

Best Practices for Virginia's New CDFI Fund

Virginia First Cities Bd. Meeting

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State and Local Government Policy Clinic

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DISCLAIMER

The ideas and recommendations expressed in this presentation are not those of the University of Virginia, or the University of Virginia School of Law. They are those of the authors of this presentation alone.

State and Local Government Policy Clinic

- Established in 2020, the Clinic provides free legal and policy research to state and local government officials.
- Examples of Clinic work
 - Worked with individual legislators to develop, draft, and secure passage of legislation (all bills passed)
 - Assisted one local government to research youth violence prevention strategies
 - Worked with Local Government Attorneys Association to engage in comprehensive research on collective bargaining.
 - Conducted research for First Cities on CDFIs.
 - Staffed and supported Governor's Commission to Examine Racial Inequity in Virginia Law

CDFI Research Approach

- Reviewed relevant state and federal law
- Researched additional state and federal funding opportunities
- Reviewed CDFI coalition survey
- Interviewed 4 CDFI Leaders
- Spoke with key DHCD staff, and listened in on stakeholder calls
- Reviewed a range of literature and studies on best uses of CDFIs and CDFI Funds

Virginia's CDFI Landscape



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Survey & Interview Findings

- Virginia's CDFIs overwhelmingly are looking for funds in the following two buckets:
 - (1) **low-cost loans** that increase lending capital
 - (2) **grants** that help CDFIs meet their operational needs
- ALL CDFIs in Virginia see it as a priority to **share CDFIs' stories with policymakers** and get the word out about their work.
- All CDFIs interviewed expressed a desire for **predictability and sustainability, if not longevity**, in the use of the fund.
- Smaller and newer CDFIs see the initial \$10 million, even after being split several ways, as a potentially catalytic amount of money, a grant or loan from which could dramatically increase loan and/or organizational capacity. These CDFIs agree though that the goal should be to use the funds in a way that makes the funds last and grow, rather than using it up immediately.

Incoming Federal Funds

- CDFI Fund
 - Certification
 - Financial and technical assistance programs for CDFIs
- CDFI Rapid Response Program
- Emergency Capital Investment Program
- The American Rescue Plan Act's State Small Business Credit Initiative Allocation
 - Administered by the states
 - \$1 billion incentive program for “robust support”

Alternatives: Possible Uses of CDFI Fund



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Stakeholder Goals for the Fund

- Greatest Measurable Impact
- Rapid Deployment
- Equitable Access for women and minority owned businesses
- Aid in Long-Term Covid-19 Recovery
- Leverage Outside Funding
- Build Success Stories for Political Momentum

Options for Fund Strategies

- Loan Loss Reserves
- Credit Enhancement
- Direct Grant
- Balance Sheet Support
- Technical Assistance

Loan Loss Reserve Pools

State funds support **pools of reserve capital** that backstop large portfolios of **small working capital loans** through a form of **default insurance**. Even small reserves (<15% of total principal) can de-risk loans significantly, helping to unlock access to private capital for high-risk/low-credit borrowers.

- Works well for minority/low-income borrowers
- Creates an extremely high leverage ratio
- Closest direct connection to job support
- Flexible + can deploy funds quickly

- Requires high volumes of small customers
- Can take time to build effective reserve pools
- More effective at retaining existing jobs than creating new ones.

- Good for startups and young businesses; can help them access private credit
- Works well for micro-businesses who need working capital to sustain cash flow
- Works best for high-volume micro-lenders, who have experience running reserve pools and connections to borrowers in market
- Pools can be parked with CDFIs in advance, giving them a platform to raise private capital and make more/bigger loans.

Tailored Credit Enhancements

Grant funds ease credit and capital requirements for **individual loans** through tailored mechanisms like **collateral support, partial guarantees, and loan participation**. These structures tend to support **larger loans** (\$500k-\$1m), often to finance **asset and real estate purchases** that are too risky for traditional banks.

