OPPORTUNITY FINANCE NETWORK

Mr. Daniel Upham
Acting Director
Office of Economic Opportunity
U.S. Small Business Administration
409 Third Street SW
Washington, DC 20416

Re: Docket No. SBA-2018-0000

Dear Director Upham:

Opportunity Finance Network appreciates the opportunity to comment on Docket Number SBA-2018-0008, "Changes to the Small Business Administration's Community Advantage Pilot Program".

OFN is a national network of community development financial institutions (CDFIs). CDFIs are mission-driven community development banks, credit unions, loan funds and venture capital funds investing to benefit low-income and low-wealth communities across America. OFN's membership has originated $65 billion in financing in urban, rural and Native communities through 2017. Roughly half of this financing is devoted to affordable housing with the balance going to small business, community facilities, commercial real estate and consumer products. Our members are also reaching the hardest to serve communities: Forty percent of OFN member lending occurs in persistent poverty census tracts.[1] These are loans and investments that would not be made but for CDFIs' mission-driven business model.

OFN commends the Small Business Administration (SBA) for its efforts to bring capital and credit to small businesses often overlooked by mainstream financial institutions through the Community Advantage pilot program. Since the program launched in 2011, mission-driven lenders have used it to expand access to credit for small businesses in underserved areas with impressive results: Community Advantage lenders have made more than 4,900 loans totaling more than $643.7 million, including more than 1,100 loans totaling $157.5 million in FY 2018 alone.[2]

Certified CDFIs have been an integral part of the Community Advantage pilot program's overall success by helping to reach businesses in underserved markets.[3] The program has strengthened the CDFI industry's ability to deliver affordable, responsible financial products to a growing number of small business owners.[4] Community Advantage also helps the SBA achieve its priority goal to increase the number of loans to small businesses in socially and economically disadvantaged urban

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[1] Opportunity Finance Network, OFN CDFI Coverage Map 2010-2016, Accessed October 22, 2018. http://ofn.org/cdfi-coverage-map

[2] Robert Jay Dilger, "Small Business Administration 7(a) Loan Guaranty Program", Congressional Research Service, Updated November 7, 2018. https://fas.org/sgp/crs/misc/R41146.pdf

[3] U.S. Small Business Administration, Office of Economic Opportunity, Presentation at the 2018 OFN Small Business Finance Forum, June 25, 2018.

[4] U.S. Small Business Administration, FY 2019 Congressional Justification and FY 2017 Annual Performance Report, May 8, 2018. Accessed July 9, 2018. https://www.sba.gov/sites/default/files/aboutsbaarticle/SBA_FY_19_508-Final-FINAL.PDF

communities and rural areas.[5] While OFN is pleased to see the SBA extend the pilot program through 2022, we are concerned about other aspects of the notice of extension and would like to make the following comments on the program:

Access to Capital for Underserved Businesses Remains a Challenge

The Community Advantage program was created to meet the credit, management, and technical assistance needs of small businesses in underserved markets. The program's loan guarantee provides credit enhancement to mission-driven lenders like CDFIs that are financing small businesses that struggle to access capital. Recent data shows that small business lending is still struggling to recover from the impact of the 2008 financial crisis. A 2018 report on small business lending trends from the Federal Reserve Board of Governors notes that the dollar volume of small business loan originations grew about 31% between 2010 and 2016 but remains nearly 30% below the 2007 high.[6]

There are signs of improvement in lending conditions: large bank lending to small businesses is increasing, with loan approval rates at large banks ($10 billion or more in assets) hitting a post-recession high in October 2018 and approval rates at regional and community banks rising to 50.1%, the highest for small banks since October 2014.[7] However, many small businesses still face tight lending conditions when seeking credit: large banks approved only 26.8% of loan requests by small business owners, meaning nearly three quarters of applicants were denied financing and regional banks denied nearly half of the funding requests they received in October 2018.[8]

Small business in rural communities also face continued challenges accessing the capital needed to start or grow businesses. A *Wall Street Journal* analysis of Community Reinvestment Act data reveals the dollar value of small loans to businesses in rural communities peaked in 2004, and in 2018, lending levels are still less than half of 2004 levels in those same communities. In fact, when adjusted for inflation, rural small business lending is below 1996 levels.[9] Further, loans to rural communities account for only ten percent of all small business loans.[10]

There has also been a decline in the availability of smaller dollar loans, which are critical for many small businesses especially microenterprises. For lenders, small business loans have high transactions costs, often making it unprofitable to make smaller dollar loans. In addition, new startup firms or owners with limited business experience often require a level of technical assistance that can make small business and microlending even more cost prohibitive to a lender.

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[5] "SBA Reimagined: Powering the American Dream", Small Business Administration Strategic Plan Fiscal Years 2018– 2022", Published December 2017. Accessed November 10, 2018.

[6] Dore, Tim, and Traci Mach (2018). "Recent Trends in Small Business Lending and the Community Reinvestment Act," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, January 2, 2018. Accessed July 7, 2018/ https://doi.org/10.17016/2380-7172.2122.

