SSBCI State Small Business Credit Initiative



Best Practices from Participating States: Partnering with Community Development Financial Institutions (CDFIs)

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This SSBCI Best Practices document resulted from constructive discussions with SSBCI state managers in California, Georgia, Kentucky, Minnesota, Montana and Washington.

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Jeff Stout
Director
State Small Business Credit Initiative

The State Small Business Credit Initiative and Community Development Financial Institutions

The State Small Business Credit Initiative (SSBCI) creates a significant opportunity for state economic development agencies and Community Development Financial Institutions (CDFIs) to increase the availability of small business credit. SSBCI also offers CDFIs the chance to build stronger working relationships with state officials involved in small business development.

SSBCI funds state-level credit support programs including capital access programs (CAPs), loan guarantee programs, loan participation programs, and collateral support programs. Cumulatively, from 2011 to 2013, CDFIs made $229.8 million in loans and investments nationwide as part of the SSBCI program. This represents a total of 3,657 loans in 24 different states or territories. Just under 100 of the 971 federally certified CDFIs participate in one or more SSBCI programs.

Still, the potential for further participation in SSBCI by CDFIs exists. This paper is intended to be a resource for state program managers and CDFIs alike.

How do CDFIs differ from other small business lenders?

CDFIs are mission-driven lenders doing business in low-wealth and other underserved markets. Treasury's CDFI Fund certifies organizations as CDFIs after a review focused on mission and their accountability to their target markets.[1] CDFIs include some banks and credit unions but the majority are structured as non-profit loans funds. CDFIs structured as loan funds do not take deposits and are not regulated. Without the benefit of federal deposit insurance, CDFI loan funds protect investors by maintaining high net asset ratios.[2] CDFI banks and credit unions are regulated in the same manner and by the same regulators as conventional financial institutions.

Why do states include CDFIs in their SSBCI programs?

Experienced and successful small business lenders are desirable SSBCI participants. In many states, such lenders include CDFIs as well as traditional banks and credit unions. State SSBCI programs benefit from the participation of CDFIs due to their ability to:

- **Target underserved communities:** Because of their knowledge of this market niche, and their lending expertise, CDFIs can be effective partners for states to increase access to capital for underserved communities.

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[1] http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=9

[2] Aeris is an information service that provides data, analysis, and advisory services that support investment in CDFIs. As of the fiscal year ended 2013, the median net assets ratio (net assets for financing/total assets) for CDFI loan funds that were Aeris-rated as of 10/29/2014 was 37.5 percent, with the bottom quartile at 23.3 percent and the upper quartile at 54.2 percent. (Source: Aeris Explorer, accessed 10/29/2014.)

- **Serve non-traditional borrowers:** CDFIs often reach different market segments than traditional financial institutions. For example, many CDFIs are experienced lenders to non-profit borrowers such as childcare centers or other community facilities. Some CDFIs are adept at working with micro-entrepreneurs to provide business loans too small to be feasible for conventional banks.

- **Build on their relationships with banks:** Mainstream banks usually have strong business relationships with the CDFIs in their market. Partnering with a CDFI is a low-risk way for banks to meet their obligations under the Community Reinvestment Act (CRA), so loan participations, co-investments, and other collaborations are common between a state's mainstream financial institutions and its CDFIs. CDFIs can build on this pre-existing relationship to serve as a bridge between state officials and the state's banking sector.

- **Help states meet their SSBCI leverage targets:** CDFI loans often fund a portion of a transaction that includes capital from a bank or philanthropic investor. With other sources of capital in a transaction, the SSBCI credit support can be a smaller part of the overall transaction, which increases the private leverage.

- **Boost participation in state programs:** In some markets, where demand for small business loans is weak or banking sector interest in a state's credit support programs is modest, CDFI loan funds have been the most active participants.

Why do CDFIs participate in SSBCI programs?

Job creation and economic development are central to the mission of CDFIs. Any tool that enables a CDFI to expand its small business lending is attractive because it allows the CDFI to:

- **Access additional loan capital:** Using SSBCI support, CDFIs can expand their lending activities and/or loan sizes. A few states structured their programs to allow CDFI participants to retain the SSBCI loan capital after the program sunsets so that funds will continue to revolve into new loans indefinitely. Since CDFIs' supply of capital is usually less than local loan demand, the interests of CDFIs and states in deploying capital to creditworthy borrowers are aligned.

- **Manage portfolio risk:** CDFIs can deploy SSBCI funds to fund a loss reserve, access loan guarantees, offer subordinate financing, or serve as cash collateral for their small business loans. In general, CDFIs have had more limited access to such tools so their availability through SSBCI represents a new resource for CDFIs.

