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Center for an Urban Future

Bolstering Minority- and Immigrant-Owned Businesses by Scaling Up CDFIs

Center *for an* Urban Future

Bolstering Minority- and Immigrant-Owned Businesses by Scaling Up CDFIs is a publication of the Center for an Urban Future. Researched and written by Judith Messina with Eli Dvorkin. Edited by Eli Dvorkin, Jonathan Bowles, and Charlotte Crowe. Additional research by Matthew Friedman, Melissa Lent, Ben Rosenn, and Charles Shaviro.

Center for an Urban Future (CUF) is a leading New York City-based think tank that generates smart and sustainable public policies to reduce inequality, increase economic mobility, and grow the economy.

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The Untapped Potential of Community Development Financial Institutions (CDFIs)

FOLLOWING NEARLY THREE YEARS OF A PANDEMIC THAT HAS HAD A DISASTROUS IMPACT ON SMALL businesses in communities of color across New York City, there is broad consensus that new city and state government policies and investments are needed to strengthen the city's minority- and immigrant-owned businesses. Of all the solutions policy leaders should consider, few would have a greater impact than expanding the reach of the city's Community Development Financial Institutions (CDFIs).

Although New York is home to dozens of excellent small business development organizations, the relative handful of nonprofit CDFIs across the five boroughs stand out for their unique ability to connect the city's smallest, most vulnerable businesses with access to capital and technical assistance. CDFIs have built up trust with immigrant- and minority-owned businesses and are often the only place where first-time and smaller-scale entrepreneurs can get financing. Indeed, when thousands of minority- and immigrant-owned businesses in New York were unable to access the federal Paycheck Protection Program via traditional banks or take advantage of the city's emergency grant program for small businesses, CDFIs filled the void, providing a financial lifeline to many at-risk firms.

The problem is that CDFIs serve only a tiny fraction of the businesses and aspiring entrepreneurs who could benefit from affordable loans and business advising services. Our research shows that most nonprofit CDFIs in the city make no more than a few hundred loans each year, with some CDFIs closing less than two dozen. This is a drop in the bucket—and a striking missed opportunity in a city that's home to more than 64,500 minority-owned employer businesses and tens of thousands more microentrepreneurs, the majority of whom face enormous difficulty accessing capital.[1]

The Business Outreach Center Network (BOCNet), for example, made 187 new or refinanced loans in 2021. Brooklyn Cooperative Federal Credit Union, with branches in Bushwick and Bedford-Stuyvesant, makes about 100 new small business loans each year, lending only about $500,000 annually. Accompany Capital made 319 new small business loans in 2021, totaling $7.2 million. Greater Jamaica Development Corporation's Southeast Queens Capital Access program makes just 10 to 30 small business loans in a typical year.

Overall, CDFIs account for just 0.4 percent of all small business debt lending in New York City annually.[2] Although the reach of CDFIs is similarly limited in other parts of the country, data shows that New York's CDFIs lend considerably less money than those in other major American cities. CDFIs made $138.3 million in loans to businesses in New York City's five boroughs in 2017, compared to $210.3 million in Los Angeles County and $235.2 million in Cook County, Illinois, where Chicago is located.[3]

In addition to serving a relatively small number of entrepreneurs overall, CDFIs often lack the capacity to reach the most underserved businesses. These indispensable organizations currently have a limited footprint and extremely limited funding to cover the costs of staffing, marketing, and outreach. Several of the city's lowest-income zip codes don't have a single CDFI branch, and the businessowners and entrepreneurs who most need their services are often unaware they even exist.

To bolster New York's minority- and immigrant-owned businesses and help create community and generational wealth in underserved and under-resourced neighborhoods, city and state leaders should provide new resources to CDFIs, enabling them to scale up their operations, boost the number of businesses they help with financing and advising, and extend their reach into communities with the greatest needs.

Small Business Loans by Select NYC CDFIs, 2021

Source: Center for an Urban Future interviews with CDFI leaders.

This policy brief puts forth several achievable recommendations for helping New York City's CDFIs expand their reach and increase the number of minority- and immigrant businesses they can serve with small loans, technical assistance, and other support services. The brief, made possible thanks to a grant from HSBC, also documents why CDFIs are crucial to bolstering New York City's most vulnerable businesses and provides a new level of detail about the capacity challenges facing CDFIs on the ground today.

Why CDFIs?

CDFIs play an indispensable role in low-income, minority, and immigrant communities. They fund and advise the small businesses that often go unserved by banks, city government agencies, and even other nonprofit small business assistance organizations. Part alternative lenders and part business counselors, CDFIs have the trust of these businesses and understand the unique obstacles and opportunities that they face.

Crucially, CDFIs fill a significant gap in the marketplace for entrepreneurs who are unable to acquire a bank loan and for whom other options, such as credit card debt or high-interest personal loans, are prohibitively expensive. In a financial marketplace of data-driven decision-making, CDFIs stand apart as "story lenders," spending the time required to understand the complete picture of a business owner and providing hands-on technical assistance in addition to capital. For a first-time entrepreneur wanting to open a flower shop on Fordham Road, an immigrant seamstress looking to set up a clothing alterations business in Sunset Park, or a food cart vendor in Corona looking to start a storefront restaurant, a CDFI may be the only financial institution able to offer affordable capital on flexible terms.

CDFIs were even more essential during the pandemic, when they helped thousands of small businesses access relief dollars and ride out months of closures and two-plus years of diminished revenues. In 2020, CDFIs in New York disbursed $295 million dollars in capital relief to struggling small businesses across the state and assisted with 32,612 COVID-19 disaster relief applications, while continuing to make loans to help small business owners cover expenses and even invest in growth.[4]

Most CDFIs serve just a fraction of the small businesses that would benefit from their services.

Small businesses in New York City face unmet capital needs of approximately $45 billion each year, with minority- and immigrant-owned businesses dealing with the most acute challenges accessing capital.[5] CDFIs are uniquely well-positioned to help solve this financing gap, but often lack the capacity to do so.

New York City has approximately 36 CDFIs that focus on small business lending, but only 10 to 12 of them make at least 50 loans per year, according to industry experts. And even these "more active" microlenders generally provide fewer than 350 loans annually.

Nearly all of the CDFIs we interviewed agree that they are reaching a small fraction of the minority- and immigrant-owned businesses that could benefit from their financing and advising services, and they see significant potential for their services to expand. Across more than 20 interviews with CDFIs conducted for this report, industry leaders say that the potential market for their products and services is anywhere from double or triple to more than ten times larger than their current client base.

"It's easily ten times, or more, the number of potential clients out there whom we'd like to be serving but can't today," says Yanki Tshering, founder and executive director of Queens-based Accompany Capital.

"At a minimum, we'd double or triple the amount of lending we're doing with sufficient capital to lend and resources to support our capacity-building needs," adds Aisha Benson, CEO of Nonprofit Finance Fund and former executive vice president and chief operating officer at TruFund Financial Services, a New York City-based CDFI with operations in six states. (Here and elsewhere in this report, Benson is speaking about her time at TruFund Financial Services.)

