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Thank you for holding this hearing entitled: "Small Business in Crisis: the 2020 Paycheck Protection Program and its Future." My name is Dafina Williams, Senior Vice President of Public Policy at Opportunity Finance Network (OFN). I am pleased to be here today to testify about community development financial institutions (CDFIs) role as essential partners in helping the Paycheck Protection Program (PPP) and other federal relief reach underserved businesses.

OFN is a national network of CDFIs mission-driven community development banks, credit unions, loan funds, and venture capital funds investing in opportunities that benefit low-wealth communities across America. As specialized lenders that focus on underbanked communities, CDFIs are uniquely poised to deliver federal relief resources to businesses owned by people of color, very small businesses, and other under-resourced businesses in urban, rural, and Native communities.

For nearly 40 years, CDFIs have provided responsible, affordable capital where it is needed most: CDFI customers are 85 percent low-income, 58 percent people of color, 48 percent women and 26 percent rural.[1] Nationwide, the more than 1,100 CDFIs certified by the US Treasury Department's CDFI Fund manage more than $222 billion. CDFIs are also experienced small business lenders with deep expertise reaching low wealth markets. In fiscal year (FY) 2019, certified CDFIs had more than $24 billion of small business and microloans in their portfolios.[2] With cumulative net charge-off rates of less than 1 percent, CDFIs lend prudently and productively in markets underestimated by mainstream banks.[3]

CDFIs as Financial First Responders

From the first days of the COVID-19 pandemic, CDFIs understood the threat facing their borrowers. As soon as the mandatory business closures and social distancing began, CDFIs reached out to their customers offering whatever accommodations they could to ease the economic disruption: principal and interest payment deferrals, emergency loans, loan modifications, and other emergency responses or new products to help borrowers weather the crisis.

The CDFI industry has been able to quickly respond because of deep experience leaning in during times of crisis. From natural disasters, such as hurricanes Katrina, Sandy, Maria, and Harvey, to the 2008 financial crisis and the aftermath of 9/11, CDFIs have a strong record of stepping in as the financial first responders to support families and communities in their survival and recovery efforts. CDFIs are able to weather times of economic uncertainty through a combination of strong balance sheet management, deep ties with their local communities, and public and private sector partnerships.

Paycheck Protection Program's Limited Reach in Underserved Markets

Earlier this year, CDFIs were eager to become lenders under the federal government's flagship small business relief program, the PPP. Despite a proven track record of reaching the very communities that Congress prioritized though the Coronavirus Aid, Relief, and Economic Security

[1] Opportunity Finance Network, "Impact Performance", https://ofn.org/impactperformance
[2] Opportunity Finance Network, 2019 CDFI Fund Annual Certification Reporting Database", Accessed November 19, 2020.
[3] Opportunity Finance Network, "Impact Performance", https://ofn.org/impact-performance

(CARES) Act — low-wealth communities, women, veterans and business owners of color — most CDFIs were initially sidelined as PPP lenders.

As PPP unfolded, it was apparent that for small businesses, lenders matter. The program's initial reliance on existing banking relationships with mainstream financial institutions disadvantaged very small, women- and minority-led businesses who often do not have relationships with a traditional lender. For example, research from the Federal Reserve found that less than one quarter of Black-owned employer firms had a recent borrowing relationship with a bank. For Black-owned non-employer firms, only 1 in 10 had a recent borrowing relationship.[4]

This structural disadvantage impacted borrowers: research from the National Community Reinvestment Coalition (NCRC) found that banks asked more questions and requested more information up front from Black or Latinx business owners compared to white business owners when seeking PPP financing — even when the Black or Latinx business owners had stronger applications.[5] In addition, a report by Color of Change and UnidosUS found that 51 percent of Black and Latinx small business owners surveyed had applied for PPP loans of less than $20,000. Only 12 percent said they received the full amount of assistance requested. More than three times that number — 41 percent — were denied assistance.[6]

The Brookings Institute analysis of access to PPP loans in majority-minority neighborhoods found that on average, it took 31 days for small businesses with paid employees in majority-Black ZIP codes to receive PPP loans—seven days longer than those in majority-white communities. For non-employer businesses, the loan delay between majority-Black and majority-white neighborhoods grew to nearly three weeks.[7] Part of the lag was that independent contractors and sole proprietors were not eligible to apply for PPP loans until April 10, just days before the first round of program funds were depleted.[8] This delay was potentially catastrophic for minority owned small businesses, which tend to have less than two weeks of cash on hand,[9] and especially for the more than 95 percent of black owned businesses that are sole proprietorships.

