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MICRO AND SMALL BUSINESS FINANCE IN THE USA:

A STRATEGY FOR STRUCTURAL AND POLICY CHANGES IN THE SECTOR

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Acknowledgements

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We would also like to thank our other sponsors:

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In addition, we would like to thank the many individuals who were kind enough to give up their time and allow members of our team to interview them over the past four months. The list of interviewees is in the back of the document.

Context

The American Dream is out of reach for millions of Main Street and micro business owners. Yet there is cause for optimism: Technology is making it possible for new providers to deliver capital to Main Street in new ways. Automated credit decisions that aggregate and analyze a wide array of contextual data as well as peer-to-peer lending and its corollary, crowd-funding, are fast becoming the norm. In parallel, post-crisis performance pressures mounting within the traditional worlds of banking, community development finance and philanthropy are pushing leaders in each discipline to explore new models for investment and capital formation as well as product distribution and development.

Against this backdrop, AEO, the national trade association for US microfinance, asked Ira Lieberman, one of the pioneers in enabling microfinance to scale internationally, to assemble a team of experts to answer the question, “What investments in infrastructure and capacity are required to ensure that mission-focused lenders and service providers remain relevant and achieve sustainability in the United States?”

At the same time, AEO asked Mitch Jacobs, a serial entrepreneur with a long track record of serving Main Street, to Co-Chair the Micro Capital Task Force (MCTF), a systematic and coordinated effort to bridge the emerging and established elements of the U.S. financial system in order to solve the gap in loans <$250K. The MCTF represents all of the stakeholder groups that must engage to advise Treasury and the White House.

This meeting represents the intersection of AEO’s priorities: Moving money to Main Street and ensuring that mission-focused lenders and service providers are prepared to do their part.

Our time together on 19 February will shape and inform a path forward for the Micro Capital Task Force. We will also use some of the time to test a framework and initial hypotheses for the MCTF working groups in order to continue engagement with a broader group of stakeholders.

Following this meeting, AEO will continue to engage with each of you and others as we support the conveners of the MCTF Working Groups. This entire process is expected to culminate in formal recommendations to the Department of Treasury, the White House, and Congress in June.

Contents

Overview

Primary Objectives of the Strategy

1) Provoke micro and small "Main Street" business growth and new jobs
2) Support underserved populations
3) Generate a culture where access to finance is more readily available at sustainable interest rates

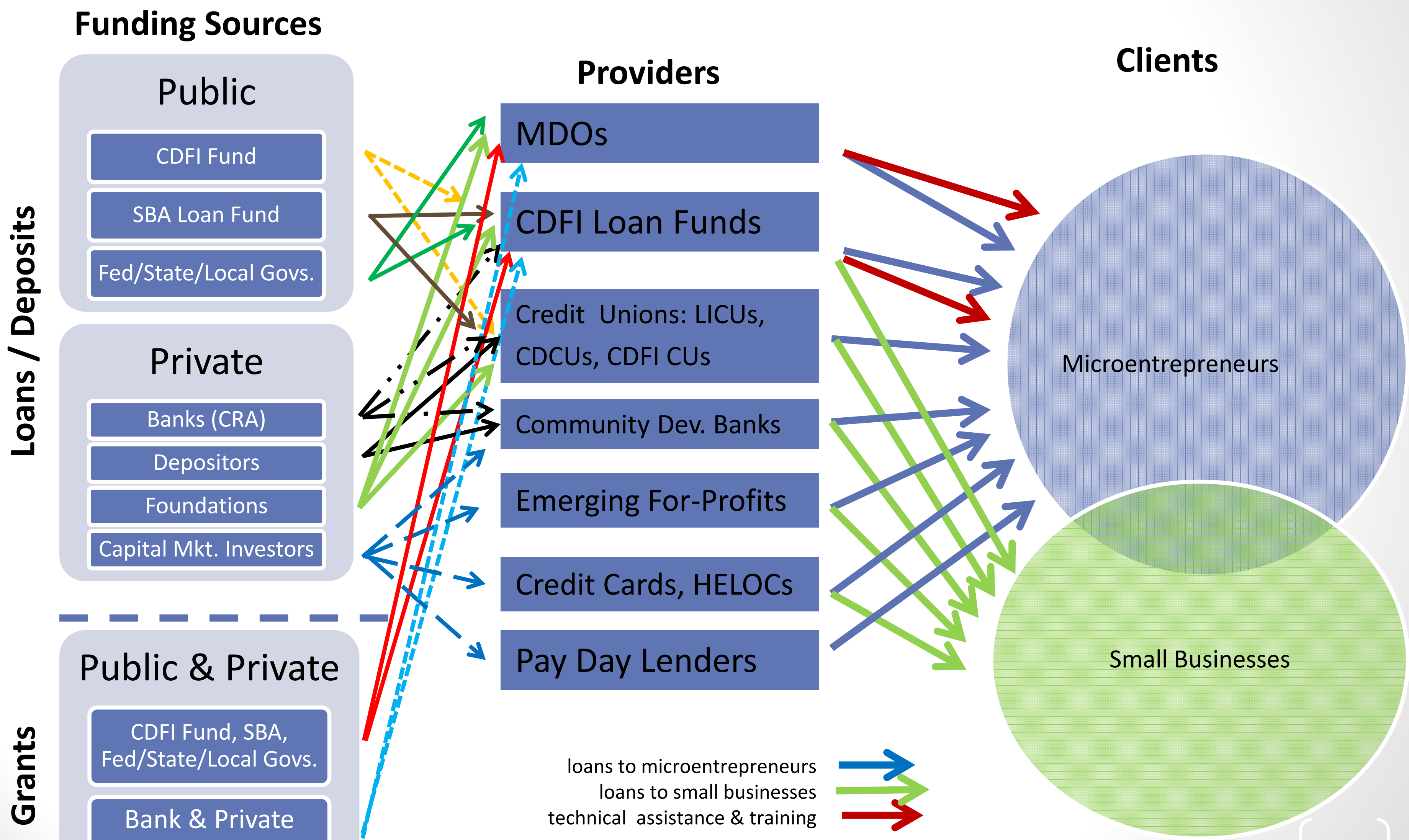
The CDFI industry needs to be re-structured to perform with much greater efficiency and sustainability

Overview

- Microfinance in the USA is defined as loans up to $50,000 provided mainly by CDFIs as NGOs to micro businesses which are firms with 10 or less employees*
- This view changes considerably with the widened scope that includes Main Street lending, that includes small business and loans up to U.S.$250,000, Community Development Banks and Business Development Services (none of which were fully addressed in the 2012 report)
- Key is to identify and support core institutions capable of scaling and becoming self-sustaining (i.e. no longer reliant on subsidy)
- Data on lending and service institutions and CDFIs that service micro and small businesses are fragmented and incomplete. There are a variety of data platforms with little analysis available
- Community Development Bank and Credit Union data is available from call reports and trade and regulatory reports
- Demand analysis for micro businesses also unavailable; demand analysis for small businesses available through regular survey and regional Federal Reserve Banks' periodic surveys
- Our conclusions and recommendations reliant on interviews and, to the extent available, data analysis
- This analysis is intended for the Micro Capital Task Force and may well repeat information well known to AEO

* See **U.S. Microfinance at the Cross Roads** by Ira Lieberman, Jenifer Mudd and Phil Goodeve, 2012 for a detailed discussion of the U.S. Microfinance sector with lessons learned from international microfinance.

Main Street Lending in the U.S.