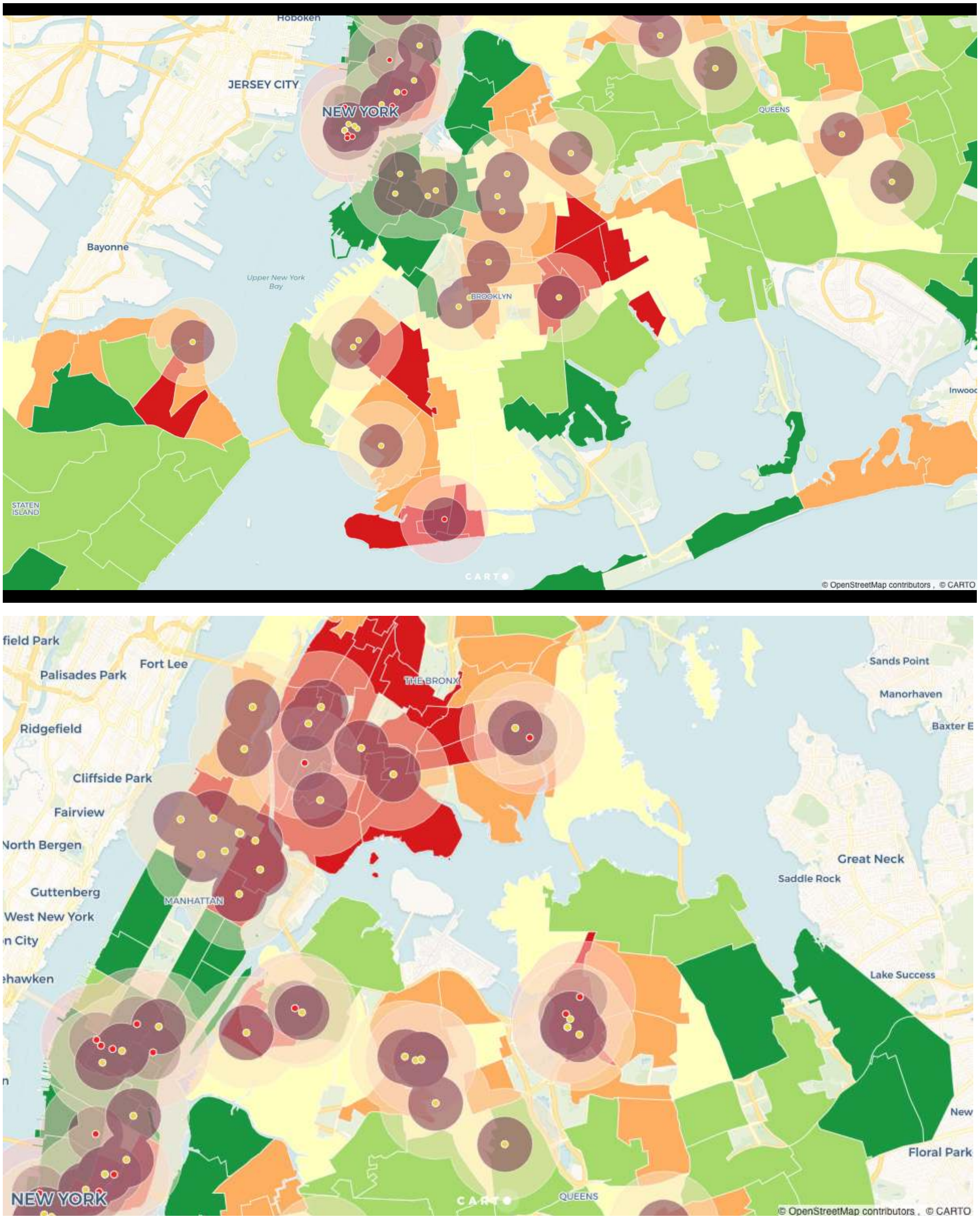
"The lack of scale is absolutely ridiculous," says Connie Evans, president and CEO of the Association for Enterprise Opportunity, a national membership organization for microbusinesses. "There is such limited capacity to get money on the street."

Geographic gaps limit the reach of CDFIs on the ground.

It's not just that CDFIs serve a fraction of those entrepreneurs who are eager to secure affordable capital, but struggle to access it. Another related problem is that most CDFIs aren't reaching low-income entrepreneurs in many communities with the greatest needs.

Because of limited capacity, CDFIs often locate in—and concentrate staff resources on—neighborhoods with the most entrepreneurs actively seeking out their capital. While such a strategy is understandable, the result is that these vital organizations lack physical locations and visibility in neighborhoods whose residents are less familiar with CDFIs but would benefit enormously from their services, including communities with a concentration of public housing developments and several of the city's lowest-income zip codes. Many CDFI leaders interviewed for this report explain they would like to assist more low-income entrepreneurs who are currently underserved by existing business support infrastructure, but they say that their organizations lack the capacity to do dedicated outreach in NYCHA developments and other communities where needs are high.

New York City Lacks CDFI Locations in Eastern Brooklyn and the Central Bronx
Dots indicate physical CDFI locations. Red areas are neighborhoods
with the lowest income levels.



Source: Data on CDFI locations from the U.S. Department of the Treasury CDFI Fund database.
Data on neighborhood income levels from the 2016-2020 American Community Survey.

“We’ve got NYCHA residents in our backyard, but we’re not seeing them coming through the door. The actual conversions of aspiring entrepreneurs into clients were few and far between,” says Alethia Mendez of Grameen America, a nonprofit microlending organization based in New York City. “We needed to bring those resources to the NYCHA campus—it wasn’t enough to just say these resources exist.”

Fewer than five of the CDFIs we interviewed say they offer programming that regularly reaches NYCHA residents through partnerships and other forms of outreach. In addition, we mapped the physical locations of CDFI offices and found that, in several neighborhoods across the city, small business owners and microentrepreneurs do not have a local CDFI to turn to—limiting awareness of CDFIs in the first place. Indeed, all the CDFIs in the city have a total of just 85 offices or branches across the five boroughs, and the lion’s share of this total comes from the handful of banks that operate with a CDFI designation. Nonprofit CDFIs, which are far more likely than their banking counterparts to serve the most vulnerable businesses and those needing the smallest loans, have fewer than 25 locations citywide.

The gaps are particularly notable in several lower-income communities with a majority-minority population, including the area around Tremont, Mount Hope, and Jerome Avenue in the Bronx; East New York and Brownsville in Brooklyn; and Far Rockaway in Queens. Staten Island is home to just a single CDFI branch, in Tompkinsville.

Physical gaps in CDFI coverage across the city have a material effect on the ability of CDFIs to reach more potential clients, says Daniel Gonzalez, director of lending at Brooklyn Cooperative Federal Credit Union. “Branches are a key part of the strategy to raise our visibility and help more people,” says Gonzalez. “The biggest challenge is letting people know that we’re here. And the biggest marketing tool is still word of mouth.”