- **Have a seat at the table for economic development planning:** Enlisting CDFIs to further state economic development objectives can lead to mutually beneficial longer-term partnerships and new opportunities.

- **Expand activities to a statewide market:** With increased access to credit support for their loans, some CDFIs may be able to expand their geographic reach.

How do CDFIs and States partner?

The SSBCI program accommodates a variety of models for state-CDFI engagements such as:

- **CDFIs as lenders that receive credit support:** In most states, CDFIs – including CDFI loan funds – may enroll transactions in the state's lending programs just like traditional banks. Across the nation, CDFIs are participating in loan guarantee, loan participation, collateral support and capital access programs.

- **CDFIs as contractors administering aspects of state programs:** Several states contracted with one or more CDFIs to administer a SSBCI-funded program. Other states have engaged CDFIs to assist with marketing or other specific activities.

- **CDFIs as borrowers:** A third possibility permitted by SSBCI Guidelines is that non-depository CDFIs are eligible borrowers under the program. This provision allows a financial institution to lend to a CDFI with SSBCI support.

A few successful case studies illustrating CDFIs as lenders and contractors are described below.

CDFIs as lenders that receive credit support

Kentucky's Collateral Support Program (CSP)

Mountain Association for Community Economic Development (MACED) is a Kentucky CDFI seeking to transform the lives of people and places in need in Central Appalachia through sustainable development. MACED focuses its resources on two key sectors in the region: energy and forestry.

Kentucky's CSP program was an excellent fit with MACED's existing initiative to promote "Energy Efficient Enterprises." Energy deals are difficult to collateralize so Kentucky's Collateral Support Program has allowed MACED to make energy efficiency loans to businesses that could not otherwise access financing for this purpose. In one deal, MACED made a loan to a grocery store in Perry County to upgrade its lighting and refrigeration systems. The profit margin on the grocery business is very thin, so cutting back on a store's use of energy can have a greater impact on profitability than increasing sales. Kentucky's CSP provides a pledged asset (cash collateral account) of up to twenty percent of the loan for up to a ten-year period to an enrolled lender such as MACED.

California's Capital Access Program (CAP)

California state officials directed SSBCI funding to its pre-existing California Capital Access Program (CalCAP). Capital Access Programs pool contributions from the state, the lender and the borrower into a loss reserve account. Each lender maintains its own CAP reserve account. If a loan defaults, the lender's loss reserve account covers losses until the reserve fund is exhausted.

Opportunity Fund is the largest microfinance organization in California and an enthusiastic participant in CalCAP. The median size loan from Opportunity Fund is $6,000. Prior to the infusion of SSBCI resources into CalCAP, Opportunity Fund was enrolling about 50 loans into CalCAP per year. Now, this CDFI enrolls virtually every loan they make into CalCAP and volume has risen to approximately100 loans per month. As of the end of 2013, Opportunity Fund enrolled over 2000 loans in the program, the largest number for any lender in any CAP nationwide. The combination of very high volume and the small size of any individual loan have made the CalCAP program an ideal tool. CalCAP enabled Opportunity Fund to expand its lending and open new branches in San Jose and Los Angeles.

Accion of San Diego also makes extensive use of the CalCAP program. Like Opportunity Fund, Accion of San Diego primarily lends to microentrepreneurs. Accion of San Diego sometimes makes slightly larger loans which has led them to participate in California's Loan Guarantee Program (CSBLP) in addition to CalCAP. By the end of 2013, Accion of San Diego had enrolled 138 loans in CalCAP and 60 loans in CSBLP.

Alabama's Loan Guaranty Program

Alabama's Loan Guaranty Program attracted the attention of United Bank, a CDFI bank serving south Alabama and northwest Florida. The Alabama program provides a 50 percent guarantee on term loans or lines of credit. By the end of 2013, United Bank had enrolled 40 loans in Alabama's program, more than any other lender in the state.

United Bank uses various government guarantee programs to support small business lending in their market. The bank is a Small Business Administration Express Lender and also uses programs sponsored by the US Department of Agriculture. While the Alabama Loan Guarantee Program guarantees a smaller portion of each loan than other federal programs, United Bank finds the state program to be more flexible and Alabama state officials can often approve a loan more quickly than their federal counterparts. United Bank's leadership treats the program as "another tool in the tool box" to serve its small business customers.

CDFIs as contractors administering aspects of state programs

Georgia, Minnesota, Montana, Pennsylvania and Washington state officials contracted with CDFIs to serve as program administrators, originators, servicers and even underwriters.