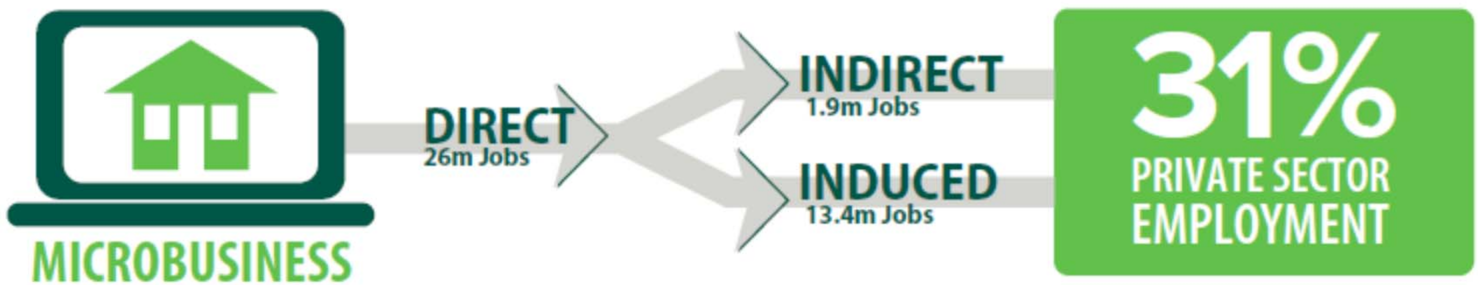
Source: Lieberman, Ira, Phil Goodeve and Jenifer Mudd. *U.S. MICROFINANCE AT THE CROSSROADS: Scale and sustainability: can lessons from international experience help guide the U.S. sector?* September 2012

Main Street Businesses
Target Clients

Target Clients: Micro and Small "Main Street" Businesses

- Micro and small "Main Street" businesses account for the vast majority of small business operators in the USA
- Micro is defined as 0-4 employees and small business 5-20 employees
- But number of employees in itself does not tell us very much—**who are the target clients?** - a diverse array of private business operators:
  - Merchants/ retailers
  - Restaurants
  - Street vendors
  - Self-employed people often working from home
  - Service establishments of all kinds
  - Small scale farmers
  - Food processors
- **Focus on** poorer regions of the country (both urban and rural) and on disadvantaged populations: minorities (recent immigrants, Latinos and Asians, African Americans), women, veterans, people over 50 years of age forced into retirement or laid off and looking for a means to support themselves and their families -- all adversely affected by the recent economic downturn
- **These are often called "life style" or "family businesses" that may employ members of the family**, often not compensated, and rely on the business' surplus to feed, clothe, provide health care to the family and to educate the children
- Not focused on hi-tech start-ups such as internet, IT or biotech operators who seek seed capital and eventually venture capital to grow
- **Need to be very clear who target clients are**

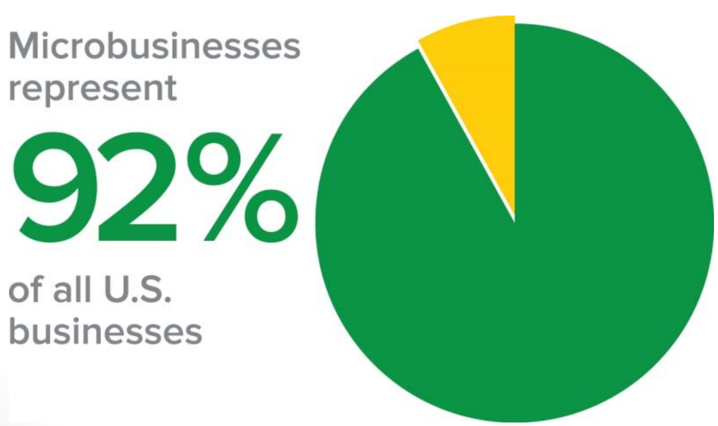
Who is Our Target Client?

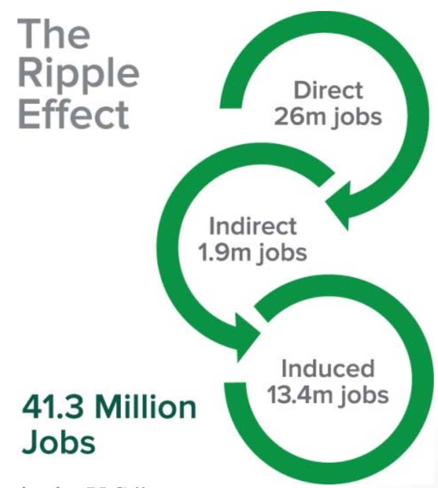


“Main Street” businesses are defined as the combination of two categories that focus on the underserved:

1) Micro businesses (0-4 employees needing up to $50k in financing)

2) Small businesses (5-20 employees needing up to $250k in financing)





Source: AEO’s 2013 Report “Bigger Than You Think: The Economic Impact of Microbusiness in the U.S.”

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By the Numbers: a Data Analysis of Community Lending Industry

Introduction

This analysis provides a high-level characterization of the supply and demand for micro and small business lending. The goal is to inform AEO and its members of the size and sources of capital and the nature of the borrowers accessing that capital. This will help target programs to increase access to capital for micro and small businesses and any disadvantaged segments of businesses or business owners.

This analysis reviews the data sources that are available for micro and small business lending - including databases, reports and academic studies. There are several constraints for this analysis.

Most publicly available data focuses on the supply of capital rather than the demand. Therefore this analysis focuses on commercial and industrial (C&I) loans under $100,000. These loan products are assumed to be for micro and "main street" businesses.

Call Reports, one of the more comprehensive sources of data for C&I loans under $100,000, also include business credit card balances. While credit cards are an important tool for business owners, it is also necessary to characterize businesses' access to other loan types (e.g., term loans) to determine if there are gaps AEO can target. Therefore this analysis introduces a simple model based on the D&B/Pepperdine Capital Access index.

Public records of the borrowers are scarce. This analysis uses past studies of the CDFI loan database to characterize borrowers based on the demographics of their census track.

There is little public information about overall alternative lending market size and their borrowers – therefore this analysis emphasizes interview data.

Discussion

Except for CDFI banks, 80% of CDFI institutions (e.g., CDFI loan funds, CDFI credit unions) have assets under $100 million; 70% of CDFI banks have assets over $100 million. It is therefore not surprising that much of the lending within the CDFI industry comes from banks. CDFI banks originated $2 billion in C&I loans as of 3Q2013. In comparison CDFI loan funds, anecdotally, originate between $100 million to $300 million in small business loans per year.

The CDFI industry is mission-driven. This is evident in the nature of small business borrowers it reaches. A 2008 University of North Carolina study identified that 83% of CDFI loans focus on areas with low or very low income and 45% of CDFI loans focus on areas with high minority population. As an example Accion-Texas' clients are 72% minorities and 40% women.

Compared to the approximately 7000 total banks and thrifts in the United States, CDFI banks represent a small fraction of the overall banking industry's small business lending. According to US Treasury's Call Reports, in 2012 there was $120 billion in outstanding C&I loans for under $100,000 and $46 billion in outstanding C&I loans for between $100,000 and $250,000.

Most of the overall SB lending by banks, thrifts and holding companies, however, consists of credit card balances. Within the Call Reports the average balance of loans under $100,000 for 2012 was under $6,000. In contrast, where banks accessed explicit small business lending programs (e.g., SBLF), average loan amounts are more indicative of term loans (e.g., average loan size of $27,345 for loans under $100,000).

By modeling these loan amounts and small business owners' access to capital, as captured in the D&B/Pepperdine Capital Access index, we are able to separate banks' small business lending from credit cards balances. Our initial modeling suggests that banks provide approximately $15 billion to businesses with under $5 million in annual revenue. Our modeling suggests banks lend $3 billion to businesses with under $500,000 in annual revenue. It is not clear how much of this lending is accessed by minorities and women. There is an opportunity for future studies to drill deeper into the survey data to characterize minority and women's accessibility to capital from the banking industry.