Six Key Barriers Currently Inhibiting CDFIs from Scaling Up

1. CDFIs lack staff capacity to do more small business and microenterprise lending, even with sufficient capital.

Even as the amount of loan capital available to CDFIs has increased, most are starved for dollars to hire staff that can underwrite loans and conduct small business advising, all while providing technical assistance, meeting regulatory compliance, implementing technology upgrades, and coordinating marketing and fundraising efforts. Indeed, lending at interest rates that are affordable to CDFI borrowers doesn't begin to cover costs for most CDFIs. Between providing "one-on-one counseling to borrowers and handling paperwork, it takes as much, if not more, time to underwrite a $10,000 loan as a $100,000 loan—for substantially less income. As a result, to expand the reach and impact of CDFIs, significantly more support is needed to offset these costs.

"To double the number of loans we make, staffing is key," says Tshering of Accompany Capital. "We would need new loan officers and support staff to make more loans, provide support, and manage the back office, even with more capital to lend."

At the Greater Jamaica Economic Development Corporation's CDFI, Aron Kurlander, the organization's director of business services, says that a lack of funding to increase staffing is the single greatest barrier to serving more businesses.

"There's at least two or three the amount of potential loans to be done," says Kurlander. "I think the number is in the hundreds, but we'd need a lot more staff to make that happen. It's more than just assessing the risk of the potential loan, it's helping to put all the pieces of the business together—there's so much technical assistance that goes into making that loan a success. And we're paying twice: once to lend the money at an affordable rate and again to provide that hands-on technical assistance."

The reality for most CDFIs is that while banks, government entities, and social impact investors are providing CDFIs with more capital to lend to borrowers, CDFIs are not receiving nearly enough support for operations—unrestricted dollars that can pay for staff, technology, rent, compliance, marketing, and other costs. As a result, even as more lending capital flows to CDFIs, staffing levels remain stretched thin and their ability to scale up is seriously restricted. For instance, Accompany Capital made more than $7.2 million in loans and helped clients access about $13.5 million in COVID relief in 2021, with a staff of just 18. At BOCNet, the team made 187 new or refinanced loans in 2021, while processing 1,452 Paycheck Protection Program (PPP) loans, all with a staff of just 5 loan officers and 5 staffers focused on one-on-one technical assistance. This undertaking required working 18-hour days, seven days a week, says Nancy Carin, BOCNet's executive director.

"We don't have a development director, community partnerships lead, or someone strictly dedicated to compliance. We're really lean and mean," says Carin.

Nearly every CDFI we spoke with described tangible opportunities to reach more immigrant and minority entrepreneurs that would only be possible with additional staff. For example, TruFund developed many new relationships with small business owners through the process of disbursing PPP funds, but needs more staff capacity in order to continue serving these new clients in the months and years ahead. Another CDFI, SoBro's Credit Inc., wants to hold classes to teach potential borrowers about money management before they apply for a loan—something that would bolster their chances for success—but needs more staff to do so. Neighborhood Trust Federal Credit Union, a federally certified CDFI in upper Manhattan, wants to train loan officers to work with small businesses that do much of their business in cash, but lacks the capacity to develop and implement its own training program without additional operating funds.

2. CDFIs need grant funding and support to develop and implement modern technology tools.

In addition to challenges presented by limited staff, CDFIs need significantly more funding to support technology investments that can help them keep pace with a changing marketplace. A handful of CDFIs are using technology to develop new online loan processing capabilities, including Albany-headquartered Pursuit. But most CDFIs lack the necessary funds to make these vital technology purchases. As a result, some see desperate business owners turning to for-profit online lenders with high interest rates but lightning-fast approvals, while CDFIs require a process that can take six weeks or longer to close. Given the intense pressures facing CDFIs to reach underserved entrepreneurs and underwrite loans with very limited staff capacity, technology tools can help make processing small loans far more efficient—but the upfront cost of implementing these tools is out of reach of most nonprofit lenders.

"CDFIs need to use and leverage technology to be able to scale their impact in small business lending," says Steve Nunes, a partner at NextStreet, a national small business advisory firm and consultant on CDFI issues. "There is not a path to small business lending without that."

CDFIs take pride in their high-touch practices and the mentorship and training they provide small business owners—services that are crucial to their success. Still, to compete more effectively with online lenders and meet the cash needs of local businesses, experts say, industry practices need to keep pace with the times. Not only can technology move money out the door more quickly, but it can help free up staff time to focus on the detailed underwriting and hands-on support that are central to most CDFIs' mission.

"Having the budget to integrate a technology platform would allow us to process loans more quickly, be more user friendly for clients, and implement online decisioning to make those smaller dollar loans more efficient," says Benson formerly of TruFund. "If small businesses can find a loan from an online lender and get a response in ten minutes, they'll go that route. If we, as responsible lenders, had access to the same technology platform, businesses could easily upload documents and get a faster response."

Aron Kurlander of the Greater Jamaica Economic Development Corporation agrees, explaining that the market now offers borrowers much faster turnaround times—but that those products are typically inaccessible to underserved borrowers with poor or no credit profiles, or come with painfully high interest rates.

"As technology has changed, a lot of things could help move money quicker," says Kurlander. "I have to go through the underwriting process to make sure they're viable, but they can't wait for six weeks of underwriting."

The problem is that few CDFIs have the resources to develop or purchase the kind of technology that would streamline the credit process, or hire the tech talent necessary to manage it.

"The hardest money is the $2 million to build out a new tech system," says Brett Theodos of the Urban Institute. "If you need to fund it on the back of profits from a $15,000 micro loan, you will wait a long time."

The National Development Council, for one, had to "save up" for the better part of a decade, eventually hiring a young development company to build a platform, which they installed in 2019. It has reduced paperwork and streamlined underwriting, allowing NDC to get more money to more businesses.

"It's the number one reason we were able to reach so many businesses [during COVID]," said NDC Assistant Director Oseremi Adekoye. "Technology has made life easier and the lives of clients easier. It really was the number one reason we made so many loans and reached so many businesses and in areas we would not have reached without technology. It is a lifesaver for us."

3. CDFIs still struggle to raise or borrow enough capital to meet growing demand, all while maintaining necessary reserves.

Although additional lending capital is not often the first issue CDFI leaders cite when describing obstacles to increased scale and reach, a steady supply of affordable money to lend remains an important issue. Nearly every CDFI interviewed for this study reported challenges securing enough capital to meet the demand of borrowers while maintaining the reserves needed to backstop those loans.

As New York City strives to move beyond the economic turmoil and emergency mentality of the pandemic period, experts say that the boost in lending capital directed through CDFIs should not be a one-time infusion. CDFIs will need ongoing capital infusions to continue serving the thousands of new clients who discovered CDFIs while seeking support for PPP loans; to ensure that nondepository CDFIs have sufficient capital to lend as demand grows; to keep interest rates affordable for small business borrowers; and to provide larger loans that can help close the gap between $50,000 and $250,000, where most CDFIs tap out and before most commercial banks will consider a loan.

