to statewide or local economic growth.

It is not clear whether the program has performed at a level acceptable to the Legislature. Based on criteria developed by the National Community Capital Association which mirror the loan and lending issues we identified, the program displays the conditions requiring a decision on its future. ***The legislature should determine the future of the Microbusiness Finance Program.***

Improving Program Operations

We identified several steps that should be taken to improve program operations.

There is a lack of understanding of proper lending procedures at the local level. MBDC staff believe bad loans were made because lending staff was not properly trained and there was high staff turnover. Currently the department does not specify qualifications for lending staff. The department has not established clear criteria to evaluate whether MBDC staff has the ability to administer the loans. MBDC lending policies are also not clear.

The department should establish minimum qualifications for MBDC lending staff and evaluate whether MBDCs are hiring staff meeting these qualifications as part of their on-site review process.

The department should make additional resources available to MBDCs to provide training to staff. In addition, they should require MBDC lending staff complete a specific number of training hours.

The department should review and approve local MBDC lending policies and procedures. If necessary, they should provide sample policies and procedures to MBDCs describing the proper lending process.

Collect Information on Program Outcomes

At the present time neither the department nor the local MBDCs know for sure how many financed businesses are still operating. The department does not have a system to evaluate the outcomes of the program and whether it meets the expectations of the Microbusiness Act.

The department reports since inception, the program has created 730 new jobs and retained over 560 existing jobs. However, the process used to compile this information raises questions as to the accuracy of this data. The program generally takes credit for jobs created or retained even though other programs often play a role in financing the business. The department relies on estimates of jobs created provided by borrowers when loan documents are signed. Limited verification of the information takes place. Business ventures have been unsuccessful and borrowers obtained other employment so they could pay off the loan. Department records are not updated to account for these situations so the program continues to report jobs created and retained that no longer exist.

The department should develop outcome measurements for the Microbusiness Finance Program. It also needs to establish a system to collect information and measure program outcomes.

For a complete copy of the report (00P-08) or for further information contact the Legislative Audit Division at 406-444-3122; e-mail to lad@mt.gov; or check the web site at http://leg.mt.gov/audit.