Public Policy Analysis & Insights

Critical capital for small businesses: Recommendations for expanding access to credit through Community Development Financial Institutions (CDFIs)

Executive summary

CDFIs have often been lenders of first resort to small and minority-owned businesses in underserved, vulnerable, and low-to-moderate income (LMI) communities. Expanding the resources available to CDFIs and helping raise awareness for their products and services can be a channel for increasing greater wealth and economic opportunity.

Larger financial institutions can develop strong working relationships with CDFIs, whose mission-driven purpose gives them a unique opportunity to have an impact on market segments that—owing to regulatory and risk thresholds—may not be feasible for large banks. Beyond access to credit, CDFIs offer mentoring, training and technical assistance to businesses. The value of CDFIs was evident during the pandemic, as they were able to effectively channel much-needed government pandemic funding to small businesses. Heightened attention is now being directed to these lenders with the establishment of a bipartisan Community Development Finance Caucus and the Economic Opportunity Coalition (EOC).

As the financial services industry addresses long-standing gaps in access to credit and strives for economic inclusion, traditional banks continue to deepen their existing CDFI partnerships. These partnerships are important given the uneven economic effects of the COVID-19 pandemic and the associated shutdowns that continue to disrupt many parts of the economy and communities. CDFIs need continued support to serve as critical sources of additional capital. The following 10 recommendations are presented for consideration and as opportunities for advocacy:

1. **Increase awareness of CDFI products and services.** Continue to seek out mutually beneficial partnerships that can enable CDFIs to reach a large enough scale to reduce costs to their borrowers. Partner on marketing and educational events, and even on transaction and digital platform technology, to help expand CDFIs' reach in the communities they serve.
2. **Formalize traditional bank-CDFI referral processes.** Develop a bank-to-CDFI referral channel with strong processes that are consistent with fair lending practices. At traditional banks, establish points of contact who understand the needs of small businesses and foster a strong bank-CDFI connection that can enable borrowers to maintain their bank relationships while having access to CDFI products that may not be available from traditional banks.

CDFIs

In 1994, the U.S. Treasury Department established the Community Development Financial Institutions (CDFI) Fund, a major source of short- and long-term funding for certified CDFIs. Its programs:

- Fund community revitalization efforts among more than 1,300 mission-driven lending institutions
- Support low- and moderate-income communities through assistance and investment of federal dollars
- Leverage private sector capital and incentivize bank and institutional investment

CDFI Comparative Advantage

- Focused on the small business and minority-owned lending market
- Competency in technical assistance and outreach to small and nascent businesses
- Higher credit risk tolerance
- Localized decision-making
- Flexible financing to prioritize needs of impacted communities
- Deep community knowledge that informs their investments
- Mission-driven vehicles that facilitate impact investors
- May be more efficient than large banks in addressing market segments

CDFI Types

- Community Development Banks
- Community Development Credit Unions
- Loan Funds
- Venture Capital Funds

Examples (Client Focus)

- Minority-owned
- Veteran-owned
- Women-owned

3. **Engage in continued federal- and industry-level dialogue.** See to it that industry participants are prepared to articulate investment opportunities and recommend improvements to existing regulatory and legislative frameworks in order to help better align business models with client interests while preventing disparate impact or treatment, especially among the most vulnerable and at-risk populations.
4. **Make the Community Advantage (CA) Loan Program permanent.** Make the CA loan program permanent so that it remains dedicated to providing technical assistance to small businesses in underserved markets. Its permanence can make more CDFIs willing to invest the time and resources to become CA lenders. Reexamine underwriting requirements, lender eligibility, loan limits and guarantees to help increase funding available through CDFI lenders.
5. **Expand the SBA Microloan program.** Review the terms of the SBA Microloan program and consider increasing the number of eligible lenders. Make efforts to automate and digitize the SBA loan technology platforms in order to shorten loan processing times and allow businesses to receive credit faster and more seamlessly.
6. **Incentivize innovative public-private partnerships.** Deepen mutually beneficial public-private partnerships among government agencies, foundations, financial institutions, CDFIs, advocacy groups and even equity investors. Innovation around investment models can be transformative for directing capital to CDFIs.
7. **Address CDFI loan loss reserves.** Explore the use of philanthropic grants as loan loss reserves or establish a loan loss pool backed by the Department of the Treasury. Approaches like these can allow CDFIs to expand their loan products with more flexible and potentially higher risk underwriting criteria.
8. **Increase funding and streamline CDFI certification.** Support efforts to have the Department of the Treasury increase the funding for CDFI programs. In addition, streamline the CDFI certification process.
9. **Increase liquidity and capitalization through federal programs.** Support government-backed guarantee programs, equity or subordinate funding, and multiyear grants from the CDFI Fund that can provide long-term flexibility and low-cost capital to CDFIs.
10. **Review requirements under the CDFI Bond Guarantee Program.** Increase the accessibility of the bond program to smaller-sized certified CDFIs by reviewing eligibility criteria and both the minimum guarantee amount and end-loan underwriting parameters.

Introduction

The impact of the COVID-19 pandemic on small and nascent businesses continues, and in some cases its negative effects have become sustained.[1] New business opportunities have exploded in areas of emerging technology and innovation, logistics and e-commerce. Simultaneously, labor-force patterns have changed and certain types of jobs across industries, sectors and communities have shifted. The ongoing inflationary pressure, the geopolitical economic shocks and the Federal Reserve's response continue to create uncertainty and hinder decision-making. Millions of small businesses have adapted their business models in the face of supply chain disruptions and rising labor costs.[2] Shifts in consumer behavior and spending have resulted in small businesses being challenged by falling earnings.[3] Businesses that received Paycheck Protection Program (PPP) loans had the potential for loan forgiveness, while others that secured more traditional debt financing continue to meet their repayment schedules. Overleveraged balance sheets and weak forecasts for revenue and profit streams are impairing the ability of small businesses to gain access to affordable credit (SBCS 2021).[4] Small business optimism has dropped every month in 2022 amid rising concern over unemployment, inflation and the recent downward revision to U.S. economic growth.[5]

Small businesses top concerns for year ahead

The Bank of America 2022 Small Business Owner Report finds a Y-o-Y drop in business owners' confidence in the national and local economy. Of small business owners, 80% say inflation will have an impact on their bottom line into 2Q2023.