[7] Biz2Credit Small Business Lending Index, October 2018, https://www.biz2credit.com/small-business-lending-index/october-2018.

[8] *Id* at 7.

[9] Ruth Simon and Coulter Jones, "Goodbye, George Bailey: Decline of Rural Lending Crimps Small-Town Business", December 25, 2017. Accessed July 6, 2018. https://www.wsj.com/articles/goodbye-george-bailey-decline-of-rural-lending-crimps-small-town-business-1514219515

[10] *Id* at 9.

The SBA's data shows that loans of less than $150,000 increased from FY 2013 until peaking in FY 2016, then declined in FY 2017 and FY 2018. Loans of $150,000-$350,000 also increased from FY 2013 through FY 2015 and remain relatively flat, even as demand for small dollar business loans remains strong.[11] The Federal Reserve's 2017 Small Business Credit Survey found that 70% of applicants sought $250,000 or less in financing, demonstrating a significant capital access gap.[12]

The Community Advantage program helps fill that gap, providing credit enhancement that enables lenders to make those smaller loans of less than $250,000 that are often difficult for business owners to access. With an average loan size of $129,108[13], much lower than the average approved loan amount of $420,401 under the traditional 7(a) program, Community Advantage meets a pressing unmet financing need for small businesses.[14]

Program Evaluation Should Include Impact in Underserved Communities

In the Federal Register notice, the SBA notes with significant concern that Community Advantage loans exhibit more risk than other 7(a) loans, including recent increases in the early problem loan rate, higher early default rate, and the last 12-month default rate trending higher than other similar 7(a) loans and the overall 7(a) portfolio.[15] While these increases warrant additional scrutiny, the SBA should also continue to focus on the program's intent to expand access to lower dollar loans and lending in traditionally underserved communities. Any review of the program's performance should provide data and context about whether there is progress towards that goal.

OFN recognizes that monitoring the performance of the loan portfolio is a critical aspect of oversight of the 7(a) programs; however, delinquency and default rates should not be the only measure of success for the Community Advantage program. OFN urges the SBA to consider the program's impact in underserved communities, including meeting the credit needs of low- and moderate-income business owners, women, people of color and other underserved populations.

Expanded Underserved Market Definition

The definition of underserved should be expanded to include New Markets Tax Credit eligible census tracts.

Loan Loss Reserve Requirements

The Federal Register notice increased the loan loss reserve requirement from three to five percent of the outstanding amount of the guaranteed portion deposited in the loan loss reserve account (LLRA) if the loan is sold in the secondary market. The increase in loan loss reserves will place additional financial constraints on many mission-driven lenders already operating with limited liquidity.

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[11] John Miller, "7(a) Connect Call", Small Business Administration Office of Capital Access, July 10, 2018.
[12] "2017 Small Business Credit Survey: Report on Employer Firms", Federal Reserve System, https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2018/sbcs-employer-firms-report.pdf
[13] *Id* at 3.
[14] *Id* at 2.
[15] Small Business Administration, "Notice of extension of and changes to Community Advantage Pilot Program; and request for comments", Federal Register, Published September 12, 2018. https://www.gpo.gov/fdsys/pkg/FR-2018-09-12/pdf/2018-19885.pdf

Limitation on Community Advantage Fees

OFN is concerned that the SBA is limiting the total fees an applicant can be charged by a Community Advantage lender to $2,500. The SBA acknowledges that mission-oriented community lenders are primarily nonprofit financial intermediaries focused on economic development in the communities they serve, almost all of which offer technical assistance and business counseling using a "high touch" approach that includes a high level of individual attention and service.[16] This approach to lending is an important risk mitigation strategy used by CDFIs to work with borrowers to workout troubled, delinquent loans and minimize the risk of default.

Personalized technical assistance varies between business owners; some require far more intensive training and technical assistance than others. As a result, the cost to provide technical assistance to each business owner is not static. Fees allow nonprofit lenders to defray upfront costs of delivering technical assistance to potential borrowers. Placing limitations on fees could inhibit the ability of mission driven lenders to offer the products and services that best serve the needs of business owners, as well as the ability to mitigate the risk of default.

The limited ability to collect fees along with the imposition of new loan loss reserve requirements will impact the financial feasibility of making Community Advantage loans, just as the program is ramping up lending to the small businesses that are creating jobs and stimulating economic growth in underserved communities.

Conclusion

OFN encourages the SBA to continue to monitor the performance of Community Advantage loans and to consider easing these program restrictions as the portfolio shows signs of improvement. We also urge the SBA to conduct analysis on the changes in portfolio to better understand any underlying factors that could impact the program's performance.

OFN appreciates the opportunity to provide feedback on the Community Advantage Pilot Program and looks forward to continuing to work with the SBA. Thank you for your consideration of these comments. Please do not hesitate to contact me if you have questions or concerns about these recommendations via email at dwilliams@ofn.org or phone at 215.320.4318.

Thank you,

Dafina Williams

Vice President, Public Policy

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[16] *Id* at 15.