In 2017, the most recent period for which county level data is available, CDFIs in New York City made loans totaling just 66 percent of the amount lent by CDFIs in Los Angeles County and 59 percent of that in Chicago.[6] While capacity-building investments in staffing, marketing, and technology are essential for enabling CDFIs to expand their impact, there is little doubt that ongoing infusions of long-term, affordable lending capital are also needed.

Even as additional lending capital has made its way to the city's CDFIs via new or expanded government programs and increased investment from banks via the Community Reinvestment Act (CRA), lenders say that there is a continuing need for lending capital that is longer term and lower cost—and for additional dollars to lend as client businesses grow and seek out larger loans.

To begin with, CDFIs need access to lending capital at below-market rates in order to keep costs under control for their borrowers. "If we borrow money with any kind of interest rate and try to survive on the spread, small businesses end up paying crushing interest rates," says NDC's Ann Finnegan. "If I am able to attract equity at 1 percent to 2 percent, that's money a CDFI could turn around and have [an] impact."

While additional lending capital with low interest rates is helpful, grant funding for loans has the greatest impact, says Chicago Community Loan Fund President Calvin Holmes.

"[Grant funding] sits on the balance sheet, empowers CDFIs to take on more risk, and enables them to borrow money from banks and other sources at a lower rate," says Holmes. "Then they can start to be really innovative with their credit products."

CDFIs also report the need for lending capital made available through multi-year commitments, which is a challenge today. Most sources of capital are allocated on a yearly basis, which makes long-term planning difficult and prevents lenders from offering longer-term loans that would lower the monthly costs for low-income borrowers.

"The challenge has always been consistent funding for lending capital," says Jessie Lee, managing director of CDFI Renaissance Economic Development Corp. "[Multi-year funding] would provide a new level of stability. I can budget better and it allows me to have strategy and focus."

Some CDFIs are also concerned that recent increases in lending capital—issued in response to the pandemic—will become a one-time-only influx, leaving CDFIs struggling to raise sufficient capital to meet the ongoing needs of new clients that first connected with a CDFI over the past two years.

"We have thousands of businesses that were not previously in our client base and that need continued assistance," says Benson formerly of TruFund. "We need to help those businesses beyond an emergency, and we need the capital to do it."

4. Although some CDFIs have found ways to make larger loans, there is still a significant gap between $50,000 and $250,000.

While a small number of CDFIs have found ways to make larger loans, the vast majority of nonprofit CDFI lenders are making small and microloans of less than $25,000—and, in many cases, less than $10,000. These loans fill a crucial gap in the market for small business financing, where few other products exist. But as a growing number of the businesses receiving these small loans succeed, larger levels of financing are required to help them achieve and sustain growth—from investing in new equipment and locations to financing the supplies needed to fulfill a major new contract. Often, these next-stage financing needs are in the range of $50,000 to $250,000. But while that's more than what most CDFIs can manage, those sums are less than the level at which most commercial banks are willing to lend. As a result, experts describe a gap in the marketplace that prevents some CDFI clients from being able to reach the next level of success.

When a neighborhood business has been successful and sees opportunities for growth, it is likely that $10,000 or even $50,000 is not enough to underwrite an expansion. But for most CDFIs, and particularly smaller ones, lending upward of $50,000 to $100,000 is not possible without the participation of other institutions.

"The highest we'll generally go is $100,000," says Gonzalez of Brooklyn Cooperative Federal Credit Union. "It's much harder to do participation loans [where multiple lenders lend to a single borrower]."

For some nondepository CDFIs focused on microlending, their primary source of capital is from philanthropic foundations, and few provide the level of investment needed to help clients get to the next level of borrowing.

"We have to depend on foundations, and they are not giving us the kind of capital to get someone from $25,000 to $250,000, at which point businesses would be able to get money from a traditional lender," says Maria Otero, founder and president of the Women's Venture Fund, a CDFI focused on supporting low-income women entrepreneurs.

That ceiling is a function of the size of many of the small businesses served and their needs, but it also reflects the capital and reserve constraints that prevent many CDFIs from making larger loans, even as some clients have needs that few lenders are able to meet.

"We are one of very few CDFIs in New York City that are servicing that gap," says Benson formerly of TruFund. "CDFIs started out as microlenders and many remain micro-focused. Some have begun to increase their exposure, but typically to the $100,000 or $150,000 mark. It requires more capital and reserves, more in-depth underwriting, and higher risk tolerance. It really takes time to be able to get to that next level."

5. To reach far more potential customers in underserved communities, CDFIs need help with marketing, outreach, and expansion.

Even with additional capital to lend, CDFIs would still face challenges extending their services to reach more underserved small business owners. Many CDFIs, especially smaller ones, do not have a staff person dedicated to marketing or, if they do, it's only one task on a longer list of responsibilities.

"The biggest challenge is letting people know we exist," says Gonzalez of Brooklyn Cooperative Federal Credit Union. "A lot of people don't know what a credit union is or what we can provide."

According to Federal Reserve survey data, only about 2 percent of employer firms nationally have used a CDFI as a financial services provider, although the share increases to 6 percent of Hispanic-owned firms and 9 percent of Black-owned firms. (Many CDFI clients are microentrepreneurs or very small business owners and, as such, would not have participated in these surveys.) Notably, CDFIs earned the highest level of satisfaction, 70 percent, among employer businesses of any lenders, including large and small banks, credit unions, financial services companies, and online lenders.[7]

Raising the profile of CDFIs in an era of online and app-based lending presents additional challenges, while the digital divide among small business owners makes door-to-door marketing equally essential. But New York's nonprofit CDFIs generally budget no more than a few thousand dollars for marketing and outreach each quarter—a shockingly small sum in a market as large and as costly as New York, and a fraction of what is needed to raise the visibility of these vital organizations.

"We budget about $35,000 annually for marketing," says Tshering of Accompany Capital. "This has to cover online, in person, and social media marketing campaigns and direct outreach to businesses. It can't go very far. If we had, say, $150,000, and could add staff completely focused on both in-person and online marketing, we'd have a much larger pool of people to service. Out of every ten leads we generate, we're lucky to end up making one new loan."

Already strained for capital, few CDFIs have a trained marketing person on staff dedicated to getting the word out or the capacity to evaluate the results of whatever marketing they are able to do. They rely on referrals from banks, community organizations, and the Business Solutions Centers operated by New York City's Department of Small Business Services, as well as word of mouth from existing clients who refer their families and friends.

"We just don't have a budget for marketing," says Benson formerly of TruFund. "There's very little we can do with grant-based funding to invest in marketing on the level of an individual CDFI."

In some cases, clients eventually find their way to a CDFI, but only after ending up in trouble with predatory loans from payday or other lenders.