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[4]Claire Kramer Mills and Jessica Battisto, "Double Jeopardy: Covid-19's Concentrated Health and Wealth Effects in Black Communities", New York Federal Reserve Bank. Published August 2020. Accessed December 7, 2020.
https://www.newyorkfed.org/medialibrary/media/smallbusiness/DoubleJeopardy_COVID19andBlackOwnedBusinesses

[5]National Community Reinvestment Coalition, "Lending Discrimination Within the Paycheck Protection Program", Published July 15, 2020. Accessed December 6, 2020. https://ncrc.org/lending-discrimination-within-the-paycheck-protection-program/

[6] Color of Change and Unidos US, "First COVID-19 Survey of Black and Latino Small-Business Owners Reveals Dire Economic Future", Published May 18, 2020. Accessed December 6, 2020.
https://theblackresponse.org/wp-content/uploads/2020/05/COC-UnidosUS-Abbreviated-Deck-F05.13.20.pdf

[7] Sifan Liu and Joseph Parilla, "New data shows small businesses in communities of color had unequal access to federal COVID-19 relief", The Brookings Institution, Brookings Metro COVID-19 Analysis Series, Published September 17, 2020. Accessed December 6, 2020. https://www.brookings.edu/research/new-data-shows-small-businesses-in-communities-of-color-had-unequal-access-to-federal-covid-19-relief/

[8] Elaine Pofeldt, "COVID-19 Aid to Small Business Owners Trickles Out as SBA Clarifies CARES Act Rules for Sole Proprietors", Forbes. Published April 15, 2020. Accessed December 6, 2020.
https://www.forbes.com/sites/elainepofeldt/2020/04/15/covid-19-aid-to-small-business-owners-trickles-out-as-sba-clarifies-cares-act-rules-for-sole-proprietors/?sh=4d6a61417495

[9] Lauren Leatherby, "Coronavirus Is Hitting Black Business Owners Hardest", New York Times, Published June 18, 2020. Accessed December 7, 2020. https://www.nytimes.com/interactive/2020/06/18/us/coronavirus-black-owned-small-business.html

Despite the CDFI industry's expertise in lending to minority-owned, very small, and other disadvantaged businesses, CDFIs were underestimated and underutilized in the early days of PPP. The impact of excluding CDFIs was clear: PPP relief funds could not reach small business borrowers without reaching their lenders. The intention of PPP was to help small businesses survive during the pandemic, but the initial execution left out millions of businesses. Very small businesses and nonprofit organizations had difficulty in the early weeks of the program finding a lender to process their PPP applications because they did not have a preexisting relationship with banks. CDFIs were able to bring more businesses into the fold but for some it was too little, too late.

Program Adjustments Increase CDFI Participation

After a rocky start, Congress, the Small Business Administration (SBA) and the Department of Treasury made changes to the program that increased CDFI participation. These changes include a set aside of PPP lending authority for CDFIs, access to SBA systems for small lenders, lowering barriers to entry for non-depository lenders, and access to the Federal Reserve's PPP lending facility. These program adjustments allowed CDFIs to take a larger role in PPP lending:

- PPP set-asides for CDFIs **-** In the PPP and Health Care Enhancement Act (P.L. 116-139), Congress directed SBA to create a $30 billion set aside for PPP loans made by "community financial institutions", which included CDFIs.[10] In late May, the SBA announced a dedicated $10 billion set-aside specifically for CDFIs. These set asides were critical to CDFIs and their customers.

