



**2011 AND 2012  
LINKED DEPOSIT REPORT  
TO THE  
MARYLAND GENERAL  
ASSEMBLY**

January, 2013



Maryland Department of Housing  
and Community Development

**MARTIN O'MALLEY**, *Governor*  
**ANTHONY G. BROWN**, *Lt. Governor*

**RAYMOND A. SKINNER**, *Secretary*  
**CLARENCE J. SNUGGS**, *Deputy Secretary*

## **2011 & 2012 Linked Deposit Report to Maryland General Assembly**

### **Introduction**

Each year, pursuant to State Finance & Procurement Article § 6-211 (c) (4), the Department of Housing and Community Development must report annually to the Governor, Treasurer, and in accordance with § 2-1246 of the State Government Article, the General Assembly, on the overall performance of the Linked Deposit Program. This report addresses fiscal years 2011 and 2012.

Maintaining and increasing access to affordable capital for small business development, especially for disadvantaged businesses, is especially important during these challenging economic times. Launched in 2009, Maryland's Linked Deposit Program is a relatively new program aimed at helping small minority-owned businesses access more affordable capital. The program is a promising tool for making business development more affordable to Maryland's certified Minority Business Enterprises (MBEs), but the program is underutilized.

Linked Deposit (LD) is a statewide initiative that is staffed by the Department of Housing and Community Development and is promoted and managed in close coordination with the Department of Treasury and the Governor's Office of Minority Affairs. In addition, DHCD also coordinates with the Maryland Departments of Transportation and Business and Economic Development to implement the program. The authorizing legislation for LD, House Bill 1431 Chapter 396, was passed during the 2006 session of the Maryland General Assembly.

Enrolled financial institutions in return for making loans to certified MBEs at reduced interest rates, receive a "deposit" of cash from Treasury in which the interest rate expected by the State is reduced commensurately. Maryland financial institutions apply to the Treasury to become eligible for making Linked Deposit loans and holding Treasury deposits. The Maryland legislature has authorized the use of up to \$50 million in State funds for deposit with enrolled LD banks.

In the fall of 2012, the Maryland Department of Housing and Community Development (DHCD) convened a Linked Deposit Workgroup of public and private industry stakeholders at the request of the Senate Finance Committee, to study the barriers affecting the use of the MBE Linked Deposit Program and to advise on ways to improve usage of the LD program. In particular larger financial institutions are proving harder to enroll in the program. In summary, the Workgroup found that barriers to lender participation include: reporting requirements; net cost of enrolled loans to lenders in a low interest rate environment; complex process for enrolling as a lender via Treasury's RFP; and Treasury's collateral requirements for enrolled lenders. House Bill 1452 and SB 1072 were introduced into the 2013 Session of the Maryland General Assembly

in order to address the cost of loans and collateral issues. Other barriers are being addressed administratively.

The full Workgroup report is included as an attachment to this report.

### **Marketing Activities**

Marketing and outreach for the Linked Deposit Program has been very proactive in the last two years, including:

- participation in the Statewide tour of MBE University sponsored by the Governor's Office of Minority Affairs;
- participation in County level minority outreach events sponsored by the Maryland Department of Housing and Community Development;
- participation in and sponsorship of the Annual Asian American Business Conference;
- participation in and sponsorship of the Annual Hispanic Business Conference; working in concert with the Governor's Office of Community Initiatives – Ethnic Commission;
- participation in the Women Entrepreneurs of Baltimore (WEB) events; participation in the Mayor's Office of Minority and Women-Owned Business Development events; and
- co-marketing efforts of the Maryland Department of Transportation, the Maryland Department of Business and Economic Development, and the State Treasury Office.

### **Program Activity**

Activity in the program has been limited by the number and location of participating financial institutions. Participating lenders currently are: Columbia Bank, Bank Annapolis and Industrial Bank.