[1] Approximately 70% of survey respondents said there was a large-to-moderate negative effect on their small business. Data collected January 10–16, 2022. U.S. Census Bureau, Small Business Pulse Survey, accessed February 23, 2022.
[2] U.S. Census Bureau, Small Business Pulse Survey, accessed February 23, 2022.
[3] See the U.S. Census Bureau, Small Business Pulse Survey, for additional statistics.
[4] The survey is based on employer firms.
[5] The NFIB Research Center latest March 2022 survey indicates that small businesses see inflation as the major problem and are pessimistic about future business conditions.

Short-term federal financing and financial aid programs have been expiring throughout 2022. Borrowing costs will rise as a result of the Federal Reserve's decision to raise interest rates. New COVID variants continue to affect the pace of economic recovery. Small businesses, which are integral to their local economies, will continue to struggle without further assistance. Moreover, they remain critical incubators for ideas and product improvements, and as job creators within their communities (CRS 2022). As such, small business access to affordable credit should remain a strategic priority for any public-private partnership that is aimed at an inclusive economic recovery.

PPP applications and outcomes

Small banks were the most common source for PPP loans among employer firms, and the source from which applicants were most successful in obtaining all the PPP funding they sought.

PPP applications and outcomes, by source

	Share of PPP applicants that applied for PPP funding at source.[A] N=7,696	Share of PPP applicants that had an existing relationship with the lender at which they applied, by source		Share of PPP applicants that received all of the PPP funding they sought, by source	
Small bank	48%	83%	N=3,598	78%	N=3,621
Large bank[B]	43%	95%	N=3,348	70%	N=3,389
Online lender[C]	9%	33%	N=624	47%	N=671
Credit union	5%	80%	N=387	63%	N=391
Finance company[D]	3%	28%	N=213	41%	N=225
CDFI[E]	2%	26%	N=164	44%	N=178

Source: See 2021-sbcs-employer-firms-report (fedsmallbusiness.org).

[A] Respondents could select multiple options; respondents may have submitted more than one application.

[B] Respondents were provided a list of large banks (those with at least $10 billion in total deposits) operating in their state.

[C] "Online lenders," also called fintech lenders, are nonbanks that lend online. Examples include: Lending Club, OnDeck, CAN Capital, Paypal Working Capital, Kabbage, etc.

[D] "Finance company" includes nonbank lenders such as mortgage companies, equipment dealers, insurance companies, auto finance companies, etc.

[E] Community development financial institutions (CDFIs) are financial institutions that provide credit and financial services to underserved markets and populations. CDFIs are certified by the CDFI Fund at the U.S. Department of the Treasury.

For small businesses operating in lower-income and minority communities, the effect of the pandemic has been disproportionately severe. Using the Current Population Survey and SBA administrative data, Fairlie (2020) revealed that the number of working business owners fell 22% — from 15 million in February 2020 to 11.7 million just two months later in April 2020. Of those, Black/African Americans experienced the largest losses, with a 41% drop in the number of active business owners, followed by Hispanic-Latino-owned businesses with a 32% drop. Female business ownership declined by 25%. The same study also reported higher revenue losses for female, Black/African American, Hispanic-Latino and Asian businesses with a concentration in industries such as personal services. Access to credit had a disproportionate impact on those surveyed, with 30% of all Hispanic-Latino and Black/African Americans surveyed reporting credit availability was the single most important challenge for them early in the pandemic. In the Bank of America 2022 Small Business Owner Report, 88% of businesses indicated that inflation was currently having a negative impact on their businesses. As interest rates rise, high-risk borrowers will find it difficult to access affordable credit. The Fed (2021) small business credit survey also found that minority-owned and small business borrowers with medium and high credit risk were more likely to use high-priced fintech loan products for financing.[6] Fewer capital sources and formal banking options have created opportunities for subprime and predatory lenders in these minority communities (Wolff and Ratcliffe, 2008). According to the Fed (2021) survey, minority-owned small businesses, more than white-owned ones, relied on personal savings and took on additional debt to avoid shuttering permanently.

[6] See Fed (2021) "Small Business Credit Survey: 2021 report on firms owned by people of color," Federal Reserve Banks, April 2021.

CDFI heterogeneity

Four primary types of CDFIs emerged from the 1990s CDFI industry consolidation: credit unions, banks, loan funds and venture capital funds. The Annual Certification Report (2022) indicated that as of July 2022 there are 1,372 certified CDFIs comprising loan funds (53%), credit unions (25%), banks or thrifts (13%), depository institution holding companies (8%) and venture capital funds (1%).

CDFI products vary by region, lending amounts and type of investment needed. Their comparative advantage is in the provision of technical assistance, financial literacy, business plan development and business planning assistance.

CDFIs — whether mission-driven or profit-oriented — share a common goal of catalyzing investment and economic opportunity within the communities they serve.

CDFIs have traditionally been lenders of first resort to many minority- and women-owned small businesses, and to the underserved within their communities. Located predominantly in low-income areas, CDFIs have a mission of creating economic opportunity. As community-based institutions, they provide banking services and work with families to finance their first homes. As business lenders, they provide loans/capital, technical assistance and development services to grow resilient small businesses. To both households and businesses, CDFIs may provide unique financial products and technical assistance to help them graduate into the economic mainstream.