The agreements between each of these states and the CDFIs include a provision that the CDFI will retain the SSBCI loan capital at the conclusion of the SSBCI program in 2017. Retaining the SSBCI capital as unrestricted capital on the balance sheet is extraordinarily valuable to a non-depository CDFI as it enables the CDFI to take on additional debt, which increases its lending capacity and volume. The unrestricted net assets also create the opportunity for SSBCI funds to revolve indefinitely, further stimulating lending, providing more capital for businesses, and increasing SSBCI's impact in low- and moderate-income communities.

Washington's Craft3 Fund

Washington contracted with one CDFI, Craft3, to administer a direct loan program. The Craft3 Capital Corp Fund received $9.2 million from the state's overall SSBCI allocation of $19.7 million. Craft3 injected $2.2 million of its own capital and loaned the fund an additional $10.0 million. With this funding in a subordinate position, Wells Fargo loaned $31.5 million to the Craft3 Capital Corp Fund, creating private leverage of 4.75:1 even before a loan is made.

The Craft3 Capital Corp Fund makes loans from $250,000 to $5 million. Most of these loans are direct loans to businesses, although Craft3 Capital Corp Fund will also purchase participations in bank loans. The average term is between 5 to 7 years, with interest rates from 5 to 9 percent and fees charged between 1 and 2 percent.

Under Washington's program, Craft3 handles all underwriting responsibilities while coordinating closely with the state Department of Commerce on program compliance issues. The state and Craft 3 hold bi-monthly calls to share information and coordinate.

The relationship forged through the SSBCI program has led to other partnerships between Craft3 and the State of Washington. In November 2013, the state established a Clean Energy Revolving Loan Fund of $11.6 million that Craft3 will administer. The focus of this Fund is to finance residential and commercial building energy efficiency work and renewable energy technology installations.

Minnesota's Emerging Entrepreneurs Fund

Minnesota's Emerging Entrepreneurs Fund (EEF) attracted strong participation from the state's CDFI community.[3] The program provides financing for small and micro-businesses that are starting up or expanding, placing special emphasis on underserved communities. State officials focused on micro-lending due to market demand and the strong capacity of microfinance organizations, including CDFIs, in the state.

[3] As of 2013 year end, the following CDFIs had all participated in the Emerging Entrepreneurs Fund: African Development Center, Initiative Foundation, Latino Economic Development Center, Metropolitan Consortium of CDCs, Midwest Minnesota Community Development Corporation, Neighborhood Development Corporation, Northeast Entrepreneur Fund, Northland Foundation, St. Paul Coalition for Community Development (SPARC), and Women Venture

The Emerging Entrepreneurs Fund was modeled on a predecessor state program. Out of a total of $15.4 million of SSBCI funding that Minnesota received, the state dedicated $6 million to the Emerging Entrepreneur Fund. Under the program, the maximum loan size is $150,000 and each SSBCI dollar must be matched with private funds on at least a 1:1 basis. Loans under the EEF are limited to businesses with less than 50 employees. The EEF targets minority- and women-owned businesses and those located in economically distressed areas.

The state also used SSBCI funds to fund a Capital Access Program utilized by two CDFIs in particular, Metropolitan Consortium of Community Developers and Northland Foundation. These CDFI Loan Funds also accessed Minnesota's Loan Guarantee Program on several occasions. By the end of 2013, CDFIs accounted for 71 percent of all private financing supported by SSBCI funds in Minnesota.

Georgia's Funding For CDFIs Program

Georgia's Funding for CDFIs program was allocated $20 million in SSBCI funds out of a total of $47.8 million for the state. By December 2013, most of the $20 million had been deployed .

The Funding for CDFIs program did not exist prior to the SSBCI program. During the recession, numerous Georgia community banks failed, making the remaining banks extremely cautious about expanding their small business lending. In response, Georgia CDFIs helped develop the Funding for CDFIs program with state officials. The program offers a companion loan to a small business in which a bank provides 50 percent of the capital, and the CDFI, with SSBCI funding, provides the other 50 percent.

Under the program, five[4] participating CDFIs serve as contracting entities. CDFIs market the SSBCI program, recruit potential bank participants, identify potential borrowers, and underwrite and service loans. When SSBCI loan principal and interest are paid, the CDFIs retain the funds to re-lend into new SSBCI projects.

CDFIs are encouraged to offer lower interest rates on small business loans which are typically in the $100,000-$250,000 range. The program aims to provide loans to qualified small businesses to create job opportunities in low-to-moderate income, minority, and other underserved communities throughout Georgia.