While depository lenders are an important source of capital, over the past several years a relatively new industry of technology-intensive, alternative lenders has emerged. This industry provides working capital to small businesses. The Wall Street Journal estimates the size of this industry in 2013 was approximately $3 billion dollars. The typical borrower is a business that has existed for several years and has over $1 million in annual revenue.

Observations

Combining these three sources (CDFI banks and loan funds, alternative lenders, and non-credit card bank loans) captures $20+ billion of comparable small business lending and allows us to make some preliminary comparisons across the providers. (This does not include funding from friends & family, grants, crowd-funding, trade credit, credit cards, leases, asset-based lenders, factors, angel, venture, PE, Mezzanine debt or Hedge funds.)

- These loans are similar in that they are in the $20,000 to $50,000 range. In particular the CDFI and alternative lender loan amounts are very comparable in size.
- Bank and CDFI loans have lower rates than alternative lenders, but alternative lenders offer faster and more convenient access to capital.
- CDFI and alternative lenders both provide an alternative to banks with products for small business borrowers with sub-680 FICO scores.
- CDFI's deliberately support minority and women business owners. While we were unable to examine the characteristics of borrowers from alternative lenders and the banking industry, writ large, Biz2Credit's small business lending index identified that small business loan approval rates across all loan providers are 15-20% lower for women-owned companies.
- Approval rates are significantly different. Biz2Credit's lending index identified approval rates for big banks as approximately 15%, small banks as approximately 50% and alternative lenders as approximately 63% (CDFIs were not explicitly covered).

This analysis of multiple data sources roughly characterizes small business lending.

- Most publically available data focuses on the supply of capital rather than the demand.
- There are few public records of the borrowers – the CDFI loan database represents a characterization of borrowers by comparing to census track data.
- There is little public information about overall alternative lending market size and their borrowers – therefore this analysis emphasizes interview data.
- This analysis focuses on commercial and industrial loans under $100,000. These loan products are assumed to be for micro and “main street” businesses.

Except for CDFI banks, 80% of CDFI institutions have assets under $100mil…

Distribution of CDFI's Assets

	<$500 K	$500K-$1M	$1M-$5M	$5M-$10M	$10M-$50M	$50M-$100M	$100M-$200M	$200M-$300M	$300M-$400M	$400M-$500M	$500M-$600M	$600M-$1B
CDFI Loan Funds	*10.3%*	*8.2%*	*23.1%*	*13.1%*	*25.2%*	*6.0%*	*13.5% above $100M*					
CDFI Credit Unions	*81.7% below $100M*						*5.10%*	*5.60%*		*7.6% above $400M*		
CDFI Banks	*29.1% below $100M*						*40.30%*		*22.20%*			*2.80%*
CDFI Bank Holding Companies	*93.0% below $100M*						*4.70%*	*2.30%*				

…70% of CDFI banks have assets over $100mil.

Source: "CDFI Industry Analysis Summary Report", Carsey Institute, Michael Swack, Jack Northrup and Eric Hangen, Spring 2012.

But CDFI banks represent a fraction of the overall banking industry's small business lending.

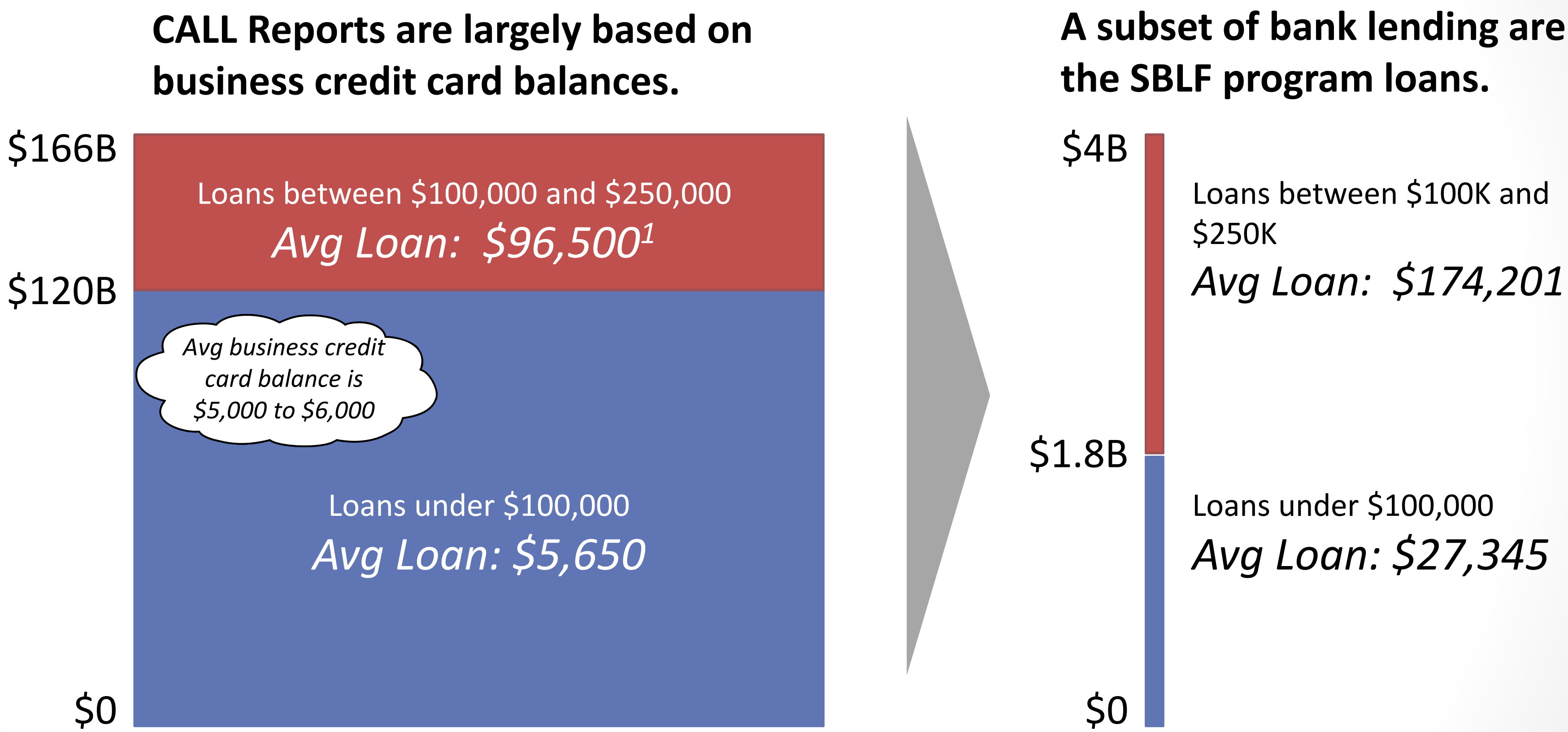
Annual SB Commercial & Industrial Loan Activity *(in billions)*

	CDFIs/Total in Industry[1]	CALL Reports[2] (2013)	**SBLF Report[3]** (7/2011-2012)	**CDFI-bank Rpt[4]** (as of 3Q2013)
Loan Funds	492/UNK			
Banks or Thrifts	76/~7000	**All U.S. banks, thrifts & holding co.'s (CDFI and non-CDFI)** •$120B outstanding (under $100K) •$46B outstanding (btwn $100K - $250K)	**306 participants (CDFI and non-CDFI)** •$1.8B (under $100K) •$2.2B (btwn $100K - $250K)	**CDFI-only** $2.0B (C&I, any size)
Bank Holding Companies	50/~4000			

(1) "CDFI Releases Updated Certified CDFI Results" 19 December, 2013.
(2) "Small Business Lending in the United States 2012" Office of Advocacy U.S. Small Business Administration. July 2013.
(3) "Report on SBLF Participants' Small Business Lending Growth, October 2013 (updated 11/1/2013).
(4) CB Peer Scorecard, 2013Q3 YTD, cb-resources.com.