The positive impact of CDFIs on their communities and their ability to act as intermediaries was evident at the height of the pandemic. Mensah (2021) and Fed (2021), analyzing post-PPP data, found that structural barriers, legal gaps for minority-owned and community businesses, and different funding levels available to minority and community borrowers were some of the major constraints facing CDFIs. Despite these constraints, CDFIs provided extensive financial relief through access to funding under the PPP and through SBA funding programs, including the Economic Injury Disaster Loans (EIDL), which provided up to $2 million to cover temporary lost revenue; Express Bridge Loans, offering up to $25,000 during the EIDL loan processing; and Debt Relief Programs that covered principal, interest, and fees on SBA 7(a) loans, 504 loans, and microloans for up to six months. In March 2021, the CDFI Fund opened the CDFI Rapid Response Program (CDFI RRP) and provided $1.25 billion to CDFIs affected by the pandemic, as authorized under the Coronavirus Response and Relief Supplemental Appropriations Act of 2021 (P.L. 116-260).

Niched and nimble CDFIs

The pandemic has served to showcase CDFIs as well-placed and niched mission-driven lenders within their communities. As an example, once the PPP funding became available, CDFIs met the liquidity and technical assistance gaps where traditional financial institutions were restricted by their lending limits or did not have capacity to quickly scale — for instance, in rural locations. In many instances, CDFIs used their strong, established partnerships with banks to ensure that small businesses had access not only to working capital but also to the complementary range of products, resources and services available across the two types of financial institutions.

The pandemic also brought many challenges to both CDFI lenders and borrowers. For lenders, it highlighted inefficiencies in the CDFI certification process. For borrowers, as Misera (2020) reports, minority owners found early access to the PPP loans obstructed by a difficult, confusing application process. Recent analysis found that the initially limited PPP activity among CDFIs - in the first round only CDFIs that were pre-approved SBA lenders could make PPP loans - resulted in delays in the processing of pandemic relief funding and grants. Perlmeter (2021) noted that small businesses that banked exclusively with CDFIs were immediately affected. In addition, the CDFIs that were pre-approved may have been slow to originate loans before the first phase PPP funding ran out, and before many applications were approved. Perlmeter (2021) found closure rates due to a lack of funding were higher for small business owners of color than for their white counterparts. Moreover, the application rate through CDFIs among firms of color was over five times higher than rates by white-owned firms, suggesting that the initial exclusion of certain CDFIs from PPP funding may have contributed to the delay as well as slower minority borrower PPP loan uptake rates.

BofA's assistance to CDFIs during the pandemic

In response to increased need for small business support, Bank of America provided more than $250 million in new capital to CDFIs to give them the liquidity needed to make Paycheck Protection Program (PPP) loans to their clients. In addition, the bank provided $10 million in philanthropic grants to help fund CDFI operations. By working with CDFIs, Bank of America was able to extend its reach beyond the PPP loans that it made directly.

At the height of the pandemic, SBCS (2021) stated that Black/African American business owners seeking to borrow reported credit availability as their top expected challenge. The Fed (2021) reported that Black/African American-owned applicant firms were twice as likely as their white-owned counterparts to be denied loans, lines of credit and cash advances — in spite of completing more financing applications than other applicant firms. The Fed (2021) also found that Black/African American-owned applicant firms were five times as likely as white-owned ones to be denied PPP funding, citing as reasons missed deadlines or a lack of awareness of the program. Robb and Morelix (2016), using the Annual Survey of Entrepreneurs, found that Native Hawaiians and Black/African Americans were the groups most likely to avoid financing because they believed their businesses would be rejected by conventional lenders. The SBCS (2021) found that Black/African American owners suffered the most adverse impact, as they tended to have weaker banking relationships, experienced worse outcomes on credit applications and were more reliant on personal funds. Those most affected by scarce 'responsibly priced' capital, Sands (2022) argues, were "… [businesses] owned by minorities, women, and veterans; those located in rural areas; and those, regardless of their ownership demographics, whose median asset size ballooned by more than 500% between 2000 and 2019 … [they were] more successful in accessing capital from CDFIs and minority development institutions than from other sources … ."

BofA investment

In July 2022, Bank of America announced its founding membership in the Economic Opportunity Coalition (EOC). The EOC members have committed to aligning their investments across four focus areas: (i) investing in CDFIs and MDIs; (ii) supporting entrepreneurship and minority-owned businesses; (iii) expanding inclusive and equitable access to credit and other financial services to facilitate financial health; and (iv) making infrastructure investments that create community wealth through preserving and expanding affordable rental and homeownership in underserved neighborhoods.

Bank of America is currently the largest private investor in CDFIs with more than $2 billion in loans, deposits, capital grants and equity investments across its over 250 CDFI partners. By providing capital to CDFIs, the Bank extends its reach beyond its own footprint, serving CDFI clients across multiple states, different industries, various business stages (startups through mature firms) and different minority groups (for instance, women and veterans).

As the industry responds to long-standing inequities and strives for financial inclusion, large banks and the government are finding more innovative ways to build capacity, provide appropriately priced capital, and address programmatic funding hurdles with the hope of deepening the CDFI network.[7] Recent CDFI hearings before both the House and Senate have underscored the importance of the role of CDFIs within their communities and the need for advocacy for them among industry leaders, government agencies and the private sector. Numerous bills have been introduced to fund the recovery of small businesses, especially those in vulnerable communities.[8] Across all proposed or enacted legislation, the two overarching themes are: ensuring access to credit, technical assistance, and startup venture capital; and modernizing oversight as well as legislative and regulatory requirements.

Local access to capital is an essential channel for economic growth, development and the creation of sustainable communities. One of the most promising means of achieving those ends is through support for CDFIs. They complement traditional lenders when they are able to scale efficiently. To lighten CDFIs' load as the recovery continues, large banks can continue to advocate for and champion their work. This paper offers 10 recommendations and opportunities for advocacy designed to drive growth, help CDFIs expand their footprints and deliver on Bank of America's commitment to our communities.