Montana's SSBCI Program

Montana dedicated its SSBCI allocation of $12.8 million to a loan participation program. The state's priority was to achieve geographic coverage, particularly in underserved rural markets, and to expedite delivery of the credit support. Montana contracted with 3

[4] Access to Capital For Entrepreneurs, Inc. (ACE), Albany Community Together Inc. (ACT!), Small Business Assistance Corporation, Southwest Georgia United and Georgia Cities Foundation.

CDFIs[5] and 6 revolving loan funds[6] (RLFs) in implementing the program. State officials concluded that these organizations brought the necessary relationships and experience with small businesses and lenders. The three CDFIs were responsible for lending over 50 percent of the state's allocation. Montana's has deployed all of its SSBCI allocation..

Under Montana's program, the participating CDFIs and RLFs identify loan participation opportunities following credit standards mandated by the Montana Board of Investments. Qualified lenders are usually community banks but CDFIs are also eligible lenders. The nine CDFIs and RLFs prepare loan applications, and close and service loans. The Montana Board of Investments underwrites the loans, which average about $500,000 with terms of 15-20 years. Interest rates are in the 5-6 percent range. SSBCI funding was available on a "first-come, first-served" basis which created an incentive for the nonprofit partners to identify and process potential deals quickly.

A strong working relationship between state officials and Montana CDFIs pre-dated the arrival of SSBCI resources. This enabled the state to move quickly to identify participants and implement the program. CDFIs and RLFs retain the loan capital after it is repaid, allowing it to revolve indefinitely in the state to support small business lending.

Lessons Learned Thus Far

CDFI and state officials' understanding of one another varies from state to state.

Some states have a long history of working with CDFIs. Beginning in the 1990s, Pennsylvania directly supported the growth of the state's CDFIs through a dedicated program.[7] In Pennsylvania, it was natural for the state's SSBCI strategy to include a significant role for CDFIs.

When community banks and other traditional lenders are strong participants in state SSBCI programs, the lack of an existing working relationship made little difference to the success of the state's programs. In other states, failing to engage CDFIs represented a lost opportunity for both parties as well as for small business borrowers.

Some CDFIs overlook the importance of reaching out to state officials. While most CDFIs work closely with the federal level of government, particularly the CDFI Fund, some have devoted minimal attention to relationships at the state level.

In most states, the CDFI sector is small compared to community banks.

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[5] Butte Local Development Corporation , Great Falls Development Authority and Montana Community Development Corporation

[6] Revolving Loan Funds (RLFs) are similar to community development loan funds, the most prevalent form of certified CDFIs. These Montana RLFs may have decided not to pursue federal CDFI certification because they determined this credential was of limited value or they may not have met one or more of the eligibility criteria. For purposes of the Montana SSBCI program, the RLFs effectively functioned as CDFIs.

[7] For more information see http://www.newpa.com/find-and-apply-for-funding/funding-and-program-finder/pennsylvania-community-development-bank-loan-program-pcd-bank

As of the September 30, 2014 there were 917[8] certified CDFIs nationwide; the number of community banks (which includes CDFI banks) was over eight times[9] that number. More CDFIs focus on housing finance than on small business lending, reducing the pool of potential CDFI participants even further. In some states, there are no or very few CDFI small business lenders. See Appendix I for resources to locate CDFIs operating in a particular state.

<u>States' target business customers for their SSBCI programs which may not match the target market of local CDFIs.</u>

Some states explicitly targeted "underserved" customers based unemployment and poverty rates. Other states target much broader categories such as "rural" or "formerly banked." Sometimes this motivated CDFIs to expand their target markets. In other instances, there was a mismatch between a CDFI's choice of customer and a state's broader definition of borrowers deserving of credit support.

<u>CDFI Loan Funds represent a particular challenge to state officials.</u>

CDFIs structured as non-profit loan funds are unlike conventional banks in their financial structure, risk mitigation measures and customer targets. State officials noted that banks and credit unions report standard data; ratings may also be available through regulators. While the CDFI loan fund sector is developing a similar capacity through Aeris, the majority of CDFIs are not Aeris-rated, and complete information about rated CDFIs is only available by subscription.

The availability of SSBCI resources prompted some states to open up their credit support programs to CDFIs for the first time. For example, Minnesota did not allow loan funds to enroll loans in its CAP before SSBCI but changed its eligibility criteria to welcome loans enrolled by CDFIs when SSBCI funds became available.

Conclusion

Successful relationships between CDFIs and states in the SSBCI program demonstrate the mutual interests in rapidly deploying funds to underserved small businesses. Unfortunately, some states and CDFIs have overlooked these opportunities so far.