Note: Depository lenders hold about 60 percent of the total loans to small business borrowers from traditional sources of credit (excluding owner loans); the remaining 40 percent of loans (not included here) are from finance companies, brokerage firms, family, friends, and other businesses.
SBLF: participation from 265 commercial banks & 50 CDLF's. The terms "banks" and "community banks" encompass banks, thrifts, and bank and thrift holding companies with consolidated assets of less than $10 billion.

Most of reported small business lending by banks consists of credit card balances…



…but where banks accessed small business lending programs (e.g., SBLF), we see loan amounts more typical of term loans.

(1) Less than $100,000 average loan likely due to rounding errors.

By modeling bank lending based on small business survey data, we can estimate non-credit card bank lending.

Modeling Approach

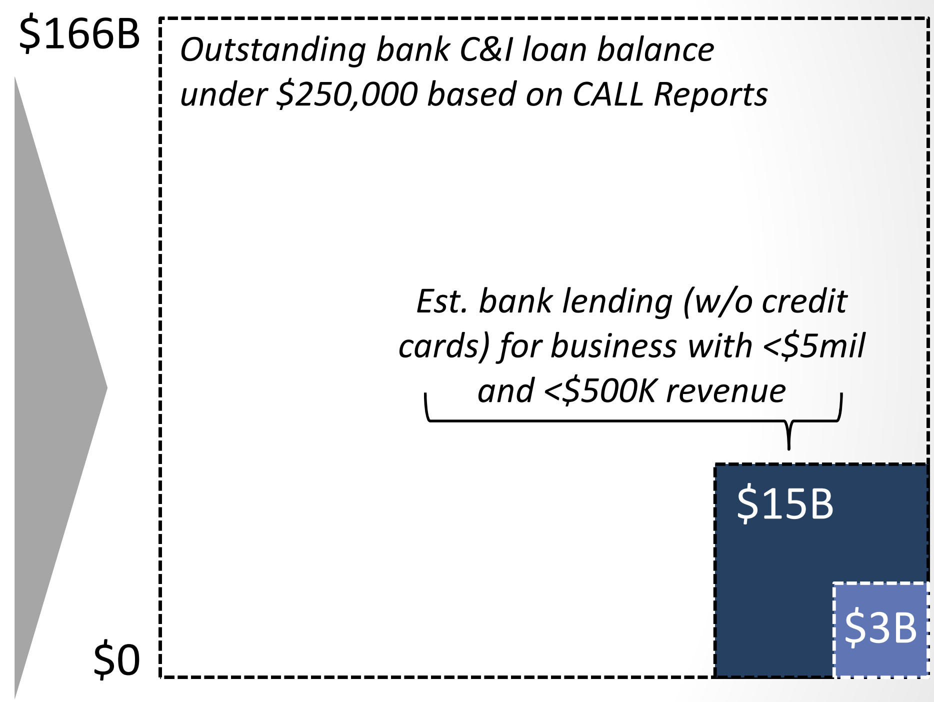
 # Firms **X** *% Attempting to Borrow* **X** *% Seeking funding from Banks* **X** *Success Rate* **X** *Loan Amount*

Business with <$5mil Rev	5,699,017 x 28% x 55% x 34% x $50,473 =	**$15B**
Business with <$500K Rev	3,705,275 x 29% x 52% x 19% x $27,345 =	**$3B**

Model Results Compared to "Known" Bank Lending Amounts

$2B	$3B	$4B	15B
CDFI-banks As of 3Q2013	***Model Result (<$500K rev)***	***Total SBLF Program***	***Model Result (<$5M rev)***

Bank Lending



Source: CALL Reports, SBLF, US Census, Pepperdine Capital Access Index & Special PCA Index Survey for <$500K. Uses average loan size from SBLF program.

Using the same approach we can estimate lending from CDFI/Credit Unions.

Modeling Approach

 # Firms **X** *% Attempting to Borrow* **X** *% Seeking funding from CDFI/CU* **X** *Success Rate* **X** *Loan Amount*

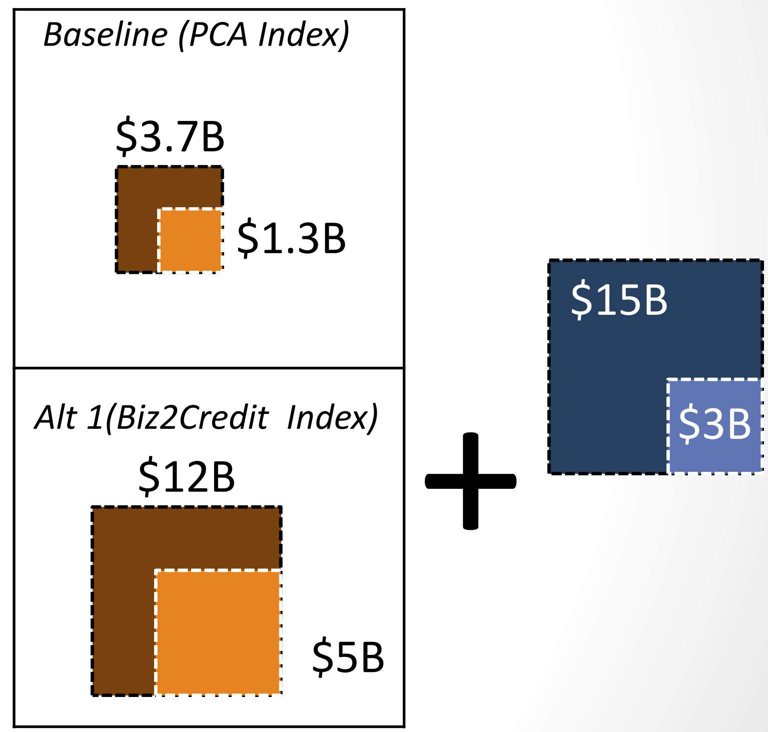
Business with <$5mil Rev	5,699,017 x 28% x 31% x 15% x $50,473 =	**$3.7B**
Business with <$500K Rev	3,705,275 x 29% x 37% x 12% x $27,345 =	**$1.3B**

Success Rate Varies from other Indexes

(likely b/c CDFIs are combined with CU's)

12%	15%	48%
PCA Index (<$500K rev)	***PCA Index (<$5M rev)***	***Biz2Credit Index for CU's only***

Adding CDFI/Credit Union Lending to Bank Lending (w/o credit cards)