- Strong connection to new job growth
- Lets small businesses deploy their capital to grow
- Helps smaller CDFIs stretch their borrowing capacity and de-risk their portfolios

- Less impact in minority/low-income communities
- More capital-intensive than reserve pools
- Highly tailored to individual projects, requiring experienced program administration/oversight

- Good fit for growing businesses, turnarounds, and capital-heavy startups.
- Works well for owner-occupied real estate, specialty equipment, and growth assets.
- Allowed smaller CDFIs to take part in bigger, riskier loans that stretch their lending capacity but have high returns when de-risked.
- Can fill gaps in programs like SBA 504 loans

Direct Grants

Grant funds are funneled directly into **loan principals**, either through **targeted grants** to CDFIs to enable lending or **grant-funded programs** administered by CDFIs. The role taken on by the CDFI varies, and can include origination, underwriting and servicing of loans; payments usually flow back into CDFIs as a balance sheet asset.

- Directly supports small businesses; can help create success stories + political momentum
- Flexible + easy to deploy capital to borrowers
- Can fundraise on future returns to lever portfolio

- One of the least efficient methods leverage-wise
- More capital intensive; may eat up small fund
- Requires risky bets on high-growth businesses; may require thoughtful design/oversight.

- Program design is versatile based on goals:
 - **Speed**—Wide-open, first-come-first-served structures speed fund deployment
 - **Targeting**—Tight criteria and close partnerships can help target key areas
- May be too inefficient for a small fund, especially given need for close oversight; can be more impactful with significant private leverage

Balance Sheet Support

Grant funds can support CDFIs through balance sheet support (**equity, long-term/low-cost debt**) to increase CDFIs' financial health and empower them to access private capital. Governments can **contribute directly** to CDFIs or **incentivize private investment** through tax credits and community reinvestment initiatives.

- Equity can help CDFIs grow + leverage portfolio
- Long-term, low-cost debt provides CDFIs patient capital for active, flexible lending
- Incentivizes major private investment into CDFIs

- Feels a bit disconnected from entrepreneurs; may be challenging to create success stories.
- Could rapidly consume small CDFI Fund
- Federal programs hit same niche with more \$\$\$

- Virginia CDFIs say a broader financial base will help them tap ample private credit supply and meet heightened borrower demand
- Prizes CDFIs as linchpin of VA development plan
- Could be a major long-term investment in equitable capital access + economic growth in low-wealth and underserved areas.
- Tax credits and reinvestment plans help direct ample private capital streams into CDFIs

Technical Assistance

Grant funds invested in **technical assistance (TA)** make capital investments more effective by **bolstering CDFI capacity** (with staffing support, market expertise, marketing resources) and **empowering small entrepreneurs** (through business support, financial planning, workforce development and other professional resources)

- Removes hurdle to efficient capital deployment
- Builds capacity and supports long-term growth in minority and low-income communities
- Creates strong, lasting public-private partnerships

- May serve CDFIs' goals more than DHCD's
- Lender-focused TA lacks direct connection to small business growth
- Metrics for success will be secondary

- Virginia CDFIs say lender-focused TA is essential to help them maximize their potential, connect ample credit supply + borrower demand
- TA grants are cheap and flexible, and can be folded into larger projects to ensure success.
- Setting precise goals will help ensure efficient use of TA funds; programs might target underserved populations, or address particular capacity gaps that could boost CDFI lending.

Equity Considerations

- Limited racial and gender data tracking
- Opportunities for targeting women- and minority-owned business enterprises

Recommendations for City Leaders

- Identify CDFIs in your city, or those who could work in your city.
- Understand their current work plans and goals
- Partner to identify and develop strategies to address economic needs in your jurisdiction to aid in Covid recovery, support small businesses, and promote racial and gender equity in economic opportunity.
 - Identifying and targeting specific businesses
 - Collaborating, where possible, on capital development
 - Supporting outreach efforts to raise awareness about CDFI's and their services and lending programs.