### **Fiscal Year 2011 Linked Deposit Program Activity**

<b>Participating Lender</b>	<b>Loan Amount</b>	<b>Jobs Created</b>	<b>Jobs Sustained</b>
<b>FY 2011</b>			
Columbia Bank	\$150,000	0	6
Columbia Bank	\$1,000,000	15	75
Columbia Bank	\$75,000	2	10
Columbia Bank	\$250,000	4	10
Total	<b>\$1,475,000</b>	<b>21</b>	<b>101</b>

### **Fiscal Year 2012 Program Activity**

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<b>FY 2012</b>	<b>Loan Amount</b>	<b>Jobs Created</b>	<b>Jobs Sustained</b>
Columbia Bank	\$150,000	10	7
Columbia Bank	\$50,000	1	8
<b>Total</b>	<b>\$200,000</b>	<b>11</b>	<b>15</b>

*\*Between July 1, 2010 and June 30, 2012, the Program received 55 eligible applications.*

*\*\*Please Note: "Eligible" is defined as an applicant that is currently a certified minority business in good standing with the Maryland Department of Transportation and thereby qualifies to apply to the program. It does not signify that the applicant is eligible or approved to receive a loan.*

## **Conclusion:**

DHCD believes the program is an effective and cost effective means to encourage affordable access to capital for Maryland's certified MBEs. However, the progress of the program is challenged by the overall tightening of credit access for small businesses due to current economic uncertainties. This tightening of credit impacts MBEs harder than other businesses.

In addition, the findings of the workgroup study led to House Bill 1452 and SB 1072 being introduced into the 2013 Session of the Maryland General Assembly in order to addresses these and other program reform issues.

DHCD and our agency partners continue to maintain an open discussion with the Maryland Bankers Association and lenders to consider means for expanding lender participation.

# **REPORT OF THE LINKED DEPOSIT WORKGROUP**

To the Senate Finance Committee,  
Maryland General Assembly  
January 7, 2013



**MARTIN O'MALLEY**, *Governor*  
**ANTHONY G. BROWN**, *Lt. Governor*

**RAYMOND A. SKINNER**, *Secretary*  
**CLARENCE J. SNUGGS**, *Deputy Secretary*

# INTRODUCTION

The Maryland Department of Housing and Community Development (DHCD) convened a Linked Deposit Workgroup of public and private industry stakeholders this fall at the request of the Senate Finance Committee. The Workgroup was charged with studying barriers to the effective use of the MBE Linked Deposit program. The MBE LD program was enacted into law by the Maryland General Assembly in 2006 and formally launched by DHCD in 2009. The 2006 legislation was passed in response to recommendations from the Task Force on Lending Equity Within Financial Institutions Providing State Depository Services, chaired by Senator Verna Jones-Rodwell and Delegate Michael Vaughn.

This study is also aimed at ensuring the effectiveness of the *new* Small Business Linked Deposit program, established through SB792 and HB571 in the 2012 session of the Maryland General Assembly. The legislation for structuring the new Small Business program mirrors that which established the MBE program; therefore, the Workgroup's recommendations pertain to both.

The LD programs are meant to stimulate the growth and success of minority business enterprises and small businesses by assisting them in obtaining loans at lower than market interest rates. Lowering the cost of credit can make the difference in whether and how such businesses can invest in growth, including job creation.

However, voluntary lender participation in the existing MBE LD program has been low since inception. Therefore, the Senate Finance Committee requested that the Linked Deposit Workgroup:

- study how funds are being spent through the current MBE LD program;
- study factors causing lenders in Maryland to refrain from issuing loans through the current MBE program;
- study ways to increase and maximize future funds made available through the programs;
- consider alternative methods of financing for the programs that would increase a lender's likelihood of participating in the programs; and,
- make recommendations that seek to ensure the long-term success of the programs.

The Workgroup also reviewed the features of successful State LD programs in New York and Washington states, programs which have been in place for nearly three decades. This proved to be very helpful to the consideration of options for enhancing lender participation in Maryland's programs.

# PROGRAM FEATURES AND LIFETIME ACTIVITY

The Office of the Treasury determines key LD program policies and procedures, including the timing and requirements for enrolling lenders, reporting requirements for lenders with enrolled loans and the identification of key indexes which determine the minimum return on deposits that the Treasury will require from its deposits. Treasury also coordinates with participating lenders to make deposits equal to the eligible amount that the bank loans to the MBE. *Deposits of up to \$50 million can be made through the MBE LD program; since program inception, total deposits of approximately \$5.6 million have been made in correlation with enrolled loans.*

DHCD's role is to conduct outreach and education about the program, respond to lender and applicant inquiries, to process MBE applications (including verification with MDOT of MBE certification status), to disseminate applications to enrolled lenders, and to maintain and report metrics on program activity. If a lender applies on behalf of a borrower, DHCD assists by verifying the borrower's certified MBE status.