"Not until they are actually in dire stress with predatory lenders will you see them come to us," says Erika Powell-Sinclair, director of loan fund and portfolio management at the Harlem Entrepreneurial Fund, a CDFI that provides loans to small businesses in Harlem, Washington Heights, Inwood, and the Bronx. Powell-Sinclair says that when she started working at the Fund, she was the sole underwriter, compliance officer, and marketer. The Fund has since added one more loan officer, but its marketing budget this year is just $10,000 to $15,000.

In immigrant communities, the challenge of marketing CDFI products and services is compounded by the need to make materials available in multiple languages—including translating materials from government agencies. According to Jennifer Sun, co-executive director of Asian Americans for Equality, the parent organization of Renaissance Economic Development Corporation, her team had to recruit volunteers in New York and New Jersey to translate documents for emergency relief grant applications and market these resources in multiple languages.

CDFIs also need more support to reach some of the city's most underserved entrepreneurs, including public housing residents, those on public assistance, and new immigrants—all of whom face unique barriers to starting a business, generating savings, and acquiring assets. With a combination of affordable capital and one-on-one technical assistance, CDFIs are uniquely positioned to help aspiring entrepreneurs overcome these barriers, but lenders say that they have little visibility or presence in some communities that could benefit the most from their services.

"We can help them, but people don't know [about us]," says Gonzalez of Brooklyn Cooperative Federal Credit Union. "Just spreading the word that we're here, that we exist, would go a long way."

Marketing Budgets of Select NYC CDFIs on Average, 2021

CDFI	Budget
Accompany Capital	$35,000
The Harlem Entrepreneurial Fund	$12,500
TruFund	$0

6. Serving more low-income and underserved borrowers requires more support to manage risk.

Given the higher level of risk assumed by CDFIs, loan loss reserves and loss guarantees are critical to enabling these institutions to expand their impact and serve more of the hardest-to-reach business owners in lower-income communities. Such backstops bolster CDFIs' balance sheets and enable them not only to disburse more capital but also become a more attractive recipient of corporate and philanthropic investment.

For most CDFIs, raising capital to lend to borrowers is only part of the challenge. First, CRA funds typically require CDFIs to maintain a net asset ratio of around 20 to 30 percent or lose their ability to borrow. That means that for every $10 they lend, they need to raise $2 to $3 of additional equity. In addition, CDFIs spend significant staff time and resources on technical assistance for borrowers, further increasing the total cost of making a loan.

CDFI leaders say that reaching more of the most underserved entrepreneurs would require substantial new commitments to boosting loan loss reserves, new technology to better assess creditworthiness using a multitude of data points, support to expand the use of no-collateral loans, and other types of credit enhancement and risk-mitigation techniques.

"We need more collateral guarantees," says Gonzalez of Brooklyn Cooperative Federal Credit Union. "We have the capital to lend, thanks to our deposits, but stronger guarantees are a great way to ensure that we can make more of these loans."

CDFI leaders point to a handful of credit enhancement mechanisms that are working and which, experts say, could be expanded in order to help institutions provide loans to entrepreneurs with significant potential to succeed but whose history makes their credit profile less attractive—or who lack a credit history in the first place.

Several CDFI leaders pointed to the New York City Economic Development Corporation's Neighborhood Credit Fund as a workable model, which provides loan loss reserves to CDFIs, allowing for $2 in reserves for every $1 a CDFI puts up. For 2019 and 2020, however, the fund was budgeted at just $2.5 million and "has a lot of room to grow," says Steven Cohen, president of Pursuit Community Finance.

Strengthening CDFIs in Chicago

In the city of Chicago and surrounding Cook County, local CDFIs play a critical role lending to and advising small business owners who face challenges accessing more traditional loans. In 2017, the most recent year for which data is available at the county level, CDFIs based in Cook County made $235.2 million in small business loans, more than Los Angeles County or New York City. However, experts say that even as Chicago's CDFIs lend more money than those in other major cities, similar capacity challenges prevent them from reaching many of the 22,500 minority-owned employer businesses that would benefit from their services.

In addition to capacity challenges around staffing, marketing, and technology, the CDFI landscape in Chicago includes significant geographic gaps, including several of the city's lowest-income neighborhoods that could most benefit from CDFI support. The gaps are particularly notable in the historically Black neighborhoods of Chicago's South Side. The South Shore, Calumet Heights, and South Deering communities are all neighborhoods well below the city's median income level and lack a physical CDFI branch presence.

To expand their impact across these underserved neighborhoods, Chicago-based CDFIs need more support to invest in outreach, expansion, and marketing. The Chicago-based CDFI Allies for Community Business (A4BC) is one of the largest in the region, with a $45 million balance sheet and more than 1,500 loans booked in 2020. However, the organization still lacks sufficient funding for the marketing and physical expansion needed to reach more of the city's most underserved entrepreneurs.

"Marketing is always a huge challenge," reports A4CB CEO Brad McConnell. "We don't have an unlimited marketing budget and even though we're getting better at using megaphones, the underserved are harder to find."

Another obstacle preventing CDFIs from achieving greater impact is the cost of implementing current technology. CDFIs in Chicago say that advances in technology can enable faster decision-making and cut down on staff time—making small-dollar loans more sustainable for the lender while improving the experience for the client. Only the very largest CDFIs have been able to invest in these crucial upgrades—and for those who have, like A4CB, the results have been transformative.