Treasury allows all certified CDFIs to participate in states' SSBCI programs without any modification to a state's original application. States still have time to enroll loans originated by CDFIs and to build relationships with these specialized lenders before the SSBCI program ends. States and CDFIs should continue to explore how to work together in meeting their shared goals of expanding access to credit for underserved communities.

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[8] http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=9
[9] https://www.fdic.gov/regulations/resources/cbi/report/CBSI-ExecSumm.pdf

Appendix I Resources for more information about CDFIs

1. List of certified CDFIs from CDFI Fund:
   http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=9

   Download an excel spreadsheet of CDFIs currently certified by the US Treasury Department's CDFI Fund. Sortable by state. Includes contact information

2. Aeris CDFI locator and fact sheets

   http://www.aerisinsight.com/selector

   Selector tool allows sorting by state and whether the CDFI engages in small business lending. Limited to CDFI loan funds reporting data to Aeris.

3. OFN CDFI locator and fact sheets

   http://ofn.org/cdfi-locator

   Locator tool allows sorting by state and whether the CDFi engages in small business lending. Limited to OFN member organizations.

Appendix II Resources for more information about state SSBCI programs

1. State programs

   http://www.treasury.gov/resource-center/sb-programs/Pages/state-programs.aspx

2. Policy guidance

   http://www.treasury.gov/resource-center/sb-programs/Pages/summary-of-where-to-find-program-rules-for-the-ssbci.aspx

Appendix III: Top 15 CDFIs by Amount Loaned and by Number of Loans

Top 15 Largest SSBCI CDFIs, by Dollar Amount Loaned
(Cumulative through 2013)

Rank	CDFI	Number of Loans	Amount Loaned	Average Amount Loaned
1	Access to Capital for Entrepreneurs (GA)	15	$28,132,635	$1,875,509
2	Opportunity Fund (CA)	2470	$23,591,861	$9,551
3	Craft3 Capital Corporation (WA)	14	$19,399,900	$1,385,707
4	Albany Community Together, Inc. (GA)	10	$15,655,924	$1,565,592
5	Small Business Assistance Corporation (GA)	14	$11,677,933	$834,138
6	One PacificCoast Bank (CA, OR)	14	$9,970,470	$712,176
7	Southwest Georgia United Empowerment Zone, Inc. (GA)	2	$8,470,000	$4,235,000
8	PriorityOne Bank (MS)	11	$8,395,200	$763,200
9	Natural Capital Investment Fund (WV)	10	$8,342,500	$834,250
10	Atlanta Micro Fund (GA)	7	$7,410,598	$1,058,657
11	The Progress Fund (PA)	16	$6,933,800	$433,363
12	Philadelphia Industrial Development Corporation (PA)	2	$6,870,980	$3,435,490
13	Clearinghouse CDFI (CA)	3	$6,238,000	$2,079,333
14	Renaissance Economic Development Corporation (NY)	220	$5,527,000	$25,123
15	United Bank (AL)	41	$5,095,325	$124,276
	TOTAL	2849	$171,712,126	$60,271

Top 15 Largest SSBCI CDFIs, by Number of Loans

(Cumulative through 2013)

Rank	CDFI	Number of Loans	Amount Loaned	Average Amount Loaned
1	Opportunity Fund (CA)	2470	$23,591,861	$9,551
2	Renaissance Economic Development Corporation (NY)	220	$5,527,000	$25,123
3	Acción San Diego (CA)	200	$3,183,151	$15,916
4	TMC Development Working Solutions (CA)	88	$1,352,632	$15,371
5	Fresno Community Development Financial Institution (CA)	66	$1,585,555	$24,024
6	BOC Capital Corporation (NY)	55	$1,371,124	$24,930
7	United Bank (AL)	41	$5,095,325	$124,276
8	California Coastal RDC (CA)	30	$1,029,000	$34,300
9	Northland Foundation (MN)	27	$4,222,293	$156,381
10	Metropolitan Consortium of Community Developers (MN)	25	$1,641,840	$65,674
11	Forge (AR)	23	$256,000	$11,130
12	Opening Doors, Inc. (CA)	21	$231,393	$11,019
13	Arcata Economic Development Corporation (CA)	20	$1,290,618	$64,531
14	Economic Opportunities Fund of the Women's Opportunities Resource Center (PA)	17	$136,450	$8,026
15	The Progress Fund (PA)	16	$6,933,800	$433,363
	TOTAL	3319	$57,448,043	$17,309