  The "first-come, first-served" model disadvantaged business owners who needed additional time to prepare their PPP loan applications. Many of these borrowers turned to a CDFI once more CDFIs became eligible PPP lenders. The set-asides enabled lenders to appropriately assist their clients, who often do not have ready access to accountants or tax professionals and require technical assistance to prepare PPP applications.

- Dedicated access to E-Tran for small lenders - In late April, the SBA provided a brief window of limited access to the SBA's e-tran system to lenders with less than $1 billion in assets. This was another important opportunity for CDFIs to process their loans and have access to the SBA systems without directly competing with thousands of other PPP lenders, including those with longstanding SBA relationships.

- Lower barriers to entry for nondepository lenders - On April 30, Treasury dropped the lending volume threshold from $50 million to $10 million, opening access to more CDFI lenders. However, that action was taken more than a month after the program opened. Easing that requirement earlier in the process would have allowed more CDFIs to become PPP lenders and serve additional customers, especially in the early days of the program when demand was extremely high.

- Access to the Federal Reserve's PPP facility for nondepository lenders - On April 30, the Federal Reserve also opened access to its PPP facility to non-depository CDFIs, helping CDFIs access liquidity to support their PPP lending. Some CDFIs were able to access the facility by developing correspondent relationships with depository institutions that have master accounts with the Federal Reserve. However, the process was delayed and complex, limiting access to liquidity at a critical time when CDFIs needed it most. CDFIs would also

[10] Public Law 116–139, Paycheck Protection Program And Health Care Enhancement Act, April 24, 2020, https://www.congress.gov/116/plaws/publ139/PLAW-116publ139.pdf

have benefited from the CARES Act provision authorizing SBA to purchase PPP loans directly from lenders but was never implemented.

CDFIs Outperformed Peers as PPP Lenders

The regulatory changes and set-asides in place for the second round of PPP funding allowed CDFIs to ramp up their PPP lending. CDFIs showed remarkable success as PPP lenders, outperforming much larger and better capitalized lenders to provide more than $7.5 billion in PPP loans in just a few short months.[11]

SBA data shows that on average, loans made by CDFIs were significantly smaller than those made by other lenders. Based on the SBA's data, the average PPP loan size for CDFIs was about $65,000, approximately 35 percent smaller than the average loan size for all PPP lenders. In the second round of funding, average loan size for CDFIs was even lower at $43,000. Some CDFI PPP lenders report making loans of less than $1,000. CDFI PPP lenders served not only their existing customers, but also the small businesses and nonprofit customers that lacked the banking relationships often needed to access PPP.

The following are examples of CDFI PPP lending:

- Washington, DC-based Latino Economic Development Center participated in the second round of PPP and deployed 109 loans totaling $2.2 million to businesses in DC, Maryland, Virginia, and Puerto Rico. Their clients' average PPP loan size was just slightly over $20,000.
- Orlando, Florida-based BBIF made a total of 200 PPP loans totaling more than $7.2 million that retained 1,333 jobs. The average loan size was $36,194. BBIF approved PPP loans throughout the state of Florida to diverse small business owners: 86 percent of their total PPP loan recipients are ethnic minorities and 67 percent are black business owners. Ninety percent of their PPP were made to new customers that had not worked with BBIF before.
- Missoula, Montana-based MoFi made 1,270 PPP loans totaling $33.1 million with an average loan size of $26,000. Loans were made in five states: $13.8 million in Idaho (42 percent), $8.9 million in Montana (27 percent), $3.4 million in Oregon (10 percent), $4.3 million in Washington state (13 percent) and $2.6 million in Wyoming (8 percent). Forty-two percent of PPP loans were made in Idaho totaling $13.8 million. MoFi made more loans to businesses this year than in the past 15 years combined. The vast majority of MoFi's borrowers were struggling to access PPP loans at a bank or credit union. Banks referred businesses they could not serve: one local bank in Idaho referred nearly 150 borrowers to MoFi, while a regional bank in Montana referred nearly 50 borrowers.
- St. Louis, Missouri-based Justine Petersen, closed 436 PPP loans, totaling $14.8 million, with 74 percent of loans made to small businesses of color, 62 percent of loans to female headed small businesses, and 71 percent to businesses in low- and moderate-income communities. The CDFI also created an online portal to expedite the forgiveness stage of the program. The portal allows documents to be uploaded, easing the labor investment required to process the forgiveness applications.
- San Jose, California-based Opportunity Fund and four of their partners offered PPP loans to new and existing customers. A total of 1,160 small businesses were approved for PPP loans