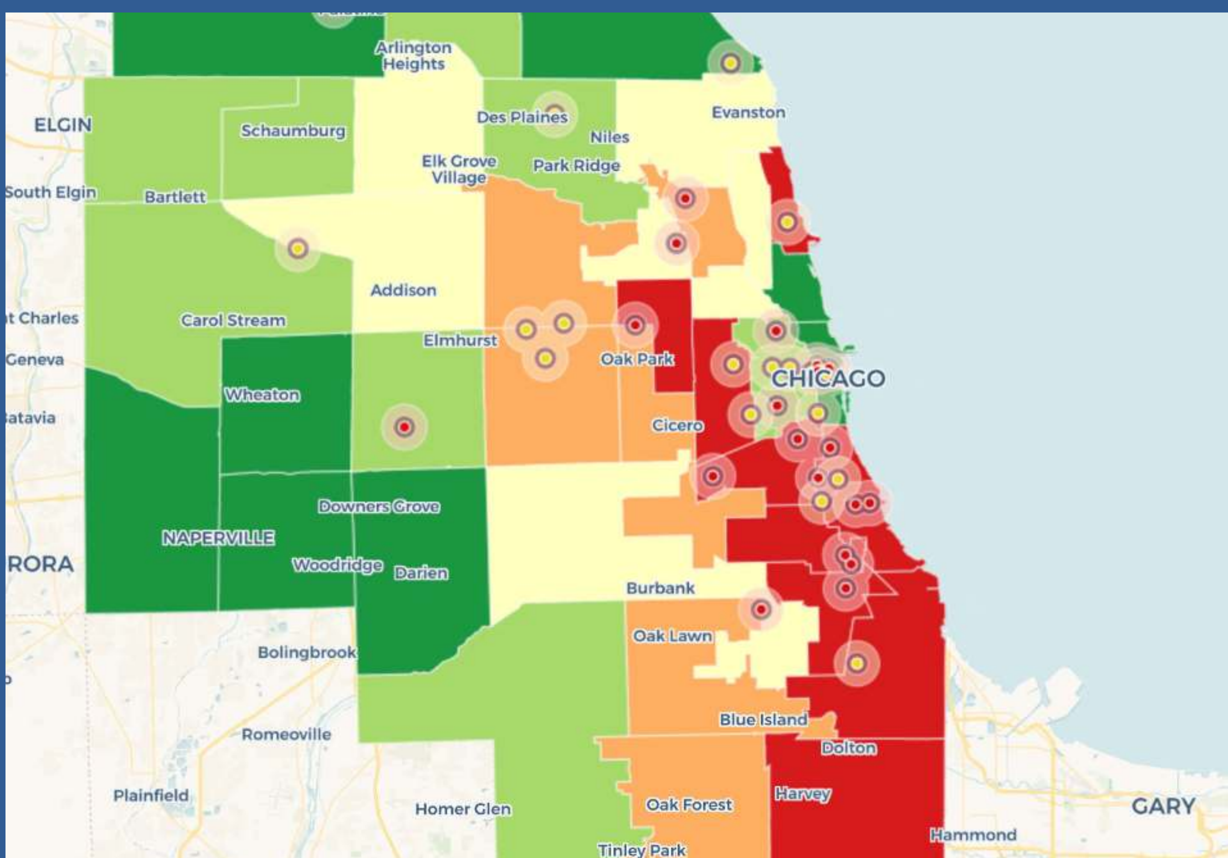
“We now don’t use credit scores at all,” says McConnell. “We don’t use the value of an entrepreneur’s personal collateral because we have the technological capacity to machine-read the line items off credit reports from TransUnion and to go underneath the credit score with our own algorithm to figure who to lend to. We developed it ourselves and it’s targeted to people we care about—the people left behind, who are served poorly and pay 47 percent interest rates to online lenders.” For most CDFIs, a system like this is out of reach; upgrades can cost hundreds of thousands of dollars, grant funding for technology is very limited, and saving for these upgrades with retained earnings can take years.

Chicago’s CDFIs have the potential to expand their scope and scale their impact, but they need the resources to increase their capacity. More than low-cost lending capital, CDFI leaders say that flexible grants are needed to enable CDFIs to scale up their services and connect with more hard-to-reach entrepreneurs. “A grant sits on the balance sheet, empowers CDFIs to take on more risk, and enables them to borrow money from banks and other sources at a lower rate,” explains Chicago Community Loan Fund president Calvin Holmes. “Then they can start to be really innovative with their credit products and provide products to the marketplace that are right sized to market conditions.”

With additional unrestricted grant funding for staff, marketing, outreach support, and technology upgrades, Chicago’s indispensable CDFI organizations can be scaled up to serve more of Chicago’s thousands of immigrant- and minority-owned small businesses and reach far more entrepreneurs in need of their services.

Some low-income neighborhoods in Chicago lack CDFIs

Dots indicate physical CDFI locations. Red areas are neighborhoods with the lowest income levels.



Source: Data on CDFI locations from the U.S. Department of the Treasury CDFI Fund database. Data on neighborhood income levels from the 2019 American Community Survey.

Boosting CDFIs in Los Angeles

CDFIs also act as a lifeline for thousands of minority-owned small businesses and microentrepreneurs in the Los Angeles area. Like their counterparts in other large, urban centers, Los Angeles CDFIs are often the only place where first-time and smaller-scale entrepreneurs—including recent immigrants and those with thin or poor credit profiles—can get financing and business counseling. Still, CDFIs struggle to meet the needs of the county's more than 81,500 minority-owned employer businesses. In 2017, Los Angeles County CDFIs lent out $210.3 million to small businesses—less than Cook County, Illinois, which is home to fewer than one-third as many minority-owned businesses.

In addition to serving just a sliver of the entrepreneurs eager to secure affordable capital and business assistance, Los Angeles County's CDFIs face challenges reaching lower-income entrepreneurs in many of the county's most vulnerable communities. Neighborhoods in South Los Angeles, like Watts, Florence, and Huntington Park—all communities with a majority-minority population and income levels well below the city median—lack access to a nearby CDFI.

Since most CDFIs do not have the marketing resources necessary to expand their reach into more of the city's lowest-income zip codes, residents who may benefit from local CDFI services may not even be aware of them in the first place. Marketing to small businesses that may never have heard of a CDFI is a significant challenge for these institutions, especially given chronic staffing shortages. Robert Villarreal, chief external affairs officer of CDC Small Business Finance + Capital Impact Partners, which has seven branches in California, including one in Los Angeles, reports that customer acquisition continues to be one of the biggest challenges. "Customer acquisition is always an issue," says Villarreal. "It's expensive to hire loan officers, put them on the ground. We're all struggling with it."

