CRF USA

Capital for Communities –
Opportunities for People®

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February 25, 2016

Mr. Grady B. Hedgespeth, Director
Office of Economic Opportunity
U.S. Small Business Administration
409 Third Street, SW
Washington, DC 20416

RE: Request for Comments on the Notice of Extension of and Changes to the Community Advantage Pilot Program

Dear Mr. Hedgespeth:

On behalf of Community Reinvestment Fund, USA, (CRF), I appreciate the opportunity to provide comments on the extension of and changes to the Community Advantage (CA) Pilot Program as published in the *Federal Register* on December 28, 2015. The purpose of the CA Pilot Progam is to increase SBA-guaranteed loans to small businesses in underserved areas. CRF shares the Small Business Adminstration's (the SBA or Agency) commitment to expanding access to capital for small businesses and entrepreneurs unable to obtain conventional credit. We strongly support the SBA's efforts to refine and improve the effectiveness of the CA Pilot Program. Although the economy continues to improve, the National Association of Small Businesses' 2015 Year-End Economic Report notes that "…one-in-four small firms still cannot access adequate financing". Moreover, the absence of capital continues to hinder small-business owners' ability to finance increased sales and increase inventory to meet demand. "Nearly one-in-five small firms say lack of capital availability has rendered them unable to finance increased sales."[1] Clearly, there is a pressing need for programs such as the CA Pilot to fill the gap in access to credit for small firms and especially those operating in underserved areas.

BACKGROUND

Community Reinvestment Fund is a national Community Development Financial Institution (CDFI) and a leader in channeling resources from the capital markets to support community economic development and helping mission-driven organizations improve efficiency and build capacity. Our mission is *to improve the lives of disadvantaged people and strengthen communities through innovative finance*. We have worked with community partners, investors, foundations, and financial institutions to deliver more than $2 billion in loans, investments, and bonds, resulting in the creation or preservation of 73,000 jobs, the financing of nearly 19,000 affordable housing units and funding for a wide range of community facilities. Since its inception, CRF has funded over 1,700 small business loans, nearly 500 of which were made to businesses owned by women or people of color. To date, CRF has deployed resources in more than 850 communities in 48 states and the District of Columbia and served 1.7 million people.

[1] National Small Business Association, *2015 Year-End Economic Report*, pg. 9.

CRF is best known as a financial innovator, establishing the first secondary market for small business and affordable housing loans to supply liquidity to CDFIs and other community-based lenders. We pioneered the development of securities collateralized by community development loans to offer mainstream institutional investors (banks, pension funds, and insurance companies) with a way to invest capital in projects and businesses serving low-income people and revitalizing distressed communities. CRF also played an instrumental role in helping launch the New Market Tax Credit (NMTC) Program. Together with its affiliate, National New Markets Tax Credit Fund, Inc., (NNMTCF), we have received $804.5 million in tax credits and deployed $768 million in the form of flexible loans for both non-profit and for profit operating business located in low-income communities throughout the country. Since 2003, we have funded 366 NMTC loans totaling nearly $794 million. In 2013, CRF was named the first Qualified Issuer (QI) for the CDFI Bond Guarantee Program. As the only QI to participate in the each of the three funding rounds conducted to date, we have issued $425 million in bonds on behalf of six CDFIs.

As stated in the Community Advantage Participant Guide, the Pilot Program was created "…to meet the credit, management, and technical assistance needs of small businesses in underserved markets."[2] The Guide specifically notes, "CA provides mission-oriented lenders, primarily nonprofit financial intermediaries focused on econmic development, access to 7(a) loan guarantees for loans of $250,000 or less."[3] CRF has a unique appreciation for the purpose of this Program. In the wake of the financial crisis, we chose to acquire one of the 14 non-depository SBA 7(a) licenses in order to continue delivering credit to underserved small businesses. Unlike most other non-bank 7(a) lenders, CRF is a national CDFI. We specifically direct our 7(a) lending to small firms located in distressed areas and / or to borrowers unable to access conventional credit in keeping with our mission. Just as CA Lenders must provide 60% of their loans to borrowers in underserved markets, CRF's 7(a) business model is designed to serve a national market comprised of the very same customers – those who cannot access the capital they need to sustain and grow their businesses.