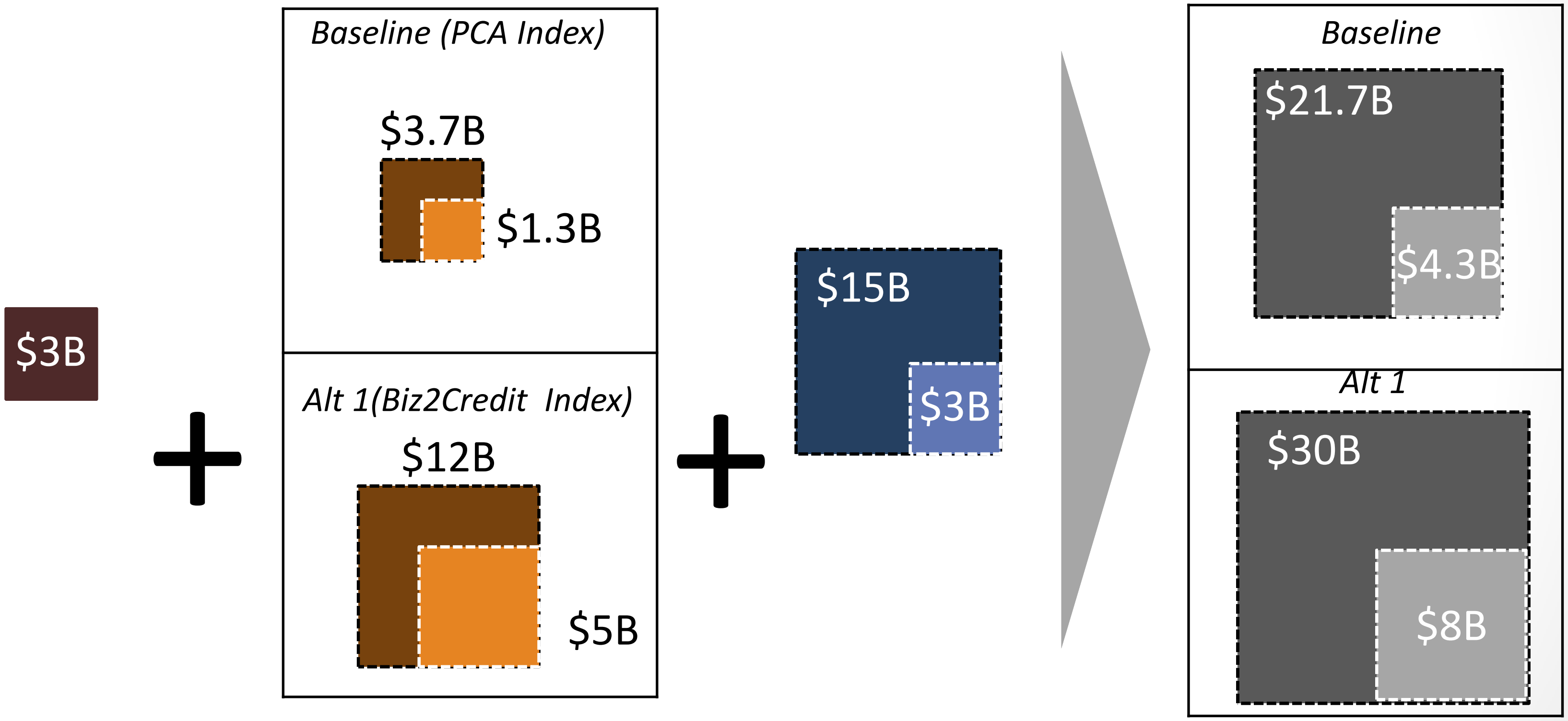


Source: CALL Reports, SBLF, US Census, Pepperdine Capital Access Index & Special PCA Index Survey for <$500K, Biz2Credit Lending Index. Uses average loan size from SBLF program. PCA Index does not separate CDFI and CU's.

Finally we can add in an estimate of the lending from alternative lenders…

The WSJ Estimates Alternative Lenders Provided $3B in Loans in 2013…

Total bank, CDFI/CU, and alternative lender loans



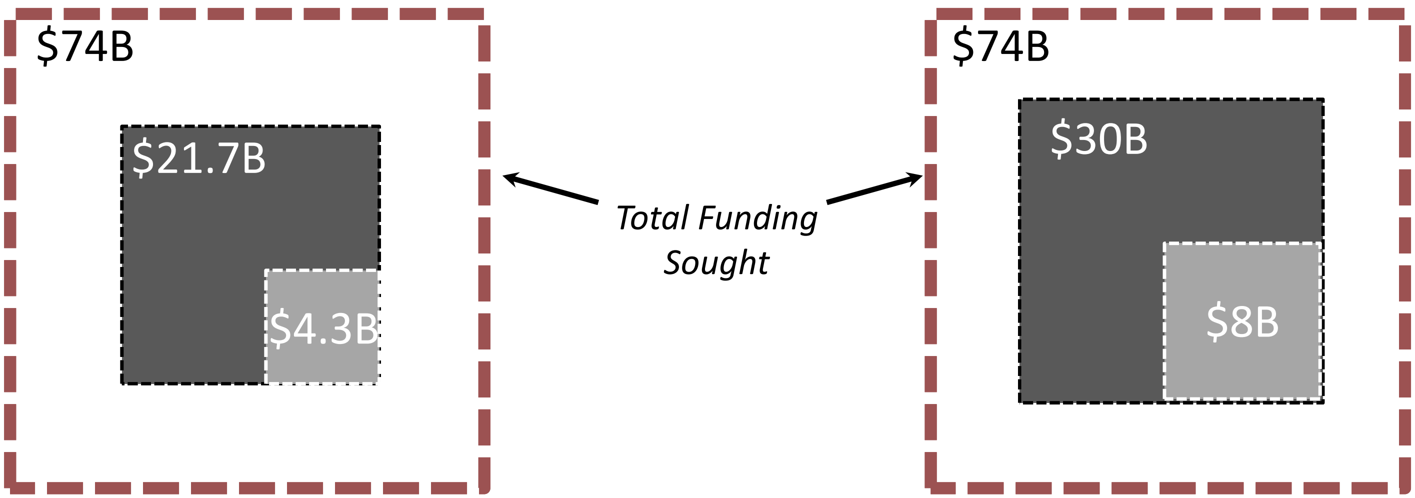
…to create a picture of <u>comparable</u> small business lending.

Source: CALL Reports, SBLF, US Census, Pepperdine Capital Access Index & Special PCA Index Survey for <$500K, Biz2Credit Lending Index, "Alternative Lenders Peddle Pricey Commercial Loans" WSJ.

Based on this model, SB borrowers sought $74B and received between $21.7B and $30B (businesses under $500K sought $26B)….

Capital Sought v. Provided - Baseline
(model based results)

Capital Sought v. Provided - Alt 1
(model based results)



Other studies have found in particular that approval rates across all loan providers are lower for women and minorities. If even 5% of this unmet need is credit-worthy, CDFIs in partnership with alternative lenders could create significant impact.

…this represents between $44B and $52B of unmet "need".

Source: CALL Reports, SBLF, US Census, Pepperdine Capital Access Index & Special PCA Index Survey for <$500K, Biz2Credit Lending Index, "Alternative Lenders Peddle Pricey Commercial Loans" WSJ.

Finally CDFI and alternative lenders both provide an alternative to banks with products for SB borrowers with sub-680 FICO scores…