[11] Small Business Administration, "Paycheck Protection Program (PPP) Report Approvals through 08/08/2020". Published August 10, 2020. Accessed November 18, 2020. https://www.sba.gov/sites/default/files/2020-08/PPP_Report%20-%202020-08-10-508.pdf

totaling $17.96 million with $14 million of those loans funded directly by Opportunity Fund. Opportunity Fund received more than 2,100 PPP applications requesting $46 million in funding before the program expired in August.

- Durham, North Carolina-based Self-Help Credit Union made 1,758 PPP loans totaling $183 million with a median loan size of $21,000. Fifty-nine percent of loans were made to businesses or nonprofits led by people of color. These PPP loans saved 19,895 jobs.
- Jackson, Mississippi-based Hope Credit Union made 2,587 PPP loans totaling $81 million to small businesses across the Southeast that saved more than 10,000 jobs. The average loan size was less than $30,000 and the median loan size was around $11,000. The majority of loans were made to businesses owned or led by people of color or women, with nearly 40 percent of their PPP loan dollars reaching persistent poverty communities. Prior to PPP, Hope originated about 50 business loans in a year. At their PPP lending peak, nearly half of Hope's staff was dedicated to PPP lending, with many providing small borrowers with much needed technical assistance.
- Chicago, Illinois-based IFF partnered with another CDFI, Minneapolis-based Community Reinvestment Fund to deploy PPP loans. The organizations committed $50 million of their own liquidity to ensuring PPP loans were made to smaller nonprofits, nonprofits serving lower-income communities, and nonprofits led by or serving people of color throughout the Midwest.

Challenges Remain for PPP Lenders and Borrowers

The PPP has been a valuable lifeline to the businesses able to secure access, but challenges continue for both lenders and borrowers:

- Loan forgiveness process - As the first wave of PPP loans became eligible for forgiveness earlier this fall, the SBA's forgiveness platform was not ready to begin accepting applications. For weeks, tens of thousands of applications languished in the system with little information available to lenders or borrowers about their status. Once the platform opened and applications were accepted, there were delays in processing applications and remitting payments to lenders. In recent weeks, SBA has made improvements to their systems and processes, and forgiveness applications are being processed.

  As the volume of forgiveness applications ramps up, a backlog at SBA could cause substantial delays in the processing of those applications. The SBA's implementation of 3508S, the streamlined forgiveness form for loans of $50,000 or less, is an important step in the right direction to simplifying the forgiveness process. Streamlined forgiveness for smaller loans of less than $150,000 that rely on documentation already submitted during the application process would further ease cost burdens for lenders and borrowers.

- Fee structure encourages larger loans **–** One of the reasons borrowers seeking the smallest loans received less consideration from lenders is because the fee structure created incentives to make larger loans. Even though fees were designed to decrease as loan size increased, there was still an incentive to make larger loans to maximize fee income. For example, a $50,000 PPP loan would generate a five percent fee of $2,500, while a $350,000 PPP loan would generate a five percent fee of $17,500, and a $1 million PPP loan would generate a three percent fee of $30,000. Adjustments to the fee structure could spur more small dollar PPP lending.

- Unanticipated costs for lenders **-** A record amount of PPP loan production from all lenders, including CDFIs, means increases in staff time and costs, technological upgrades, and additional documentation and recordkeeping. The delayed forgiveness process also means that lenders are incurring costs of servicing PPP loans for longer than anticipated as well as costs related to providing borrowers with support needed to navigate the complex forgiveness process.