[7] In a March 2022 letter to the Treasury Department, the ABA urgently requested reconsideration of ECIP eligibility. Concerns included: (i) the lack of adequate cure periods and similar options to address noncompliance with program documents, including for the loss of CDFI status following an ECIP investment; (ii) requirement for rigid adherence to the institution's Investment and Lending Plan, with no apparent tolerance for subsequently changed circumstances, including those beyond the institution's control; (iii) lack of appropriate protections in the event the Treasury Department exercises its right to appoint board observers and directors; and (iv) restrictions on transfers of the Treasury Department's interests, and exceptions for circumstances when those restrictions would not apply.

[8] In addition to the temporary extensions of programmatic funding and amendments to the functions of the SBA, Congressional Financial Services and Small Business committees introduced H.R.6745 to establish or modify requirements relating to minority depository institutions, community development financial institutions, and impact banks, and for other purposes; and provided grants under the Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act.

Awareness, outreach and advocacy

Despite the documented positive impact of CDFIs, the wider public is not familiar with these institutions' business models and the products and services they offer to their borrowers. Unlike larger lenders, CDFIs tend to be locally based and do not have resources to engage in promotional campaigns. Even small business owners who have heard of CDFIs may not know how to reach the ones operating in their local communities.

Female entrepreneurs

Bank of America has committed $100 million in capital to connect women small business owners to affordable loans through a partnership with the Tory Burch Foundation. Since the program's launch, more than 4,300 women entrepreneurs have received more than $75 million in loans through CDFIs to help them grow and refine their businesses.

Bank of America continues to deliver on responsible growth in its advocacy and support of CDFIs. Currently, the bank helps CDFIs build a broader awareness of their existence and products as well as collaborating with its CDFI partners to identify and support activities that maximize community impact.

1. Increase awareness of CDFI products and services

CDFIs have shared that one of their biggest challenges is customer acquisition. Small budgets limit CDFIs' ability to connect their products with potential borrowers. They cannot generally dedicate large budgets to the kind of marketing that can drive future business performance.

In addition to providing capital to CDFIs, banks can help supplement CDFI marketing efforts to increase education and awareness. Through their own marketing and education programs, banks can visibly support CDFI programs, products and services, especially in communities where small businesses are not served by traditional banks. Banks may also consider partnering with CDFIs on events and forums to share educational resources with their small business clients.

BofA's CDFI Locator and Access to Capital Directory

As part of its commitment to the communities it serves, Bank of America hosts a portal that allows small business owners to locate a CDFI in their community within the U.S., Puerto Rico and the District of Columbia. The CDFI Locator portal connects small businesses with over 250 CDFIs. The portal provides a short list of CDFIs that may be able to meet the user's financing needs based on the size of the loan requested and user location.

Though not specifically focused on CDFIs, the Access to Capital Directory is part of the bank's overall initiative to provide women-owned, Black/African American- and Hispanic-Latino-owned businesses with resources to help them understand the capital landscape.

Access to technology and payment systems is critical if the industry is to remain relevant. Where CDFIs cannot achieve sufficient scale — for instance on transaction and digital platforms — banks can establish mutually beneficial partnerships to help reduce borrower search and CDFI intermediation costs. Banks can also explore technology partnership opportunities such as loan platforms for centrally managing and automating different stages in the loan servicing cycle (loan application, document verification, automated underwriting).

Recommendation

Continue to seek out mutually beneficial partnerships that can enable CDFIs to reach a large enough scale to reduce costs to their borrowers. Partner on marketing and educational events, and even on transaction and digital platform technology, to help expand CDFIs' reach in the communities they serve.

2. Formalize traditional bank-CDFI referral processes

For small business lending, the borrower-bank-CDFI relationship can be mutually beneficial. The delivery and servicing of the Paycheck Protection Program showcased how CDFIs can leverage their knowledge and community connections within the overall loan delivery process. The pandemic demonstrated that small businesses need to maintain their bank relationships to have access to sophisticated payment solutions. Connecting borrowers to both traditional banks and CDFI partners can not only lower search costs, but also expand the range of products and services. An inclusive partnership can deepen the role of both types of financial institutions within underserved communities and populations. This connection is important because businesses will need to reengage with traditional and mainstream banks as they move through their life cycles. One way to formalize the CDFI-bank relationship is through a single point of contact. More specifically, that point of contact would be situated at a traditional bank and would work toward ensuring that both institutions understand the short-, medium- and long-term needs of the businesses in those LMI and multicultural communities (MCCT). Banks may consider partnering on educational series, delivering access to capital education and supporting startup incubators in those areas.

Referral tracking and CDFI ambassador

In 2022, Bank of America will launch a 'roadmap' for working with CDFIs. That playbook will set out comprehensive education on CDFIs and how to work with them and layout how referral tracking will be accomplished. Anchoring this outreach will be the establishment of a CDFI Ambassador, who will provide committed coverage of small business teammates aligned to CDFIs in every market nationally. These connections can deepen the ecosystem and keep small businesses connected to both institutions as they move through their life cycles.

A second approach could be through a formal locator and referral program that matches small businesses to CDFI programs, products and services. Banks can review their lending processes to allow loan officers to refer potential borrowers who have been declined to appropriate CDFI partners. Bank-to-CDFI referrals of this nature can be process-controlled to be consistent with fair lending practices and focused on connecting borrowers to CDFI products not generally available at traditional banks. Referrals can benefit small businesses that may otherwise be faced with the higher cost of finding an appropriate lender, and may even strengthen the borrower-bank-CDFI relationship. Legal issues associated with referrals — information and data privacy, fair lending — will require regulatory approval (no action letters), and banks may need to seek CFPB guidance.

Recommendation

Develop a bank-to-CDFI referral channel with strong processes that are consistent with fair lending practices. At traditional banks, establish points of contact who understand the needs of small businesses and foster a strong bank-CDFI connection that can enable borrowers to maintain their bank relationships while having access to CDFI products that may not be available from traditional banks.