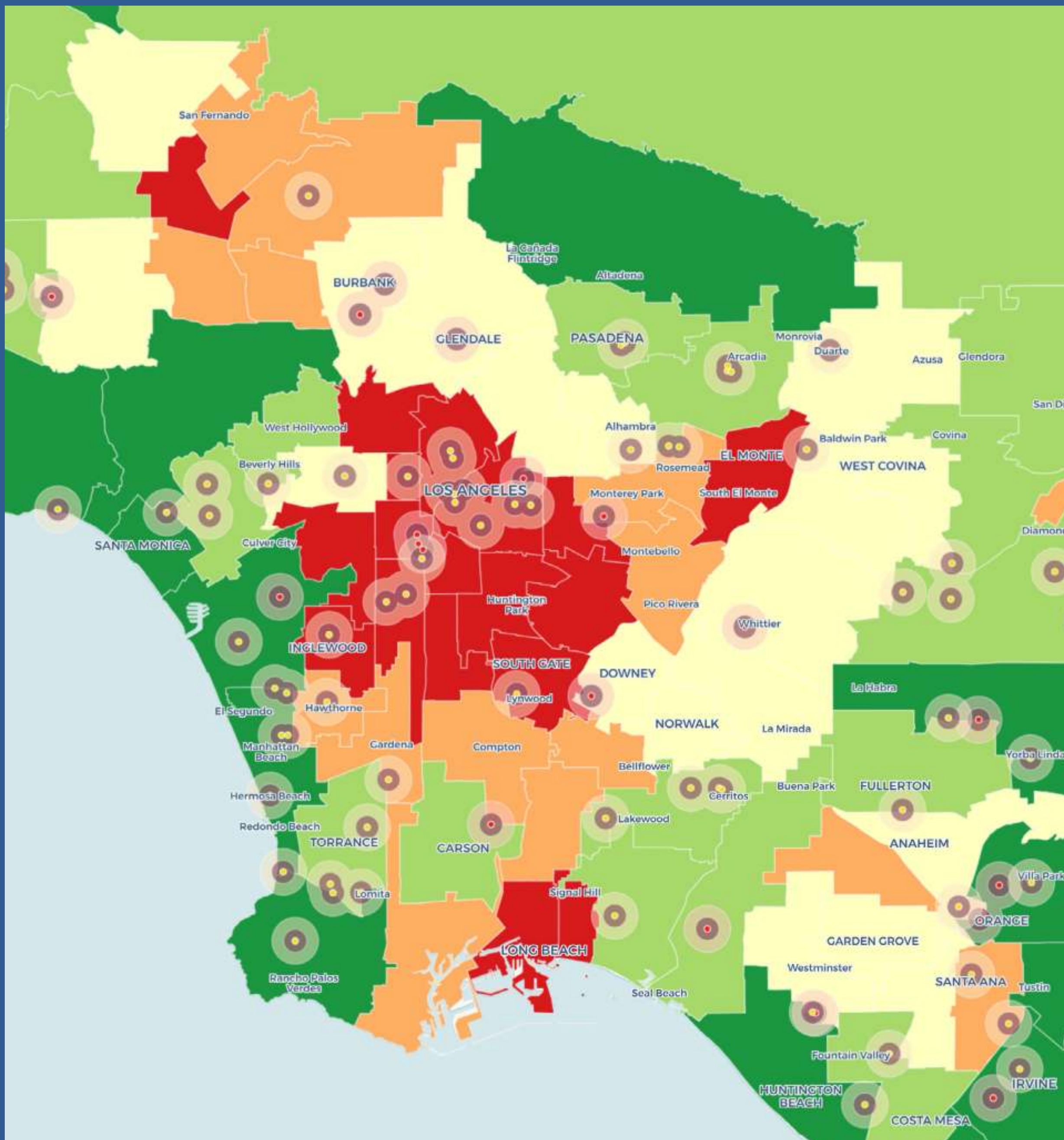
Even if CDFIs are able to reach more potential clients, a dearth of grant funding makes it difficult for CDFIs to implement current technology tools and deliver their services on a timeline comparable to online lenders. As a result, some businesses are opting for much more costly loans simply because they can get the financing they need more quickly—and CDFIs are struggling to keep pace. Additional resources to upgrade their technology systems would allow most CDFIs to quicken the speed of their underwriting process, keeping up with for-profit lenders and better serving the needs of their clients. For instance, CDC Small Business Finance + Capital Impact Partners typically needs 30 to 60 days to process a loan, according to Villareal.

"How do we get that Black-owned business that has $75,000 to $100,000 a year in revenue without them going to an online fintech lender and getting a decision in three hours?" he asks.

Ultimately, a lack of flexible grant funding for capacity-building investments—in staffing, outreach, marketing, and technology—is the greatest obstacle to greater impact for Los Angeles's CDFIs. "There's lots of need out there that we would love to address, but we do not have the capacity," says Delores Brown, president of the Community Economic Development Corporation in Los Angeles, which partners with Clearinghouse CDFI to make small business loans. Brown says that she and her colleagues are creative in sourcing money, seeking out public-private partnerships, and working to tell the CDFI story, but they need a new level of public investment to reach their full potential.

South Central Los Angeles lacks access to CDFIs

Dots indicate physical CDFI locations. Red areas are neighborhoods with the lowest income levels.



Source: Data on CDFI locations from the U.S. Department of the Treasury CDFI Fund database. Data on neighborhood income levels from the 2019 American Community Survey.

Recommendations

How To Help CDFIs Expand Their Reach and Deepen Their Impact

1. Make CDFIs a key component of city and state efforts to boost underserved small businesses.

With decades of experience supporting immigrant- and minority-owned small businesses and unparalleled trust among entrepreneurs from lower-income communities, CDFIs are uniquely positioned to help more underserved entrepreneurs start and grow their businesses. But despite the near consensus among city and state policymakers that strengthening these businesses should be a top priority, CDFIs have seldom been enlisted as essential partners in these efforts. They also receive just a tiny fraction of city funding that goes to small business services. If government is to succeed in bolstering underserved businesses for years to come, this will need to change. Mayor Adams should start by directing New York City's Department of Small Business Services (SBS) and Economic Development Corporation (EDC) to embrace and support CDFIs to a far greater extent. This means taking steps to ensure that CDFIs receive a larger share of city funding for small business assistance, integrating CDFIs into every new small business assistance grant and loan initiative launched by SBS and EDC, greatly expanding the number of referrals to CDFI partners made by the city's Business Solutions Centers and through programs like Black Entrepreneurs NYC and Women Entrepreneurs NYC, and consulting with CDFIs regularly on the design and implementation of new small business support programs.

2. Create a new capacity building fund for CDFIs, enabling them to increase staff and invest in technology.

One of the clear findings of this report is that CDFIs are most in need of additional operational support—not lending capital—so they can hire more staff to underwrite loans and invest in new technology tools that make processing small loans far more efficient. Despite the clear need for operating support, however, government and private sector partners too often only seek to provide lending capital to CDFIs. To change this and help CDFIs reach significantly more minority- and immigrant-owned businesses, city and state leaders should establish a new capacity-building fund that provides multi-year grants for CDFIs to ramp up investments in staffing and technology.

3. Help raise the visibility of CDFIs to expand their reach and impact.

CREATE A UNIFIED CDFI NETWORK MODELED ON PHILADELPHIA'S BUSINESS LENDING NETWORK, SIMPLIFYING THE PROCESS FOR SMALL BUSINESSES SEEKING FINANCING AND GENERATING REFERRALS TO CDFIS CITYWIDE. New York City's underserved small business owners have no central place to turn to connect with CDFIs and understand their menu of services. New York City should simplify the process by setting up a capital consortium modeled on the Philadelphia Business Lending Network, enabling small business owners to express an interest in receiving financing from a network of approved lenders. A unified portal would allow small business owners to complete one form and be seamlessly matched with participating CDFIs or other community lenders that could support their capital needs and provide tailored technical assistance.

HELP CDFIS REACH MORE UNDERSERVED COMMUNITIES WITH NEW SUPPORTS FOR PHYSICAL EXPANSION AND GRANTS TO DEPLOY ON-THE-GROUND OUTREACH TEAMS. More than a dozen lower-income neighborhoods across the city lack a single physical CDFI outpost, even as many CDFIs report that their storefront locations are a major driver of new client relationships. City leaders should work with the Department of Housing Preservation and Development and NYCEDC to incentivize the creation of new CDFI branch locations in existing CDFI deserts, including Tremont and the Jerome Avenue corridor in the Bronx, East New York and Brownsville in Brooklyn, and Richmond Hill and Far Rockaway in Queens. The city's housing and development agencies should work with SBS to identify ground floor locations and unfilled community facilities in city- and state-financed developments and help bring CDFIs into those spaces. In addition, city leaders should work with SBS to launch a grant program designed to enable CDFIs to deploy door-to-door outreach teams to the places where underserved entrepreneurs live and work, including NYCHA developments and public libraries.