Lender's participation in the LD program is voluntary. Their role is to underwrite the loan according to their standard criteria, including credit strength. For approved loans, the lender reduces by 2% the interest rate that the loan would otherwise be charged. The most recent loan enrolled in the program was in January of 2012. *There are only three lenders currently eligible to participate: Columbia Bank, Industrial Bank and Bank Annapolis. Of these, over the lifetime of the program, Columbia Bank has made 18 of the total 20 LD loans. Bank Annapolis has made the other two LD loans.*

The Workgroup learned that Columbia Bank's high activity in the program can be attributed to the fact that the bank proactively researched which certified MBEs were located within a particular geographical target area (Western Maryland). They found that a substantial number of MBEs were already their clients or were good prospects to become their clients. In other words, the bank realized that the LD program could provide an opportunity to strengthen their relationship with current clients as well as forge new client relationships.

Summary of MBE LD program activity since inception:

- Applications Received – 152
- Loans Closed/Enrolled – 20
- Enrolled Loan Amount Total – \$5,595,660
- Total Jobs Created -- 92
- Total Jobs Sustained – 245
- Businesses Served – 12

While there appear to be a large number of applications relative to approved loans, it should be noted that the majority of borrowers do not follow through on responding to or completing loan applications with lenders. And, of those that do, not all are eligible for a loan based upon the lender's standard underwriting criteria.

In addition, lenders report that MBE applicants have certain misperceptions about the program, including that:

- applicants commonly believe that the program is meant to help them qualify for loans for which they would not otherwise have been able to qualify, which is not the case.
- applicants believe that the deposit placed by Treasury provides a credit enhancement or loan guarantee to their loan, which is not the case.

# BARRIERS TO LENDER PARTICIPATION

At its first meeting, the Workgroup identified and discussed the barriers to lender participation in the program. *The top two barriers to lender participation are:*

## **Reporting requirements:**

Maryland and Washington State programs require monthly and quarterly reporting. Maryland requires monthly reporting on all government deposits and quarterly reporting on principal balance pay down on LD program loans. Washington requires monthly reporting on principal balance pay down on LD program loans and quarterly reporting on all government deposits.

By contrast, the New York program requires just annual reporting on LD loans and government deposits. Lenders on the Workgroup, particularly those that have experience with the New York program, indicated Maryland's reporting requirements are a disincentive to lender participation. Lenders on the Workgroup recommended that reporting requirements should be limited to annual in order to encourage more lender participation. The time involved in reporting requires staff costs that lenders are not willing to incorporate into their processes.

## **Net cost of enrolled loans to lender:**

One basic assumption of the program is that the reduction in interest income from the enrolled loan would be offset by the Treasury's acceptance of 2% less in interest on the return from their deposit of the same amount. However, particularly because of the longstanding *low-interest rate environment*, this assumption is not valid.

For instance, if Treasury's linked deposit is made to a common 4-year CD (once considered "high yield"), and that CD provides a return currently of 1%, then it is not possible for Treasury to reduce their expected return by a total of 2%. However, the lender is still required to provide the borrower with a 2% rate reduction.

In addition, Treasury has required a minimum return of 0.25%. In October of 2012, Treasury changed its expectations for minimum return to one that is tied to the Federal Funds rate which, as of January 7, 2013, is 0.25%<sup>1</sup>. Treasury's minimum return requirement (required by statute) further increases the difference between what the lender can earn in interest from the Treasury deposit and what the lender foregoes in interest from the MBE loan. In this low-interest environment, that increasing difference translates to increasing cost and lack of profitability for making enrolled loans.

Other issues that inhibit the number of lenders that participate and how eligible lenders and borrowers can participate include:

## **RFP Process for enrolling Lenders in the LD program:**

Lenders, especially the smaller community banks, have indicated that the process for applying to Treasury to participate in the LD program is lengthy and complicated. Treasury is currently participating in a parallel set of meetings to address the feedback from depository institutions; they are revising their RFP requirements and expect to have a new format by spring of 2013.