3. Engage in continued federal- and industry-level dialogue

Federal agencies, taskforce efforts and industry groups can all create discussion forums to address bottlenecks CDFIs face in accessing capital, especially in helping raise investor awareness and aligning public and private investments to address economic disparity. An example of this is the recent announcement by the White House of the establishment of the Economic Opportunity Coalition (EOC). The coalition includes corporations and foundations committed to aligning their investments in communities of color to "… develop and deploy products that solve challenges in getting resources where most needed and drive towards outcomes for meaningful action … the EOC has committed more than $3 billion of investments into CDFIs and MDIs, including $250 million in long-term, low-interest debt and over $70 million in grants to CDFIs and MDIs." The Community Development Finance Caucus is one bipartisan effort to help scale community-based lending. Since 2020, there has been a commitment of more than $200 billion in private-sector equity across Black/African American-led banks and businesses, MDIs and depository CDFIs, as well as debt and grants for CDFIs. The goal of the caucus is to provide a strategic and coordinated approach across the private and public sectors, to promote and advance legislative and regulatory efforts and to track the implementation of commitments.[9] Such collaborative efforts can further the reach of dedicated federally funded programs while allowing market forces to allocate those resources most efficiently.

Advocacy

Through U.S.-based trade associations, Bank of America supports efforts to increase CDFI funding sources. In April 2022, the American Bankers Association urged the House and Senate appropriation leaders to support $1 billion in funds for FY 2023, noting that the CDFI Fund "… would leverage up to 12 times the private capital that could be channeled to local businesses, nonprofits and others to help vulnerable communities."

There is an urgent need to support CDFIs as they formulate climate resilience strategies. CDFIs are well positioned to spearhead and implement community-based green financing. As Leybovich, Schoeman, Brusiloff and Malkin-Weber (2022) comment, "… the communities most vulnerable to the climate emergency are those that CDFIs have been dedicated to supporting for decades." Banks that have joined the Net Zero Banking Alliance are well placed to share best practices as CDFIs begin to understand carbon accounting and initiate talks with their clients about operating in a low-carbon economy.

BofA works with CDFIs to address climate challenges

In addition to being a founding member of the EOC, and as part of our Approach to Zero™, Bank of America is also involved in initiatives to help CDFIs assist their borrowers in the transition to a low-carbon economy and to protect vulnerable communities seeing the greatest impact from climate change. The bank has funded the Resilience Assessment Tool for CDFI lending programs and has provided a grant to Coastal Enterprises Inc. (CEI), a CDFI located in Maine, to develop a tool to help CDFIs assess their borrowers' environmental sustainability and identify opportunities to make their borrowers' businesses more sustainable and regenerative.

Recommendation

See to it that industry participants are prepared to articulate investment opportunities and recommend improvements to existing regulatory and legislative frameworks in order to help better align business models with client interests while preventing disparate impact or treatment, especially among the most vulnerable and at-risk populations.

Credit risk

Credit risk continues to be a barrier to small businesses accessing affordable capital. SBCS (2021) finds that 62% of employer firms reporting financial challenges during the pandemic relied on personal funds, while 55% cut staff hours or had downsized in the prior 12 months. Of the employer firms surveyed, 80% faced a financial challenge that affected the owner's personal finances. While 90% of PPP recipients expected full or partial loan forgiveness, 35% of Black/African American-owned businesses did not seek PPP assistance because they did not expect to qualify.[10] Access to programs that mitigate borrower credit risk can allow CDFIs to continue filling a financing gap in LMI and underserved communities—especially to businesses that lack access to traditional finance. Programs geared to mitigate some risk can help CDFIs expand lending and increase their ability to raise capital. While Bank of America offers alternatives to the federal loan programs, it in principle supports microloans that can be combined with technical assistance as a way of assisting borrowers that may not have access to traditional finance.

[9] See https://www.warner.senate.gov/public/_cache/files/6/d/6de66a5d-7bb5-4f01-851b-47ab36f43d8a/9491790694CE8BEA2909F731B32344EC.cdfc-summary-deck.pdf.
[10] See SBCS (2021).

4. Make the Community Advantage (CA) Loan Program permanent

In 2011, the SBA Community Advantage (CA) loan program was created to "meet the credit, management and technical assistance needs of small businesses in underserved markets." Originally a pilot program set to expire in 2020, the CA loan program is now scheduled to end in September 2024.[11] The CA loan program has proven advantageous for borrowers as well as for eligible CDFI lenders. Unlike the SBA 7(a) program, borrowers in underserved markets benefit from technical assistance provided by the CA loan program. CA lenders, including eligible CDFI lenders, receive an SBA 85% guarantee on loans up to $150,000 and an SBA 75% guarantee on loans between $150,000 and $250,000. This guarantee helps mitigate lender risk in extending small business loans. The guarantee is similar to the benefit that banks receive by participating in the SBA 7(a) loan program. Unlike the SBA 7(a) loan guarantee provided to banks making small business loans, the CA loan program does not provide any guarantee for loans above $350,000.[12] This limit, if lifted, would allow CDFIs the guarantee and loan size limits that the SBA 7(a) program offers mainstream banking institutions. In this way, borrowers can benefit from the favorable loan terms under the SBA program while receiving technical assistance to ensure resilience. More specifically, the CA loan program should be made permanent and maximum loan sizes made under the program should be increased.[13]

SBA 7(a) loan program	
Repayment terms	• Most 7(a) term loans are repaid with monthly payments of principal and interest • Payments stay the same for fixed-rate loans because the interest rate is constant • For variable rate loans, the lender can require a different payment amount when the interest rate changes
Interest rates	3 Acceptable Base Rates: Prime rate published in a daily national newspaper London Interbank One Month Prime plus 3% SBA Peg Rate Maximum Allowable Spread: • Maturity < 7 years = 2.25% • Maturity > 7 years = 2.75%
Percent of Guarantee	SBA can guarantee up to: 85% of a loan up to $150,000 75% of a loan greater than $150,000

Source: U.S. Small Business Administration.