- Unanticipated costs for borrowers – CDFIs in OFN's network report that borrowers are facing potential unanticipated PPP costs:

  - Deductibility of business expenses - While there is clear guidance that forgivable PPP loans are not taxable, the recent IRS ruling that business expenses paid for with PPP loans are not tax deductible has left some business owners concerned they could be facing a hefty tax bill next spring.

  - Deduction of Economic Injury Disaster Loan (EIDL) advances - The requirement that EIDL grant proceeds must be deducted from the forgivable amount of PPP loan has left some borrowers who anticipated a fully forgiven loan with unanticipated debt when they can ill afford it.

- Delayed Guidance - Since the program's inception, the rules put forth by SBA and Treasury changed constantly, creating confusion for borrowers and lenders alike. Such inconsistent guidance, especially around issues of loan forgiveness and tax issues, has created hesitation and impacted demand for PPP loans from small business owners.

Significant Additional Federal Investment Needed to Support Small Business

The PPP was an important first step in addressing some of the challenges facing small businesses, but more must be done. The federal relief small businesses received from PPP and the CARES Act Section 1112 debt relief payments has expired. New relief funds are needed quickly to prevent widespread business closures that will have lasting negative economic impacts. The risks are especially acute for businesses owned by people of color – 41 percent of Black businesses and 32 percent of Latinx businesses have permanently shuttered this year.[12]

Relief efforts should be targeted to reach the most vulnerable businesses to ensure a more inclusive economic recovery. Federal programs that do not reach businesses owned by women, people of color, rural businesses, and other underbanked business must be refocused.

The following are recommendations that will help ensure new federal resources reach the intended communities by enhancing the capacity of CDFIs to support the economic recovery. Many of these recommendations have been addressed through Senator Cardin's HEROES 2.0 Small Business Lifeline Act (S.4818):

- **Emergency Appropriations for the CDFI Fund -** OFN is especially pleased to see HEROES Small Business Lifeline Act invest in the mission- and community-based lenders that have a demonstrated history of getting capital to minorities, women, and other underserved communities. In particular, the $1 billion in emergency grant funding for the CDFI Fund is critical to ensuring CDFIs are an integral part of any federal relief and recovery

[12] Robert Fairlie, "The Impact of Covid-19 on Small Business Owners: Evidence of Early Stage Losses from the April 2020 Current Population Survey", Stanford Institute for Economic Policy Research, Published May 23, 2020. Accessed December 6, 2020. https://siepr.stanford.edu/sites/default/files/publications/20-022.pdf

effort. The federal government must increase the supply of capital to mission lenders like CDFIs, who are adept at channeling those resources into distressed communities. More investments at this scale are needed to enable CDFIs to step up and meet the economic challenges facing our communities.

This investment will also broaden the reach and impact of the federal government's investments. While the PPP set-asides were critical in helping capital flow to small business owners impacted by the pandemic, only a small subset of CDFIs were able to become PPP lenders, and they used their own lending capital to make PPP loans to small business customers. SBA pays a small servicing fee to PPP lenders for each loan they make, but the funds for the loan itself comes from the PPP lender.[13] PPP loans are a short-term, focused solution to meet an immediate small business need, not a substitute for critical equity capital CDFIs need to support the medium- and long-term economic recovery. CDFIs are well positioned to respond to the financial needs of low wealth markets but need their own balance sheets to be stable in order to contribute to the economic recovery. This balance sheet stability is essential to allow CDFIs to continue to leverage private and philanthropic resources.

- **Restructure and reform PPP** – OFN urges Congress to restructure and reform the PPP with a focus on reaching the most underserved small businesses. With programmatic fixes to make the program work better for businesses and lenders, new PPP funding could provide a critical bridge to businesses struggling to survive. Although there were funds left over when the program ended, the economic outlook has shifted since August. Businesses that were able survive a few months ago and might have forgone applying for a PPP loan are now facing a very different financial reality.