Although CRF launched its SBA 7(a) lending activities in 2012, we have established a successful track record in this new line of business. As of September 30, 2015, CRF's Small Business Lending Company (SBLC) moved into the largest peer group of SBA lenders which includes those who have outstanding loan portfolios of $100,000 million or more. From 2012 through December 31, 2015, we have closed 243 loans totalling $129 million in 36 states. Since January, 2014, our SBLC has had "Delegated Authority" (aka Preferred Lender or PLP status) from the SBA and this designation was renewed for another year in January 2016. The majority of the number of CRF's closed loans have been for amounts of less than $750,000, with approximately 42% of these loans for amounts of between $151,000 and $350,000. Our average loan size trended down from 2012 through 2015. Loans to start-up businesses comprise nearly 50% of our closed 7(a) loans. These borrowers typically need much smaller sized loans. The experience of obtaining a 7(a) license and the growing this book of business, with a commitment to delivering credit that has a positive impact on customers, their employees and their communities, informs the comments and recommendations we wish to offer on the recently announced changes to the Community Advantage Pilot Program.

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[2] Community Advantage Participant Guide, Version 4.0, December 28, 2015, pg. 4.

[3] Ibid.

COMMENTS ON AND RECOMMENDATIONS FOR STRENGTHENING THE CA PILOT PROGRAM

CRF is an ardent supporter of the Community Advantage and we commend the SBA for embarking upon this review of the Program to ensure its design and delivery is both effective and successful. We applaud the Agency's decision to extend the term of the Program to March 31, 2020, and to articulate a plan to evaluate whether this Pilot should be made permanent, if eligibility should be expanded to new organizations, and how it can be made even more effective.

CRF also has a strong interest in the success of the Program as our 7(a) lending platform relies (heavily) on collaboration with a broad range of community-based lending organizations around the country, including Community Advantage Lenders. We partner with these and other lenders by complementing their product offerings. For example, if a CA Lender receives a loan request in excess of the $250,000 loan limit under the Pilot Program, these lenders can refer the borrower to CRF for possible funding as we are able to provide loans of up to $4 milllion with our SBA 7(a) loan product. Our referral partners (including CA Lenders) are eligible to receive a fee for funded loans recognizing their presence and expertise in the local market.

As a national lender, CRF frequently extends smaller loans (under $250,000) to businesses in areas where there is no CA Lender present. Yet, there is still tremendous unmet demand for small loans (under $150,000) and the need is even more acute in underserved / low wealth communities.[4] According to unpublished estimates by the Association for Enterprise Opportunity (AEO), CDFI microlenders are barely able to make a dent in the credit needs of small firms in these areas. Even with 100 lenders participating in the CA Pilot Program, there are still substantial gaps in the small business credit market that need to be filled.

Expand CA Program Eligibility to include CDFI 7(a) lenders

In light of the clear / glaring need for more CA Lenders to address demand for small dollar loans, CRF respectfully urges the SBA to consider expanding the Community Advantage Program eligibility to include well-capitalized, highly-qualified, CDFIs with a national SBA 7(a) license / product. Currently, there are three such CDFIs, including CRF, that possess this capabiltiy and are using it to fulfill the credit needs of borrowers unable to secure conventional credit. As a certified CDFI, each of these national 7(a) lenders is required by the CDFI Fund to ensure at least 60% of their lending activity / loans are made / directed to designated Target Markets, including distressed areas / geographies, low income people, or specific populations that have difficulty gaining access to credit (such as people of color, women, etc.). Although the CA Pilot Program has its own definition of "underserved markets"[5], there is significant overlap and alignment with the areas and

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[4] According to an unpublished analysis by the Association for Enterprise Opportunity (AEO), there are approximately, 11.2 million businesses with less than $1 million in revenues with DUNS numbers and located in zip codes that map to NMTC eligible or distressed census tracts. Using the Federal Reserve's most recent credit survey, they estimated the "addressable market", e.g. number of small businesses in low wealth communities seeking credit, to be about 2.2 million. Using data from the Community Development Financial Institutions Fund, AEO estimates CDFIs are serving between less than 1/2% to a few percentage points (4%) of this market need.

[5] *SBA Community Advantage Participant Guide, Version 4.0*, December 28, 2015, pg. 4. "Organizations approved to participate as CA Lenders are required to make at least 60% of their CA loans in underserved markets. For the purposes of CA, underserved markets include: Low-to-Moderate Income (LMI) communities (CA Lenders are encouraged to serve low and very-low income communities); Businesses where more than 50% of the full time workforce is low-income or resides in LMI census tracts; Empowerment Zones and Enterprise Communities; HUBZones; New businesses (firms in business for no more than two years); Businesses eligible for SBA Veterans Advantage; and/or Promise Zones. "

types of borrowers that comprise / make up CDFI Target Markets. In other words, *these CDFI 7(a) lenders are in fact directly advancing the objectives of the CA Pilot Program but without the all the commensurate benefits or tools afforded to CA Lenders.*

Allowing national CDFI 7(a) lenders to become CA Lenders would contribute to the success of the Pilot Program by increasing access to SBA-guaranteed loans for small businesses in underserved markets. Permitting these lenders to offer the CA product would significantly expand coverage of the Pilot Program to areas where there may be no CA Lender present. Without the ability to obtain credit, small businesses are unable to obtain the credit they need to grow their operations and hire new employees. If the purpose of the Pilot Program is truly to make credit more widely available, it would seem counterintuitive *not* to utilize these national CDFI 7(a) lenders to reach small firms in areas without an existing CA Lender and would otherwise be unable to secure a CA loan.