CONNECT NEW BUSINESS INCORPORATION FILERS WITH CDFI REFERRALS AND ENCOURAGE BANKS TO REFER REJECTED BUSINESS LOAN APPLICANTS TO MICROLENDERS. As they pursue capital to start or grow their businesses, many underserved entrepreneurs discover that a traditional commercial bank may not be a good fit for their needs but lack awareness that CDFIs can provide a workable alternative. To address this disconnect, city and state policymakers should encourage banks to refer applicants turned down for business loans to local CDFIs. Currently, too few banks are making these referrals, even though doing so may help them get business from that entrepreneur down the road. At the same time, several CDFIs—especially those that are depository institutions—have sufficient capital to do more lending, but need a more consistent influx of new potential clients. To further boost awareness of CDFIs, New York State could provide all individuals incorporating new businesses in the state with a welcome packet introducing them to their local CDFIs and the services they provide.

LAUNCH A CDFI SUCCESS STORIES CITYWIDE MARKETING CAMPAIGN. For many CDFIs, the greatest obstacle to expanding their reach and impact is a general lack of visibility in the marketplace. To help CDFIs reach more of the underserved entrepreneurs who have the most to gain, New York City should do more to make CDFIs a household name. Launching a CDFI Success Stories marketing campaign—with outdoor and online advertising and outreach via community events, vendor fairs, and festivals—could raise the visibility of relatable business owners who have started and grown businesses with support from CDFIs.

4. Ramp up investments in multiyear loan and equity capital to support increased lending and assistance to small businesses.

Although access to loan and equity capital is a smaller challenge than the need for capacity-building support, many CDFIs report sufficient demand to expand their lending by a factor of two, three, or more—but lack the capital and reserves to do so. While New York City and State have devised a handful of vehicles to help capitalize CDFIs, funding has historically been limited and lacked the multi-year certainty that these institutions need to budget effectively and build sustainable strategies to support local small businesses. As policymakers consider new funding mechanisms and the renewal of existing vehicles, they should prioritize multiyear investments that incorporate sufficient flexibility to allow CDFIs to direct dollars to their most useful purpose; expand existing mechanisms that are working; and launch new vehicles that build on successful programs at the federal level.

SCALE UP NYCEDC'S NEIGHBORHOOD CREDIT FUND. Working with five CDFIs, NYCEDC provides credit enhancement for loans of $10,000 to $250,000 for the purposes of working capital, tenant improvements, refinancing of existing loans, and the purchase of machinery and equipment. The fund has been successful in helping CDFIs make more loans to underserved businesses by providing a two-to-one match on their reserves, but has received just a modest allocation of $2.5 million. Mayor Adams and the City Council should work with NYCEDC to expand the program to $10 million, potentially in partnership with philanthropic foundations and larger financial institutions.

5. Sustain and grow state-level pandemic-era initiatives to ensure long-term impact.

MAKE THE NEW YORK FORWARD LOAN FUND A PERMANENT PROGRAM. State policymakers and Empire State Development should work with funders to continue the pandemic-driven New York Forward Loan Fund on a permanent basis. Launched in 2020, the fund provides working capital loans to small businesses and nonprofit organizations. The state provides first-loss capital for a special purpose vehicle that purchases locally originated loans. Foundations and philanthropies provide the next layer of capital, while banks contribute $100 million in senior debt to the vehicle. CDFIs are the conduit through which the money flows to small businesses around the state. Continuing the New York Forward Fund would greatly expand the reach of CDFIs into minority and immigrant communities, providing a reliable, ongoing source of capital in partnership with private industry and philanthropic partners. New York should also seek the participation of other states, such as New Jersey and Connecticut. Such an initiative would mirror the $50 million Southern Opportunity and Revitalization (SOAR) Fund, which includes 15 southern states and the District of Columbia as participants.

FULLY FUND AND SUSTAIN THE NEW YORK STATE CAPITAL ACCESS PROGRAM. Empire State Development's Capital Access Program provides crucial matching funds that help CDFIs maintain their legally required loan loss reserves against potential defaults. However, ESD stopped providing reserves in February 2020, just weeks before the pandemic's first wave peaked. Without these funds, CDFIs are obligated to devote more of their scarce capital to backstopping potential losses rather than lending it out to businesses that need cash to survive and grow. Fortunately, the state has directed a one-time influx of $29 million in federal COVID relief dollars to recapitalize the program, but there is no guarantee that this crucial vehicle will continue. State policymakers should work with ESD to baseline the program going forward, making it a permanent part of the state's small business development strategy.

ENSURE THAT AT LEAST $100 MILLION IN FEDERAL SSBCI FUNDING FLOWS THROUGH THE STATE'S CDFIS—AND SUSTAIN THAT FUNDING GOING FORWARD. New York State was allocated $501.5 million in new federal funding through the Small Business Credit Initiative (SSBCI), a part of the American Rescue Plan designed to address the economic impact of the COVID-19 pandemic on small businesses. This investment includes funding for technical assistance providers as well as start-up capital, and could be a gamechanger for CDFIs and their clients—but only if a significant portion of that funding is directed to them. ESD has taken some important initial steps to direct this funding to support the recovery and future growth of traditionally underserved small businesses; however, for this strategy to succeed, a significant portion of the funding—at least $100 million—should be channeled through the state's CDFIs, and new programs should be developed in the coming years to help sustain the impact of this influx of funding on socially and economically disadvantaged businesses.

ENDNOTES

1. As the Federal Reserve noted in its 2022 Small Business Credit Survey, “Firms owned by people of color were more likely to apply for traditional financing than white-owned firms, but they were less likely to receive the funding sought.” Federal Reserve Banks, 2022 Report on Firms Owned by People of Color, June 2022, https://www.fedsmallbusiness.org/survey/2022/2022-report-on-firms-owned-by-people-of-color.
2. Next Street and Common Future, New York City Small Business Ecosystem Assessment, February 2021, https://nextstreet.com/research-and-publication/meeting-small-businesses-where-they-are-nyc.
3. Total dollar amount of Community Development Financial Institution (CDFI) investments that closed in 2017, as self-reported through the Community Investment Impact System and accessed through PolicyMap.
4. New York State of Opportunity and Empire State Development, Community Development Financial Institutions Assistance Program Annual Report, 2020, https://esd.ny.gov/sites/default/files/news-articles/2021-CDFI-Report.pdf.
5. Next Street and Common Future.
6. Data from the Community Investment Impact System database accessed through PolicyMap.
7. Data from the Federal Reserve Bank’s 2022 Small Business Credit Survey, 2022 Report on Employer Firms, 2022 Report on Firms Owned by People of Color, and 2021 Report on Employer Firms, https://www.fedsmallbusiness.org/survey.