## **Collateral Requirements:**

In Maryland, Treasury requires that its deposits be secured 1:1 by certain forms of pledged collateral (such as investment assets/securities), however this total amount can be reduced for deposits that are less than or equal to the FDIC insurance limit of \$250,000. Securities pledging also requires tracking within the bank and by Treasury to ensure that the State deposits are fully

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<sup>1</sup> Source: Bankrate.com



collateralized. Therefore, deposits in excess of the FDIC limits are not necessarily desirable by lenders if the increase in pledged collateral is an issue for them.

In recognition of this issue, the Maryland General Assembly passed House Bill 1319 in 2005 which allowed Maryland banks, savings and loan associations and local governments to participate in the Certificate of Deposit Account Registry (“CDARS”) for local government deposits. CDARS was created to provide a means for deposits in excess of federal deposit insurance limits. The idea for CDARS came from three former banking regulators, including former Comptroller of Currency Eugene Ludwig, who observed large public deposits being channeled out of local community banks and into the money markets during the 1990s. The trio concluded that the CDARS network would enable community banks to offer a competitive investment vehicle for local governments that would allow banks to deploy the deposits back into the community while providing customers the added protection of FDIC insurance.

CDARS works in the following way: When a government unit places a large deposit with a CDARS network member, the bank, upon approval from the local government, arranges for the placement of the funds into CDs issued by other network banks, of which there are currently 2,943 nationally and 44 headquartered in Maryland. Today, these funds are placed in increments less than \$250,000 to ensure both principal and interest are eligible for full FDIC protection. Since the CDARS network was created nine years ago, more than 30 states have acted to permit local governments to utilize the service.

For government financial managers, CDARS offers the safety of FDIC insurance with the convenience of one negotiated interest rate, one regular statement, and one banking relationship – while eliminating the need to collateralize deposits that are higher than the FDIC insurance limits.

For State deposits, this collateral issue could be avoided if the Treasury were expressly authorized to make its deposit to the loan-issuing bank through CDARS. In this way, the loan-issuing bank would place the full amount of the Treasury deposit through CDARS and the Treasury would receive a number of certificates of deposit, each within the FDIC coverage limit, from FDIC member banks. Because the entire deposit would be eligible for full FDIC insurance coverage, it would be unnecessary for the loan-issuing bank to pledge collateral or provide for other forms of security. Another benefit of placing the full deposit through CDARS is that the loan-issuing bank would receive matching deposits from customers of other CDARS participating institutions in the amount of the Treasury’s initial deposit. The net effect would be that the amount of the Treasury deposit would be retained by the loan-issuing bank and be available for lending in the community. In addition, while there is a charge to the bank for CDARS, the loan-issuing bank would avoid the costs of pledged collateral and the tracking burden associated with pledged bank collateral.

**Loan Limits:**

Maryland programs, like New York’s, allow term loans only. The Washington state program allows both term loans and lines of credit. Maryland lenders indicate that small businesses are in great need of lines of credit. Small businesses use LOC’s for such purposes as enhancing cash flows and purchasing new equipment for new business opportunities.

In addition, the MBE LD regulations currently restrict an individual borrower’s enrolled loan or loans to a maximum of \$1 million, even if borrowers pay down enrolled loans to amounts lower than \$1 million.

