



AEO *Association for
Enterprise Opportunity*
THE VOICE OF MICROBUSINESS

August 23, 2013

Ms. Lisa M. Jones
Manager, CDFI Bond Guarantee Program
CDFI Fund
U.S. Department of the Treasury
1500 Pennsylvania Avenue
Washington, DC 20220

Dear Ms. Jones,

We, the undersigned Community Development Financial Institutions (CDFIs) with the support of the Association for Enterprise Opportunity (AEO), are writing to raise concerns about the implementation of the Community Development Financial Institution Fund's Bond Guarantee Program (BGP). We acknowledge and appreciate the tremendous effort you and your team have made to design and implement the BGP since it was authorized by the Small Business Jobs Act of 2010 (P.L. 111-240). We further recognize the real and important constraints under which the BGP must operate. Yet we believe that in order for the proceeds of the BGP to support small business lending by CDFIs as intended, clarification of the rules along with small changes are necessary.

Context for Our Perspectives

From the time the BGP was enacted, we believed it represented a critical opportunity to secure long-term, patient capital for underserved entrepreneurs while introducing opportunities for innovation in our work as CDFI business lenders. The CDFI BGP presented an opportunity for a group of high-performing CDFI micro and small business lenders to finance more than 10,000 microloans. These loans would begin to address the market failure described by Treasury Secretary Lew in during a June 10, 2013 address to the Capital Access Summit, when he noted that banks turn down more than 8,000 loan applications each day.

We supported the views and recommendations submitted by AEO in formal comment letters on the Proposed Rule (August 15, 2011) and the Interim Rule (April 8, 2013). In August 2011, before much was available in the way of

implementation details, AEO urged the CDFI Fund to adopt and balance critical decision-rule principles for program design: sustainability, flexibility and innovation. The CDFI Bond Program is to be commended for its focus on flexibility. We believe, however, that opportunities for transformation through innovation were missed.

In April 2013, after more specifics were released, AEO expressed strong and clear concern that program design choices reflected in the interim rule would preclude use of proceeds for business lending. In that communication, AEO proposed that the CDFI Fund “carve out” a Bond issuance for business lending and work with a group of micro lenders to refine the rules.

Fixes Needed: Collateral Requirements & Cash Flow Model

We believe that the collateral requirements and the approach to the cash flow model in the application preclude use of BGP to finance loans to micro and small businesses. In spite of legislative intent that clearly indicated the Bond Guarantee Program would support small business lending, program design choices related to collateral and cash flow model requirements have had the unintended consequence of precluding use of CDFI Bond Guarantee Program proceeds for the purpose of micro business lending. The collateral rules qualify high-risk loans as safe (i.e. 90% LTV real estate loans are deemed fully collateralized) while precluding business lending in a manner that is both historically safer and meets the program intent.

Loans to small and micro businesses are often not secured with collateral. In these cases, underwriters look to income and other criteria to evaluate creditworthiness. While some loans may result in losses, loan performance can be modeled: in fact, AEO has modeled the historical performance of more than 50,000 CDFI loans along with another larger sample of SBA loans. Moreover, the loan pool could be collateralized such that even if portfolio losses were higher than historical experience, proceeds from the remaining loans would be sufficient to cover obligations to the federal government.

In spite of these common and proven practices, the BGP requires that each Secondary Loan be fully collateralized and program rules place a significant discount on collateral that is not real estate. Moreover, even if a small business were to have sufficient collateral to satisfy the current program design, the rules surrounding how loan collateralization must be documented make use of the BGP to fund small business loans cost-prohibitive.

Our second concern is the requirement that the cash flow model for the Guarantee Application detail each Secondary Loan each eligible CDFI will make with the BGP funds, including the date each individual loan will be made and each scheduled interest rate. This requirement renders small dollar lending nearly impossible due to the inability to define today exactly which loans would be funded six months out (i.e. the time from application to funding is typically days, weeks or occasionally

months). While it is feasible that a handful of loan applications already received will result in loans in October or after, such loans are, by definition, too early in the process for lenders to know whether they will close the loan, much less what terms would be.

As currently devised, the BGP program design is such that the only loans whose terms are so certain that they can be detailed in a cash flow model are large dollar loans. We believe that if left unaddressed, these two issues effectively preclude use of the Bond Guarantee Program proceeds for CDFI business lending.

Fixes are Within Reach: Our Recommendations

We believe that both the collateral and the cash flow model requirements could be tweaked within the constraints of the statute and relevant regulations. We respectfully request consideration of the following recommendations in order to permit the Bond Guarantee Program to support CDFI business lending:

Collateral

1. Adopt approach that reflects global rules approach for managing risk (i.e. Basel II/Basel III).
2. Permit Eligible CDFIs to lend bond proceeds to newly created, fully-owned subsidiaries authorized to hold only loans permitted under the terms of the CDFI BGP and cash.
3. Treat the loans and cash held by the subsidiary as collateral for the subsidiary's loan from the parent.
4. Recognize business lending pursuant to proven underwriting program as a permitted asset class.

Cash Flow Model

1. Recognize loans to affiliates/subsidiaries as valid Secondary Loans and do not consolidate those affiliates with eligible CDFI (i.e. permit cash flow statement to reflect loan from Bond to Eligible CDFI to subsidiary without the current requirement that affiliate then document how each micro loan gets deployed).

We appreciate the work that you and your team have undertaken to stand up the Bond Guarantee Program. None of these changes appear to be precluded by statute or regulation and we are hopeful that Treasury takes steps to implement these in time for the next round of Bond Guarantee applications. We are eager to engage with you and your team to identify solutions that conform to the program requirements and ensure that proceeds from the Bond Guarantee flow to micro and small businesses, the backbone of this nation's economy and communities around the country.

Should you have questions about our recommendations, please feel free to contact Tammy Halevy, SVP, New Initiatives, AEO by phone (202) 650-5580, ext. 52 or by email thalevy@aeoworks.org.

Sincerely,



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Enclosure

cc: Ms. Donna Gambrell, Director, CDFI Fund