  OFN supports the following provisions in HEROES 2.0 (S.4818):
  - extend PPP through March 2021 to create set-asides for first-time PPP loans to businesses with 10 or fewer employees, sole proprietors and the self-employed, nonprofits, and for loans less than $250,000 to businesses located in low- to moderate-income (LMI) areas.
  - second draw PPP loans for hard-hit businesses
  - $15 billion PPP set-aside for CDFIs, Minority Depository Institutions (MDIs), and other mission lenders.

  OFN also supports the provisions that:
  - expand eligibility to all nonprofits, regardless of size and type
  - simplifies the forgiveness process
  - repeals the requirement of deducting an EIDL advance from the PPP forgiveness amount
  - removes limitations that restrict small businesses owned by formerly incarcerated individuals from securing a PPP loan.

  Finally, OFN urges Congress to change the PPP fee structure to a flat fee to ensure that lenders, who are now fully realizing the costs associated with participating in the PPP program, can continue to make smaller loans and provide the technical assistance needed to navigate the application and forgiveness process.

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[13] Small Business Administration, "Paycheck Protection Program Interim Final Rule", Issued April 2, 2020. https://www.sba.gov/document/policy-guidance--ppp-interim-final-rule

- **Extend and expand the Section 1112 CARES Act debt relief program -** The SBA's debt relief program was a critical lifeline for many CDFIs and their borrowers. The six months of payments eased borrower's debt burden while the SBA's payments of interest and fees to lenders helped relieve stress on balance sheets from lost revenue. For some CDFIs, this additional capacity enabled them to offer their own emergency loan products or administer state and local aid programs. OFN strongly supports the provisions in HEROES 2.0(S.4818) that extends payments of principal, interest, and fees on all pre-existing and new SBA 7(a), 504 and microloans for up to a year, with more relief targeted to existing borrowers in underserved markets and the hardest-hit sectors, and expanding the relief to SBA's physical and EIDL disaster loans.

- **Direct SBA resources to small businesses located in low-wealth markets or owned by historically underestimated groups -** Congress should make improvements to the SBA's core programs, including 7(a), Community Advantage, 504, and the Microloan program. To survive the pandemic, businesses will need access to responsible, affordable loans, credit enhancements, and working capital in addition to PPP's payroll support. Programs that prioritize CDFI participation like the 7(a) Community Advantage program and the SBA Microloan program are more successful at reaching underserved businesses, especially businesses owned by women and people of color. Enhancing CDFI participation and making improvements to these programs will help reach more underbanked businesses.

  OFN supports the provisions of HEROES 2.0 related to the SBA Microloan and Community Advantage programs that would:
    - temporarily increase the amount of time that borrowers can repay their loans from 6 to 8 years.
    - temporarily increase the outstanding aggregate amount each intermediary may borrow from $6 million to $10 million.
    - temporarily waiving the matching requirements for the technical assistance grants and the 50 percent limitation on pre-loan technical assistance.
    - increase to 90 percent the loan guarantee amount on 7(a) loans, including for Community Advantage loans, until October 1, 2021.

CDFIs are Essential to an Inclusive Economic Recovery

CDFIs are critical intermediaries that build financial infrastructure to deliver capital to businesses and communities that need it most. But the work of CDFIs is not done alone: partners like the federal government remain vital to continuing the powerful work of mission driven lenders. Investments in proven solutions and programs that support the work of CDFIs will stimulate are also a smart investment for the federal government: small amounts of public subsidy are leveraged to amplify its impact.

The nation's small businesses cannot afford for CDFIs to be an afterthought in public policies addressing the economic crisis brought on by COVID-19. The PPP experience demonstrated that when CDFIs are empowered with supportive policies coupled with capital at the beginning of any relief program effort or in a sustain capacity, they outperform other lenders. With targeted resources from the public sector and partnership with CDFIs, our country's small business sector can weather the pandemic and recover to thrive. Focusing on reaching unbanked and underbanked businesses through the mission lenders that are best equipped to serve them will ensure a more equitable recovery.

Thank you for the opportunity to speak with you today. I look forward to your questions.