# WORKGROUP RECOMMENDATIONS

Given the above, the Linked Deposit Workgroup recommends the following,

- (1) **Reporting Requirements:** *The Workgroup recommends that Treasury consider a policy change to reduce reporting requirements to no more than twice a year and preferably to once per year. This will reduce the cost of the lender in staff time to participate without compromising the soundness of the program.*
- (2) **Borrower Rate Reduction & Treasury's Return on Deposit requirements:** *The Workgroup recommends that the relationship between the reduced interest rate provided to the borrower and the minimum interest return required on Treasury's deposit does not produce a net loss to the lender. The Workgroup supports in concept the idea that the required interest rate reduction could be changed to an "up to 2%" amount rather than the required 2% as long as there a way to show a clear and objective process for determining the interest rate reduction and that the resulting benefit to the borrower remains meaningful. An example of proposed language is: "**The minimum rate adjustment to the interest rate on the loan would be equivalent to the difference between the prevailing rate paid by the lending bank on a 4-year CD and the interest rate acceptable to the Treasurer for its deposits. The lending bank may at its discretion use a larger rate adjustment of no greater than 2%.**"*
- (3) **RFP Process:** *The Workgroup supports the work that Treasury is already doing to reduce the complexity of the application process for becoming an approved State depository institution. Treasury reports that a new streamlined process will be in place in the spring of 2013.*
- (4) **Collateral Requirements:** *The Workgroup recommends that Treasury consider integrating the CDARS system into its requirements for collateral. As noted above, Treasury's placement of its deposit through CDARS would make it unnecessary for the loan-issuing bank to incur the costs of pledging collateral and the tracking burden associated with pledged bank collateral. In addition, because the Treasury deposit would be matched by customers of other institutions through CDARS, the loan-issuing bank would have available the total amount of the State deposit for lending in the community.*
- (5) **Loan Limits:** *The Workgroup recommends that DHCD update the LD regulations to allow a borrower with an enrolled LD loan to have up to \$1 million in a qualified loan "at any one time" rather than basing the \$1 million loan limit on an initial or subsequent total loan amount. Lenders report that borrowers that pay down their principal are restricted by current regulations from enrolling the difference between the \$1 million and their current loan balance.*
- (6) **Loan Types:** *The Workgroup considered whether to recommend expanding the type of loans eligible for LD enrollment to Lines-of-Credit (LOCs). While LOCs are of value to small businesses, the Workgroup does not recommend expanding beyond the "term loans" that are now eligible to be enrolled. This is a policy change that Treasury can consider making in the future; however, the Workgroup felt that lender reporting requirements may be complicated by this form of credit.*
- (7) **Outreach and Education:** *While DHCD actively reaches out to the minority business community and lenders, there continues to be a lack of knowledge about the program. Therefore, the Workgroup recommends that DHCD, Treasury and DBED expand opportunities for educating potential borrowers as well as lenders about the benefits of using the program.*

# **APPENDIX A:**

## **Roster of Linked Deposit Workgroup Members**

**Delegate Michael Vaughn**

Maryland District 21

**Delegate Heather Mizeur**

Maryland District 20

**Carol Gilbert**

DHCD Neighborhood Revitalization

**Michael Haloskey**

Director, DHCD Neighborhood Business Works

**John Papagni**

DHCD Neighborhood Revitalization

**Cheivelle Hill**

DHCD Program Coordinator

**Peter M. Dolkart**

DHCD Government Affairs

**Benadette Benik**

Chief Deputy Treasurer, State of Maryland

**Tracie Watkins Rhodes**

Governor's Office of Minority Affairs

**Moira Moynihan**

Delegate Mizeur's Office

**Nicole C. Washington**

Deputy Director, MDOT Office of Minority Business

**Jorge Austrich**

DGS Director of Business Programs

**Les Hall**

DBED Small Business

**Sandy Popp**

DBED Government Affairs

**Kathleen Murphy** (and additional staff)

President, Maryland Bankers Association

**Mindy Lehman**

Maryland Bankers Association

**Judy Greenwald**

Columbia Bank

**Sean McCabe**

M&T Bank

**Chris Engel**

M&T Bank

**Michael T. Flynn**

Eagle Bancorp, Inc.

# APPENDIX B:

## Comparison of Maryland, Washington, and New York State programs

Comparison of State Linked Deposit Programs  
DHCD Division of Neighborhood Revitalization 10/15/12

	<b>Maryland</b>	<b>Washington State</b>	<b>New York</b>
<b>Contact</b>	Michael Haloskey Director, Business Lending Programs Maryland Department of Housing and Community Development 100 Community Place Crownsville, MD 21032 Phone 410-514-7245 haloskey@mdhousing.org	Kari Sample Deposit Investment Program Office of the State Treasurer 360-902-9015 360-704- 5137 (fax) kari@tre.wa.gov Mick Matsuzawa Operations Manager 360-664-9753 mickm@omwbe.wa.gov	Dolores O'Connor Empire State Development Linked Deposit Program 30 South Pearl Street, 7th FL Albany, NY 12245 Phone 518-292-5261 linkeddeposit@empire.state.ny.us
<b>Year Established</b>	2006 Began receiving applications March 2009	1993	1994
<b>Lender RFP Process</b>	Lenders must be approved by the treasurer as a depository for state funds. Then a Participation Agreement is required to join the program	Lenders must be approved by the treasurer to hold government funds. Then only an ACH form is required for the Linked Deposit program	Lenders sign undertaking agreement with Comptroller and Taxation and Finance. Then sign Linked Deposit agreement
<b>Size of Fund (total linked deposits)</b>	\$50 million	\$175 million  Office of the Treasurer, Office of Minority & Women Business Enterprises and the Department of Community, Trade and Economic Development	\$560 million  \$460 million from the NYS Comptroller \$100 million from Commissioner of Taxation and Finance