The SBA can consider expanding the list of approved CDFIs. As the process to become a CA lender is currently lengthy, there are currently too few CA loan program-eligible CDFI lenders across the U.S. to meet borrower demand. Making the program permanent could result in more CDFIs willing to become CA lenders. A review of the lender eligibility criteria to accelerate CA certification can provide CDFIs greater access to capital to engage in a wider range of lending activities.

Recommendation

Make the CA loan program permanent so that it remains dedicated to providing technical assistance to small businesses in underserved markets. Its permanence can make more CDFIs willing to invest the time and resources to become CA lenders. Reexamine underwriting requirements, lender eligibility, loan limits and guarantees to help increase funding available through CDFI lenders.

[11] In response to the pandemic, the SBA announced on July 15, 2020, that it was creating a temporary Community Advantage (CA) loan program to assist small businesses in underserved markets that have experienced economic hardship due to the COVID-19 pandemic. The CA temporarily relaxed the loan terms and provided some technical/management assistance to borrowers. All CA loans had to be approved by September 27, 2020, be fully disbursed by October 1, 2020, and have at least a five-year loan term. Lenders are authorized to charge an "extraordinary servicing fee" of up to $2,500 or 9% of the loan amount, whichever is greater, to provide at least 15 hours of technical and management assistance to the borrower. Again, all other CA loan terms and conditions apply.

[12] See Pilot loan programs (sba.gov), accessed on July 13, 2022.

[13] As loan repayment terms, current debt and credit scores were negotiable markers in the loan application, detailed business plans and repayment schedules would enable small business renewal.

5. Expand the SBA Microloan program

The SBA Microloan program provides funding to eligible SBA-designated lenders (microloan lenders) that specifically target startups along with newly established and growing businesses. Microloan lenders provide guidance for rebuilding or establishing credit to small business owners with low credit scores (FICO 575) and short credit histories. These loans are designated for small businesses — in particular, veteran, women, minority-owned and LMI individual owners, as well as nonprofit childcare centers. Lenders receive direct loans and grant funding to offer marketing, management and technical assistance to microbusinesses. Funds are available through an approved SBA Microloan program intermediary lender. The SBA Microloan program also sponsors knowledge transfer sessions from more experienced to new SBA microloan lenders.

Under the existing program, loans are generally small (under $50,000) and only available in specific geographic areas. CRS (2022) reports in FY2021 that there were 48 designated intermediary lenders across the country, granting $49.5 million in SBA loans to intermediaries, with an average microloan of $16,557 at an interest rate of 6.5%.[14] The challenge is in the program's budget allocation and administrative shortfalls when compared to the performance of the SBA 7(a) program.[15] While critics point out that the SBA Microloan program is "expensive relative to alternative programs, duplicative of the SBA's 7(a) loan guarantee program, and subject to administrative shortfalls," proponents argue for these targeted small dollar loans (CRS, 2021).[16] Advocates say the program reaches those who would not be served by the private sector or the SBA 7(a) program, particularly low-income women and minority businesses with no credit history and/or credit scores lower than most SBA 7(a) applicants.

The microloan program allows CDFIs to deepen existing client relationships, develop new ones and fulfill its societal commitments. Grant funding to CDFIs can help cover the costs of time spent working with potential microloan borrowers. Efforts to enhance the SBA loan technology platforms can allow borrowers to receive credit faster and have a seamless lending experience.

Recommendation

Review the terms of the SBA Microloan program and consider increasing the number of eligible lenders. Make efforts to automate and digitize the SBA loan technology platforms in order to shorten loan processing times and allow businesses to receive credit faster and more seamlessly.

[14] See footnote 12.

[15] Ibid, page 14.

[16] The 2020 CARES Act included the following provisions that expanded the reach of the SBA's Microloan program: P.L. 111-240 (allowing the SBA to temporarily waive the Microloan program's nonfederal share matching requirements, increasing the loan limit for borrowers from $35,000 to $50,000, and increasing the loan limit for intermediaries after their first year of participation in the program from $3.5 million to $5 million); P.L. 115-141 (relaxing restraints on the use of Technical Assistance program funds); P.L. 115-232 (increasing the loan limit for intermediaries after their first year of participation in the program from $5 million to $6 million); and P.L. 116-136 and P.L. 116-260 (providing monthly loan payments). All of these provisions were designed to create jobs by enhancing micro borrowers' access to capital and technical training assistance.

6. Incentivize innovative public-private partnerships

The State Small Business Credit Initiative (SSBCI) Program gives states the funding to incentivize private capital to enter risky small business credit markets.[17] Implemented by the Treasury Department, the Venture Capital Program within the SSBCI provides recipient jurisdictions with programmatic funding to promote access to capital (Treasury, 2021). This program allows states to set up public-private partnerships for equity investing or investment in venture capital funds. Under the current act, applications were closed in March 2022 for municipalities in states that did not submit a complete application for SSBCI capital funding (Treasury, 2021).

One example of a public-private partnership among philanthropists, financial institutions, CDFIs and advocacy groups is the California Rebuilding Fund (CRF). The CRF is geared specifically to revitalizing small businesses in economically disadvantaged and historically underbanked communities in California.[18] The program buys loans from CDFIs, providing the institutions with liquidity and removing their balance sheet constraints. This enables certified CDFI lenders to continue providing targeted technical assistance within their communities without bearing the full cost of credit losses. The CRF is structured so that the CDFI underwrites and transfers 90%–95% of its loans into one of two off-balance-sheet special-purpose vehicles (SPVs): (i) loans backed by a bank guarantee, or (ii) loans subject to first-loss support.