In addition, enabling national CDFI 7(a) lenders to offer the CA product builds upon the existing capabilities and expertise of these seasoned organizations with a demonstrated track record of deploying the full 7(a) guaranteed loan product in the *very markets* the Pilot Program was established to address. Getting credit into distressed / low income communities or to underserved borrowers is inherently more difficult, in many cases due to lack of experience or familiarity with SBA products Again, it would seem *only* logical to leverage these CDFI lenders that have demonstrated their commitment to and proven their ability to reach these small business borrowers despite the challenges.

Empowering existing, mission-aligned national CDFI 7(a) lenders with the CA product will not only help fulfill the goals of the Pilot Program, but it would do so by providing these Lenders with two key tools or capabilities to enhance their lending activities: (1) the opportunity to use delegated authority to process loan requests with low Small Loan Advantage credit scores and (2) greater flexibility in pricing smaller loans. Both of these capabilities would encourage these organizations to make even *more* small loans with less financial sacrifice /cost.

Briefly, the most recent CA Participant Guide Version 4.0, dated December 28, 2015, clearly states CA Lenders are permitted to process loan applications under delegated authority with a minimum Small Loan Advantage (SLA) score of 120 as compared to a score of 140 for applications under the full 7(a) loan program. Loans falling below these levels are subject to a full underwriting which is both more expensive and time consuming for the lender. National CDFIs 7(a) lenders are making smaller loans but it is often uneconomic for them to do so because they are not accorded the same streamlined process provided to CA Lenders. Permitting national CDFI 7(a) lenders to offer the CA product for smaller loans would address this challenge and ultimately strengthen the financial sustainability of their operations / activities.

Second, CA Lenders enjoy substantially greater flexibility in pricing their loans than full 7(a) lenders. Again, as outlined in the CA Participant Guide, Version 4.0, the maximum pricing a CA Lender may charge a borrower is Prime plus 6% while full 7(a) lenders are capped at Prime plus 2.75%. This differential is critical when making smaller loans where it is difficult to recoup all the costs of underwriting and processing a loan of this size. Many 7(a) lenders are dissuaded from making smaller loans because the economics of these loans simply do not make sense. Again, giving national CDFI 7(a) lenders the ability to price their loans more cost effectively as CA Lenders would let them make these badly needed smaller sized loans in a way that is more finacially sustainable.

On virtually all counts, it would seem to be in the best interest of the CA Pilot Program to make national CDFI 7(a) Lenders eligible to participate in this Program if the goal is to truly enhance its effectiveness and reach its target audience. This recommendation / approach ensures careful alignment of mission by limiting expanded CA eligibiity to organizations that share the purpose of this program, have the financial capacity / capability to deliver the SBA-guaranteed 7(a) product, and a demonstrated track record of reaching borrowers excluded from conventional credit option. Such a change would also level the playing field by giving national CDFI 7(a) lenders the flexibility to more efficiently underwrite, process and price smaller dollar loans. CRF's approach has been to identify and address credit gaps rather than to compete with existing CA Lenders. Should we, and other national CDFI lenders, obtain the ability to offer the CA product, we would use it to help the SBA address and close the credit gaps in this vital Pilot Program.

CONCLUSION

In closing, we wish to reiterate our support for the SBA's efforts to refine and improve the effectiveness of the CA Pilot Program. Although the country is more than five years into a recovery, growth remains elusive and anemic particularly in our most vulnerable and distressed communities. If these communities and their residents are to have any prospect of regaining the ground lost in the wake of the financial crisis, it is imperative to harness the skills and expertise of capable lenders that are serving borrowers in these areas. The SBA's changes are an important first step in strengthening this critical channel for expanding access to capital. However, we urge the Agency to carefully consider our proposal to empower mission-focused, national CDFI 7(a) lenders to offer the CA loan product to increase SBA-guaranteed loans to small businesses in markets where conventional credit is not available.

We are grateful for the opportunity to share our views and recommendations as to how the CA Pilot Program may be enhanced. Please do not hesitate to contact me with any questions regarding comments included in this letter.

Sincerely,

Frank Altman
President and CEO