Comparison of State Linked Deposit Programs  
DHCD Division of Neighborhood Revitalization 10/15/12

	<b>Maryland</b>	<b>Washington State</b>	<b>New York</b>
<b>Eligible Lenders</b>	Currently 3 lenders participating	Currently 21 lenders participating All Banks participating in the Linked Deposit program must be qualified through the Public Deposit Protection Commission (PDPC). The PDPC provides for a collateral pool for protection of balances deposited with qualified Washington public depositories. For further information on this program, contact Nancy Adams, PDPC Administrator at 360-902-9077 nancy@tre.wa.gov.	Currently 72 lenders participating Commercial Banks Savings Banks Saving & Loans Associations      Farm Credit Institutions NY Business Development Corporation
<b>Lender Reporting Requirements</b>	Quarterly - Loan Monthly - Deposit	Monthly – Linked Deposit CD’s are setup as 30 day, so balances and returns are reviewed and adjusted monthly. Lenders report Lump Sum Balances of all Government deposits  Quarterly – In depth report on all government deposits that include Linked Deposit loans	Annually

Comparison of State Linked Deposit Programs  
DHCD Division of Neighborhood Revitalization 10/15/12

	<b>Maryland</b>	<b>Washington State</b>	<b>New York</b>
<b>Loan Type (term, line of credit)</b>	<p>Term loans only</p> <p>Maximum loan term is 10 years</p> <p>Maximum loan amount \$1 million</p> <p>Unlimited number of loans per firm</p>	<p>Term loans only &amp; Lines of Credit</p> <p>Maximum loan term is 10 years</p> <p>Maximum loan amount \$1 million</p> <p>Unlimited number of loans per firm</p>	<p>Term loans only</p> <p>Maximum loan term is 4 years</p> <p>Loans with terms less than 48 months are not eligible for the program.</p> <p>Maximum loan amount \$500,000.</p> <p>The maximum amount of loans for one business is now \$2 million and unlimited number of loans as</p> <p>2011 legislative changes (was \$1 million and limited to three loans.)</p>
<b>Instrument used to determine loan interest rate deduction</b>	<p>Flat 2% reduction from the current loan rates offered by the lender.</p>	<p>The interest rate reduction is up to 2%.</p> <p>The actual rate reduction received is set by the banks individually.</p>	<p>The rate reduction is contingent on the bank's 4 year CD rate.</p> <p>The bank's 4 year CD rate will determine the maximum reduction permitted regardless of the reduction the borrower is eligible for under the LDP.</p>

Comparison of State Linked Deposit Programs  
 DHCD Division of Neighborhood Revitalization 10/15/12

	<b>Maryland</b>	<b>Washington State</b>	<b>New York</b>
<b>Eligible Borrowers</b>	Certified MBE, WBE, DBE	Certified MBE, WBE, MWBE and CBE	<p>Manufacturing firms, Service businesses and any firm that increase exporting with 100 or less NYS based employees.</p> <p>NY State Empire Zone certified            Non-certified zone businesses may qualify            Highly Distressed Area - include Federal Empowerment Zones, Enterprise Zones or Renewal Community.            Certified Minority and Women owned businesses.            Defense Industry Manufactures with 25% of their revenue derived from defense contracts or subcontracts.</p>
<b>State Deposit Rates</b>	Treasurer requires a .25% return on deposit	Treasurer is accepting 0% interest floor on deposit	State is accepting 0% interest on deposit
<b>Collateral</b>	Pledged securities and CDARS?	FDIC insurance and pledged securities when amounts exceed the amount insured by the FDIC.	Requires 100% collateral of pledged securities back by the federal government or New York State. No FDIC insurance coverage.