Targeted partnerships

As part of our long-standing commitment to advance racial equality and economic opportunity, Bank of America will invest $50 million in equity by 2025 to support minority depository institutions (MDIs) and CDFI banks. As part of this equity investment, the bank has acquired up to 4.9% of common equity, having made equity investments in 22 MDIs totaling $43 million as of August 2022.

To date, Bank of America has included 10 CDFIs across 10 syndicated corporate term loans for over $65 million in funded asset growth. In July 2022, it announced $40 million in loans to partner with CDFIs that are financing primary health care centers in regions that lack medical resources.

In September 2022, the National Association for Latino Community Asset Builders Executives and the African Alliance of CDFI CEOs received a commitment for a total of $25 million in funding from Bank of America in support of minority-led CDFIs in their networks. Both alliances represent over 130 CDFIs led by people of color in Hispanic-Latino and Black/African American communities.

Removing liabilities from the balance sheet can free up capital, allowing CDFIs to increase lending. The first loss, by the State of California, provides the guarantee to the investors and philanthropists within the CRF. Through its structured risk sharing among major stakeholders, CRF is an example of a hybrid capital structure targeted to potential economic losses and liabilities held on the balance sheet. Other institutions and state government agencies can consider similar programs to incentivize investment from banks and private equity funds. Initial borrower eligibility criteria for CDFIs could be similar to those of the CRF — limited to small businesses with fewer than 50 employees and less than $2.5 million in annual revenue, and subject to the CRF-certified CDFI underwriting guidelines. The CRF example is a new way that private investors can be incentivized to provide capital — and in so doing, provide liquidity to CDFIs.

Several states have created tax credit programs that encourage institutional investors to provide flexible capital to CDFIs. One such program is the California Organized Insurance Network. Another example of a state-led initiative is Washington House Bill HB1015, which would allow the state's Department of Commerce to create and operate a tax credit program to benefit CDFIs. The bill would provide a tax credit up to $1 million with funds directed to emerging or certified CDFIs that provide services or invest expressly in historically underserved communities.[19] The Washington tax credit offers one way of bringing in new sources of capital to CDFIs from private investors who are profit-driven and considering putting money into unfamiliar markets or products. Continued innovation around these types of public-private partnerships and investment models can be a transformative method of directing capital to CDFIs.[20]

Recommendation

Deepen mutually beneficial public-private partnerships among government agencies, foundations, financial institutions, CDFIs, advocacy groups and even equity investors. Innovation around investment models can be transformative for directing capital to CDFIs.

[17] Everett K. Sands, CEO of Lendistry, Written Witness Testimony. "An Unprecedented Investment for Historic Results: How Federal Support for MDIs and CDFIs Have Launched a
[18] See https://www.connect2capital.com/p/californiarebuildingfund/.
[19] See https://app.leg.wa.gov/billsummary?BillNumber=1015&Initiative=false&Year=2021 for details.
[20] Griffith (2022) raises oversight concern by citing the Treasury's Office of Inspector General report "… reckless misuse of funds … and conflicts of interest …" within one venture capital firm participating in the SSBCI.

7. Address CDFI loan loss reserves

Currently, financial institutions primarily lend for loan capital and provide grants to fund CDFI operation expenses and programs. Rarely have philanthropic grants been directed to these reserves. The CDFI Fund provides grants and federal awards to CDFIs that can be directed to their loan loss reserves. The more grant money is provided, the more CDFIs can scale their lending programs. With grant dollars funding loan loss reserves or establishing a loan loss pool backed by the Department of the Treasury, CDFIs can expand their loan products with more flexible and potentially higher risk underwriting criteria.[21]

Recommendation

Explore the use of philanthropic grants as loan loss reserves or establish a loan loss pool backed by the Department of the Treasury. Approaches like these can allow CDFIs to expand their loan products with more flexible and potentially higher risk underwriting criteria.

Lending capacity

During the pandemic, CDFIs demonstrated the ability to effectively mobilize capital and provide technical assistance. The 'grass-roots' level of its impact helped stabilize small businesses within their communities. During House hearings, CDFI executives shared that they were constrained by their lending capacity. To that end, efforts that free up working capital can ensure growth and scaling, in turn leading to greater inclusion of small and minority- and women-owned businesses in the recovery. Bank of America encourages the capitalization and creation of new certified CDFIs to serve more businesses and more communities. As of August 2022, the bank has included 10 CDFIs across 10 syndicated corporate term loans for approximately $65 million in funded asset growth.

8. Increase funding and streamline CDFI certification

The Consolidated Appropriations Act of 2021 contains additional allocation to two programs in the Treasury Department's CDFI Fund. The Treasury Department CDFI Fund covers an array of programmatic funding not specific to the business sector. The 2021 appropriation included a provision of a total of $3 billion in grants to the CDFI Fund through the existing CDFI Rapid Response Program ($1.25 billion) and the Emergency Support and Lending Program ($1.75 billion).[22] Regardless of the program, increasing the funding of CDFIs through these federal programs can amplify their positive impact and catalyze economic opportunities in communities.

Treasury Department CDFI Fund

The CDFI Fund funds eight programs: The Bank Enterprise Award Program, Capital Magnet Fund, the CDFI Bond Guarantee Program, the CDFI Equitable Recovery Program, the CDFI Program, CDFI Rapid Response Program, Native Initiatives, New Markets Tax Credit Program, and the Small Dollar Loan Program.

The CDFI Fund website provides a list of possible funding sources for CDFIs. These resources are managed by government agencies such as USDA, SBA, HHS, HUD, Treasury, Interior and Commerce.

The Department of the Treasury can also streamline their certification application processes to ensure that CDFIs receive timely approval. Current requirements, the application and length of the approval process all make it difficult for lenders to obtain certification.

Recommendation

Support efforts to have the Department of the Treasury increase the funding for CDFI programs. In addition, streamline the CDFI certification process.

[21] See Elam (2022).