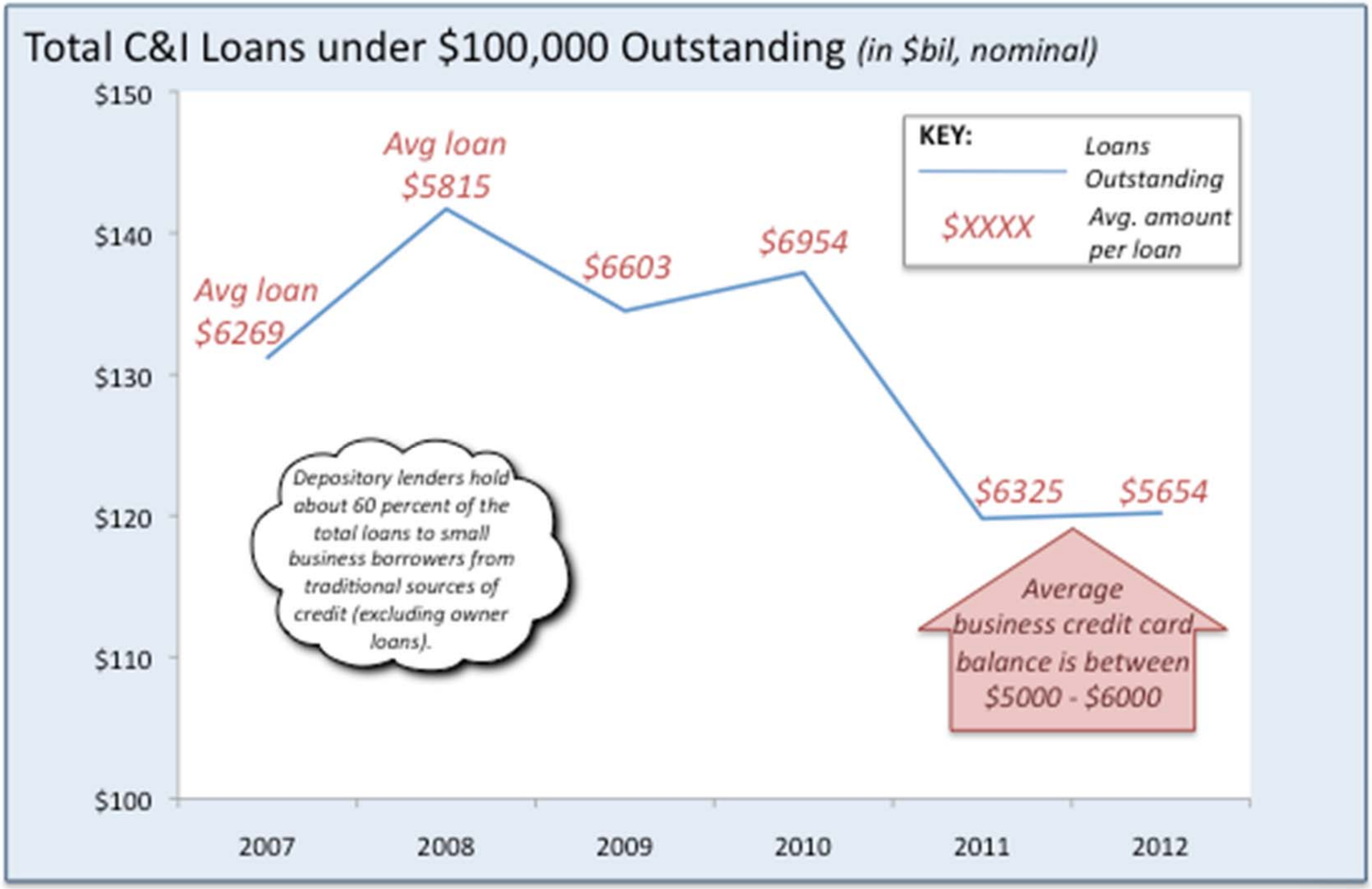
	CDFI Industry	Alt. Lender	Banks (w/ credit cards)	Banks (w/o credit cards)
Average SB Loan Size	\$15,000 - \$25,000	\$35,000	~\$6000[1]	\$50,000
SB Loans Originated	Over \$2 billion[2]	\$3 billion (est.)[3]	\$166 billion outstanding	\$15 billion[4]
SB Borrower Credit	~606 FICO	~665 FICO	Above 680	
Characteristics of target market	•83% CDFI loans focus on areas with low or very low income; 45% focus on areas with high minority population[5] •Ex: one large CDFI's clients are 72% minorities and 40% women	•Average customer generates ~\$1M in annual revenue •Minimum 6 months of business (more typical is several years)	•Established businesses with 3yrs profitability and strong credit	
Collateral	Typically required	Not typical	Varies	

…but CDFI's deliberately support minorities; no evidence that alternative lenders' portfolio skews toward minorities.

(1) "Small Business Lending in the United States 2012", SBA. Note: Includes business credit cards.
(2) SBLF, CB Peer Scorecard
(3) "Alternative Lenders Peddle Pricey Commercial Loans", Jeanne Dugan and Ruth Simon. The Wall Street Journal. 9 January 2014
(4) Model based on D&B/Pepperdine Capital Access (PCA) index.
(5) "Community Development Financial Institutions and the Segmentation of Underserved Markets." S. Cowan, D. Spurlock, J. Ratcliffe, H. Zhu. The University of North Carolina at Chapel Hill. October 2008

Back-up Information:
Data Analysis of Community Lending Industry

Most of the overall banking segment's small C&I loans consist of business credit card balances.



Note: Bank small business C&I lending includes business credit cards. Call Reports likely underestimate loans originated with larger lenders because they are more likely to securitize loans with SBA loan guarantees.
Source: "Small Business Lending in the United States 2012", SBA, SBLF report, "2012 Small Business Access to Capital Survey", NSBA.

