August 15, 2011

Ms. Jodie Harris
Policy Specialist
CDFI Fund
U.S. Department of the Treasury
601 13th Street NW
Suite 200 South
Washington, DC 20005

RE: Comments on CDFI Bond Guarantee Program

Dear Ms. Harris,

The Association for Enterprise Opportunity (AEO) is pleased to comment on the implementation of the Community Development Financial Institutions Bond Guarantee Program (CBGP), which was authorized by the Small Business Jobs Act of 2010 (P.L. 111-240).

AEO is the national member organization and voice of microenterprise in the United States. For two decades, AEO and its members have helped more than two million entrepreneurs contribute to economic growth as they support themselves, their families, and their communities. Our 450 member organizations provide capital and services to underserved business owners in every state, Washington, DC and Puerto Rico. More than 140 AEO member organizations are certified Community Development Financial Institutions (CDFIs). All of these CDFIs underwrite loans for business purposes; some are also involved in financing other community development activities.

We believe that the bond guarantee program represents a critical opportunity to secure and expand access to capital for underserved entrepreneurs as well as other lower-income Americans.

Main Street businesses are credit constrained. Last year alone, the major US commercial banks turned down roughly one million applications for small business financing.[1] This trend is expected to continue. In fact, an April 2011 survey sponsored by the Federal Reserve Bank shows increased demand for small business credit, yet small business lending declined by more than 2% in Q1 2011.[2] Some entrepreneurs are even less likely to get the capital they need to grow and to hire. Microbusinesses are 40% less likely to access credit than larger small

[1] AEO analysis based on interviews with banks and market share
[2] The April 2001 Senior Loan Officer Opinion Survey on Bank Lending Practices; SBA Quarterly Lending Bulletin released 7 June 2011

businesses.[3] Fewer than half of businesses with revenues of less than $100k – about 9 million businesses – access any credit products.[4] This means that more than 40% of black-owned, Hispanic-owned and women-owned businesses do not access credit.[5] If these businesses are going to grow and hire, they will need fairly priced capital (and high impact services) to support management and growth. For many of these business owners, CDFIs (and by extension this bond guarantee program) represent their most promising option to access capital.

At the same time, we acknowledge the challenging current fiscal environment. We are also mindful that the pilot program is only authorized for five years. As a result, it is imperative that the design and implementation of the CDFI Bond Guarantee program balance the urgent need to get capital to underserved entrepreneurs and appropriately manage the risks to government guarantors.

AEO has prepared these comments in consultation with our members and partners across the country. AEO believes that three principles should guide decisions regarding the design and implementation of the CBGP: sustainability, flexibility and innovation.

Sustainability

Ensure adequate risk-sharing reserve: When aggregated, the historical performance of business loan portfolios to underserved entrepreneurs – especially microloans – may exceed the 3% risk sharing reserve mandated by the statute. In order to address any potential concerns regarding the adequacy of the 3% risk sharing reserve and to ensure availability of funds to cover potential losses in excess of such amount, the application process should require all applicants to either:

1. Engage a government approved third party to determine the appropriate risk sharing reserve (as a percentage of the bond issuance), based on the actual historical performance of the applicant's loan assets in order to mitigate any additional risk incurred by the US government, which is acting as a guarantor of the issuance. Any additional risk sharing beyond the 3% mandated by the statute would be required as part of the issuance to receive the government's guarantee. If the adequate risk reserve is deemed to be greater than 3%, the risk reserve would be funded by the proceeds from the bond issuance. In such cases, calculation of the mandate that 90% of proceeds invested in qualified loans should either be based on proceeds from the bond issuance net of the risk reserve.

[3] Federal Reserve Bulletin, October 2006
[4] Federal Reserve Bulletin, October 2006
[5] AEO analysis of US Census data

2. Purchase insurance to cover the risk of losses exceeding the 3% risk-sharing reserve mandated by the statute. The issuer would price the cost of such insurance into the cost of funds from the bond issuance in order to mitigate the risk of loss for the US government providing a full guarantee.

Flexibility and Innovation

The regulations governing the CDFI Fund's Bond Guarantee Program should reflect the flexibility granted by Congress to craft a program that serves all underserved people and economically distressed communities, enable the full range of CDFI types and CDFI-originated or -issued assets to be eligible for participation in the program.

All presently certified CDFIs should be eligible to participate regardless of the type of loans they make (e.g. small business, small dollar/credit building, project finance, etc).

Stringent mission-based criteria coupled with simultaneous capital distribution plan and CDFI certification: The statute mandates that a qualified issuer demonstrate "appropriate expertise, capacity, and experience or otherwise be qualified to make loans for eligible community or economic development purposes." It is imperative that qualified issuers are able to demonstrate a significant and sustained track record in low-income communities. The application process should include stringent mission-based criteria. However, in order to ensure that qualified issuers also present appropriate capacity, the CDFI Fund should structure the application process in a manner that permits not yet certified CDFIs to apply for certification simultaneously with submission of a capital distribution plan. This flexibility will enable qualified new entrants and models that have higher odds of meeting the requirements of private sector capital markets, thus contributing to sustainability over time.

Permit broad range of uses of funds: The range of uses of bond proceeds should include but not be limited to re-financing, purchase of loans from non-CDFI originators as long as the loans being purchased are consistent with the mission and purpose of CDFI lending, loan loss reserves, and the required risk sharing pool.

No arbitrary underwriting criteria: CDFIs have special experience in underwriting borrowers unique to their markets (e.g., linked business development services to reduce risk of non-performance, etc.). Therefore, there should be no arbitrary underwriting requirements, such as minimum FICO scores of a borrower. Underwriting of a bond issuance should only be based on the historical credit performance of relevant CDFIs loans. This, however, only works if a CDFI is able to provide and report (with high data integrity) loan level performance of its assets. The application process should request that

CDFIs indicate their capabilities or define the actions they are taking to improve their capabilities in these areas.

Permit reinvestment of bond proceeds (e.g. "revolving" funds): Our member CDFIs presently rely on a variety of revolving funds. In some cases small business lines of credit are issued where usage depends on the borrower's working capital needs. In other cases, equipment loans amortize and get replaced by new equipment loans. Moreover, CDFIs may make multiple loans to the same customer over the life of their relationship and because many loan terms are shorter term in nature, proceeds from the repayment of the underlying loans being financed by the bond issuance should be allowed to be reinvested for the term of the bond in new underlying loans (rather than being required to repay the bond).

CDFIs should be able to service their own loans: In many cases, CDFIs collect payments directly from their borrowers. They also have other collection practices that are unique to their markets. For these reasons, the Program must allow a CDFI or any of its subsidiaries to act as the primary servicer of its own loans.

We understand and expect that each proposal from a CDFI or group of CDFIs will be subject to rigorous scrutiny. We encourage the CDFI Fund to move forward as rapidly as possible and to begin discussions with enough potential issuers to ensure that the maximum available in guaranteed bonds are issued in each year of the pilot.

As the CDFI fund proceeds with the implementation of the CDFI Bond Guarantee Program, we hope that you effectively balance tradeoffs so that underserved entrepreneurs and other Americans will access capital throughout the life of the pilot program and over time.

On behalf of our members and the underserved entrepreneurs we all serve, we thank you for the opportunity to provide these comments.

Sincerely,

Connie E. Evans

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