[22] The CDFI Rapid Response Program is accessible to depository and non-depository CDFIs to provide grants in response to the pandemic. The Emergency Support and Minority Lending Program will provide grant capital and technical assistance in communities impacted by the pandemic. It is accessible to both depository and nondepository CDFIs as well as minority lending institutions (a new class of CDFIs).

9. Increase liquidity and capitalization through federal programs

The emergency Paycheck Protection Program Loan Facility (PPPLF), created jointly by the U.S. Treasury and the Federal Reserve under the Federal Reserve Bank Act Section 13(3), demonstrated the impact of a government-backed guarantee program on the ability of CDFIs to serve as intermediates. One of the program's provisions provided balance sheet liquidity relief (over $2 billion) to lenders, including CDFIs. Under the PPPLF, the Federal Reserve charged a fee and held the PPP loan as collateral. It also allowed the Federal Reserve to temporarily supply liquidity to SBA-approved PPP lenders to increase lender capacity and confidence in making PPP loans. Nondepository CDFIs (mainly loan funds) that traditionally relied on their warehouse lines had temporary access to lower-cost capital through the PPPLF. More importantly, nondepository institutions had direct access to the Federal Reserve's discount window for the first time (Eggleston, 2021). The facility highlights the work that CDFIs can do within communities by relaxing their liquidity constraints — not only to PPP borrowers but to their existing SBA 7(a) borrowers as well.

The Department of the Treasury's Emergency Capital Investment Program (ECIP) is another federal program that provides funding to CDFIs. The scale of this program gives it the greatest impact relative to other existing federal funding programs. Certified CDFI credit unions can gain access to capital to support their loans, grants and forbearance for small and minority businesses and consumers.[23] The funding provides long-term, low-cost equity and subordinate debt for participating institutions.[24] These institutions will also benefit from a capped low-cost dividend or interest rate, with no dividends or interest payable or accruing during the first 24 months after issuance. The ECIP structure and its multiyear grants can provide long-term flexibility for CDFIs to meet capital needs.

One provision of the ECIP was an allocation to develop data-driven reporting and 'deep impact' metrics that assess pre-investment and post-investment activities (OIG, 2022). These types of measures are missing from the CDFI performance dialogue, and the Department of the Treasury is currently exploring potential metrics using granular CDFI-provided data (Department of the Treasury, 2021). Again, an increase in the number of certified CDFI lenders can extend the lending capacity and reach of these funds. Continued annual appropriations for similar capitalization initiatives through the CDFI Fund and/or other federal funding programs targeted to the underserved would deepen the industry's impact.

Recommendation

Support government-backed guarantee programs, equity or subordinate funding, and multiyear grants from the CDFI Fund that can provide long-term flexibility and low-cost capital to CDFIs.

[23] See Emergency Capital Investment Program as established under the Consolidated Appropriations Act, 2021. Treasury will set aside $2 billion for CDFIs and MDIs with less than $500 million in assets and an additional $2 billion for CDFIs and MDIs with less than $2 billion in assets.
See also James (2022).

[24] More specifically, ECIP sets aside $2 billion for participants with less than $500 million in assets and an additional $2 billion for participants with less than $2 billion in assets. See United States Department of the Treasury (2021).

10. Review minimum requirements under the CDFI Bond Guarantee Program

Created under the Small Business Job Act of 2010, the CDFI Bond Guarantee Program allows certified CDFIs that have received 'qualified issuer status' to issue bonds guaranteed by the federal government, and to use those bond proceeds to extend credit.[25] CDFIs could then borrow capital from qualified issuers for long-term, large-scale community investment, to refinance loans or extend credit to secondary borrowers. The low cost of this capital, the federal government guarantee and the term maturity of up to 30 years make this program extremely valuable to CDFIs. To date, however, fewer than 30 CDFIs have qualified and participated in the program. In part, that is because the underwriting parameters require CDFIs to originate and pledge loans meeting specific Department of the Treasury cash flow and loan-to-value parameters. The minimum $100 million bond size limits the usefulness of the program.[26] A reduction in the minimum guarantee amount from $100 million to $25 million would make the program more accessible to smaller CDFIs. Increased flexibility in end-loan underwriting parameters can make the Bond Guarantee program more usable for smaller CDFIs and CDFIs that originate small business loans. The CDFI Bond Guarantee Program Improvement Act of 2022, H.R. 7733, was introduced by Congressman Cleaver (D-MO) in the House in May 2022.[27]

Senate passage needed

In June 2022, the House considered the CDFI Bond Guarantee Program Improvement Act of 2022, which would reauthorize and improve the bond guarantee program. The bill reduces minimum issuance amount from $100 million to $25 million and revises the amount to be held in a CDFI's relending account.

Recommendation

Increase the accessibility of the bond program to smaller-sized certified CDFIs by reviewing eligibility criteria and both the minimum guarantee amount and end-loan underwriting parameters.

Conclusion

CDFIs play an important role in the financial ecosystem. Their mission-driven purpose that defines them helps address lingering inequities in the financial markets. Their grassroots presence in LMI communities and hands-on due diligence practices mitigate loan losses and foreclosures. Emerging research suggests the pandemic has materially worsened intergenerational equity and wealth gaps for minority small business owners. Transformations in customer experiences, technological innovation, digitalization and automation during the pandemic have shifted the ways in which households, businesses and communities interact with financial institutions. Currently, it is difficult for CDFIs to scale financing and augment their capital base. Within the changing landscape, CDFIs will have difficulty maintaining their current service offerings while at the same time expanding their reach. To continue their positive impact on underserved communities, CDFIs require additional support to address long-term strategic and industry changes. Any meaningful response is complex and dynamic, and requires both legislative action and the active participation of motivated private-sector players.

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[25] See https://www.cdfifund.gov/sites/cdfi/files/documents/cdfi-bond-guarantee-program-fact-sheet-(english)-12march2020.pdf, accessed March 1, 2022.
[26] See CDFI Bond Guarantee Program Improvement Act of 2022.
[27] See footnote 26.

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