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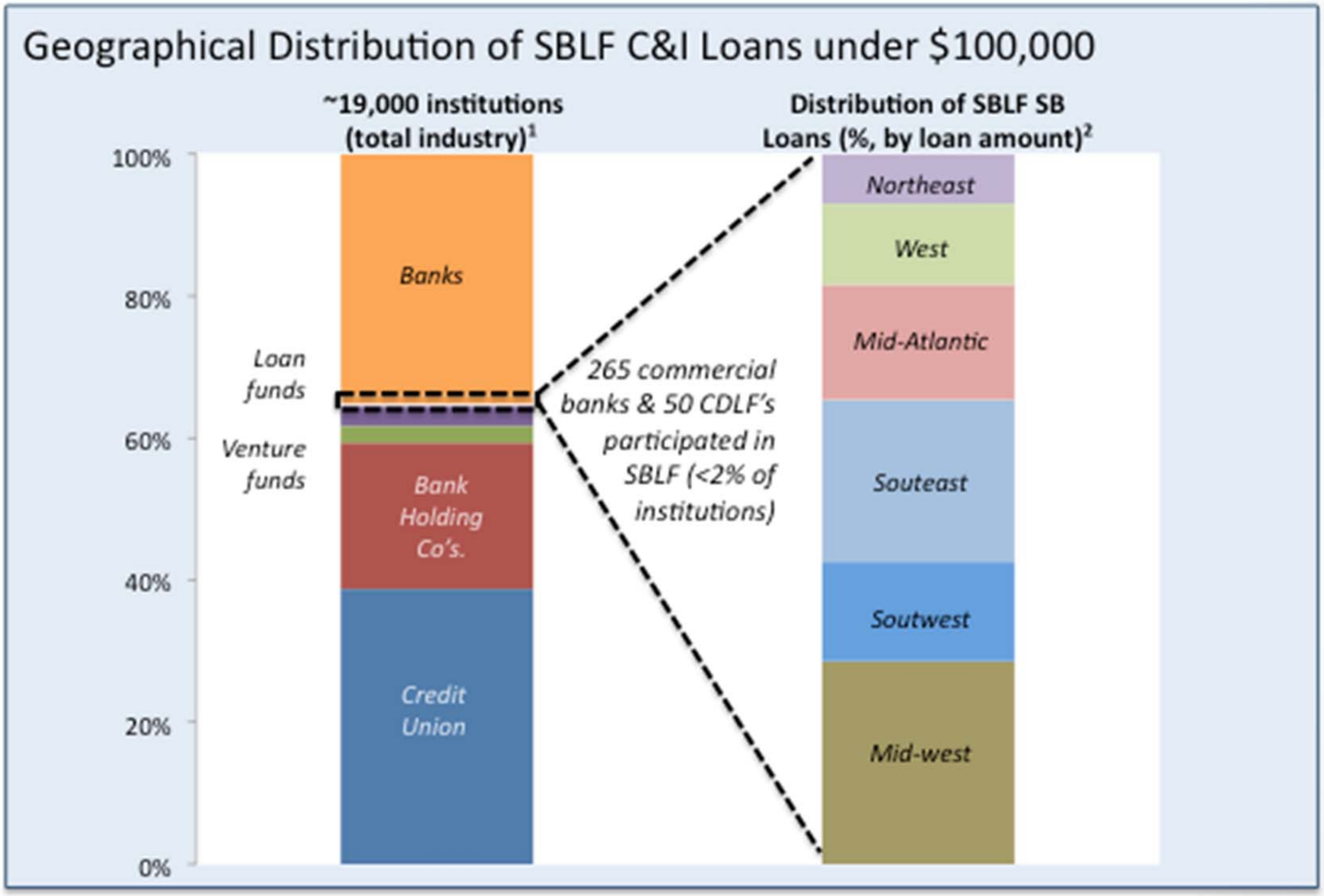
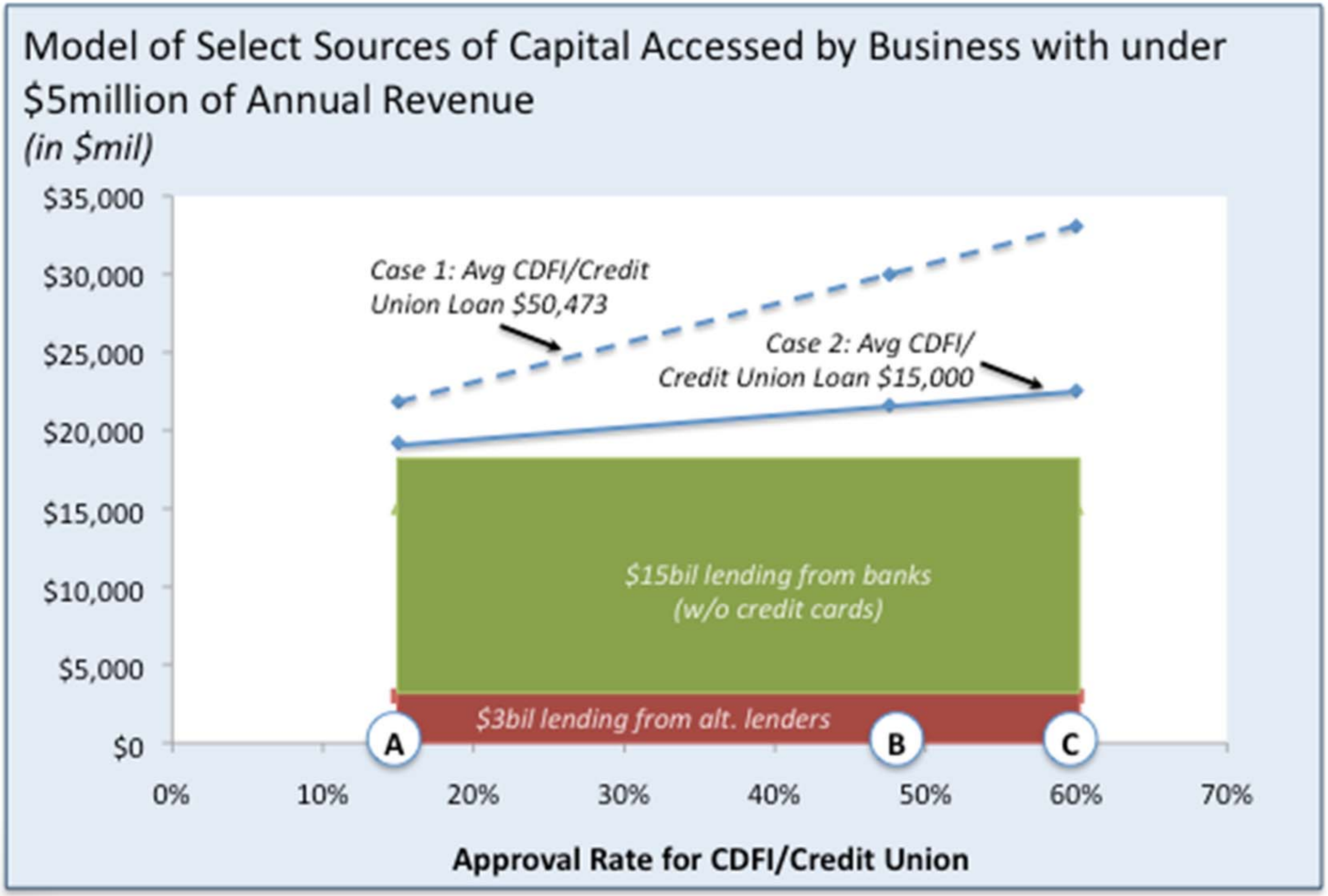
The segment of the industry that participated in SBLF program created access to small business loans across the country.



(1) "CDFI Industry Analysis Summary Report", Carsey Institute.
(2) "Report on SBLF Participants' Small Business Lending Growth, October 2013 (updated 11/1/2013).

A simple model based on the Pepperdine Capital Access index (PCA) allows us to separate credit cards from bank lending and examine sensitivities for CDFI/CU lending…

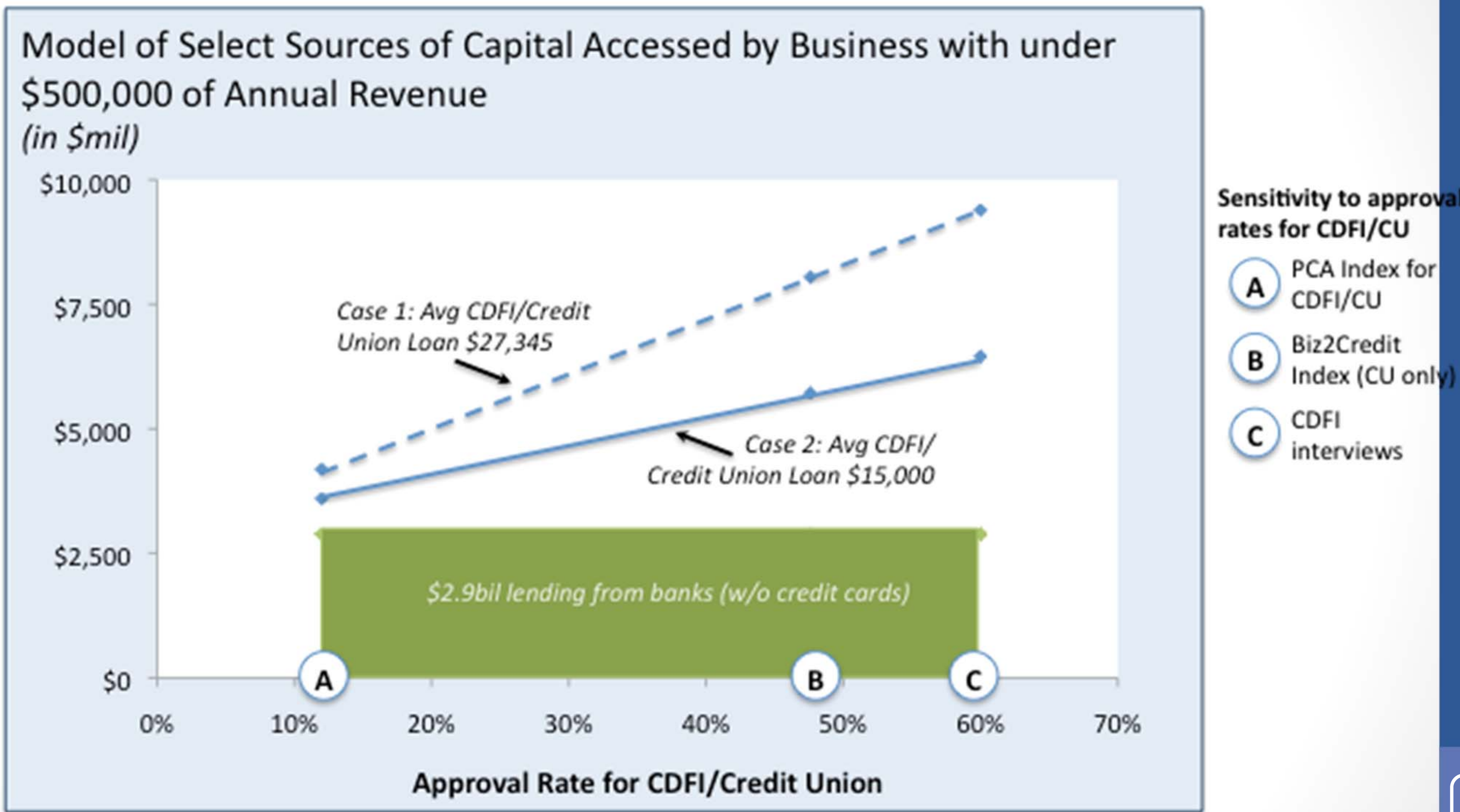


Sensitivity to approval rates for CDFI/CU

- A PCA Index for CDFI/CU
- B Biz2Credit Index (CU only)
- C CDFI interviews

Note: model does not include funding from friends & family, grants, crowd-funding, trade credit, credit cards, leases, asset-based lenders, factors, angel, venture, PE, Mezz. Or Hedge funds. Model assumptions in back-up.

…we can further examine businesses with under $500,000 rev (alternative lenders removed)



Note: model does not include funding from alt. lenders, friends & family, grants, crowd-funding, trade credit, credit cards, leases, asset-based lenders, factors, angel, venture, PE, Mezz. Or Hedge funds

Assumptions for financial modeling

	Business with <$5mil Rev	Business with <$500K Rev	Source / Rationale
Number of Firms	5,699,017	3,705,275	US Census
% Attempting to borrow	28%	29%	Pepperdine Capital Access Index & Special PCA Index Survey for <$500K
Of these, type of loan sought	Bank: 55% CDFI/CU: 31%	Bank: 52% CDFI/CU: 37%	
Financing Success	Bank: 34% CDFI/CU: 15%	Bank: 19% CDFI/CU: 12%	
Fin. Success – Alt.	CU: 48%	CU: 48%	Biz2Credit Index
Average Bank Loan	$50,473	$27,345	SBLF (avg C&I loans <$250K & <$100K)

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Provision of Financing & Services to Main Street Businesses:

Core Institutions

Types of Core Institutions

Who are the institutions?

- **Community Development Finance Institution Loan Funds (CDFI Loan Funds)**: NGOs that provide microfinance, small business finance, business development services, and other services to Main Street businesses—often described as mission driven
- **Credit Unions**: Low Income Credit Unions (LICUs), CDFI Credit Unions (CDFICUs), and Community Development Credit Unions (CDCUs)
- **Community Development Banks (CDBs)**: important source of small business loans for Main Street
- **Emerging For-Profit Financial Institutions**: growing number of diverse, non-bank, non-regulated institutions, whose focus is on internet and large data mining. Together form a "disruptive technology" that is changing the sector

Continued: Types of Core Institutions

- **There are also other institutions**
  - **Money lenders**: primarily consumer focused pay day lenders, check cashiers, tax advances— **not discussed herein**
  - **Established large-scale institutions** that are major players-**not discussed herein**— AMEX, Pay Pal, Regional Banks, Commercial Banks offering credit cards (still the major source of micro and small business loans), merchant advance and small business loans

- **Business Development Service (BDS) Providers:** Microenterprise Development Organizations (MDOs) that provide advisory services only and CDFIs

<u>Overall this is a large, diverse set of institutions</u>

- The impact of which is hard to assess and measure particularly with respect to minority and immigrant communities who primarily run family style businesses – defined as supporting the basic needs of the family unit

Core Institutions: What Constitutes Success?

- Reaching **scale** in provision of financial and service support to micro and small Main Street Business

- Reaching **higher levels of financial sustainability**, thereby reducing rate of subsidy

Interest Rate Culture

In June 2011, FIELD published a funder's guide to pricing, which highlighted a number of key findings addressing issues of pricing:

- Most, if not all, non-profit microlenders in the United States are charging prices that are subsidized and, therefore, do not cover the costs of their microlending programs.
- There is no industry-wide data on the prices charged by non-profit lenders, although participants in the Scale Academy reported charging rates between 5% and 18%.
- In comparison, as of April 2011, for individuals with subprime credit, the average credit card interest rate was 23.95%, the national average credit card interest rate was 14.67%, and the average rate for business credit cards was 12.91%.
- Rates offered by several for-profit microfinance organizations to microentrepreneurs vary broadly, ranging from 18% to 60%. The average rate for several technology lenders appears to be 40% with an average loan size of $35k.
- Funding sources play a critical role in pricing, with public sector funders appearing to be the most likely to specify the interest rates and fees that can be charged on loans made with the capital they provide.
- MDO staff members often believe borrowers will be resistant to higher pricing, although microlenders have done very little market research to test borrower perceptions.
- Some market surveys point to the willingness of potential customers to pay significantly higher prices if they can access financing in days rather than weeks.
- There is growing recognition that charging below-market interest rates may be one factor hindering the growth and sustainability of non-profit microlenders.

Source: Lieberman et. al. *Microfinance at the Crossroads.* 2012

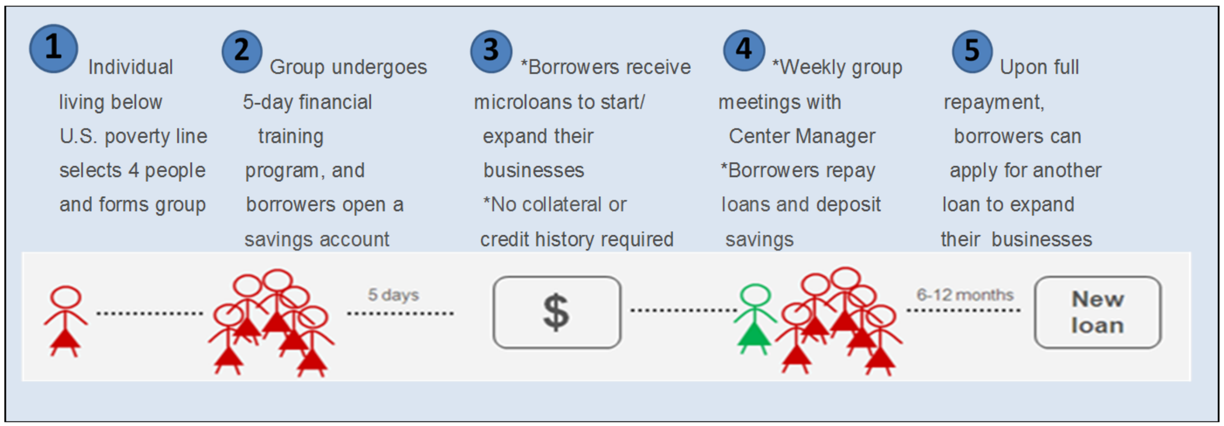
Characteristics of Core Institutions

<u>CDFI Loan Funds (NGOs)</u>

- Provision of finance, BDS and other services to Main Street businesses
- None have commercialized, small scale
- Average U.S. loan size approximately US$14,000
- Community-focused though some have extended their geographic reach; only two networks have a diverse geographic reach: Accion and Grameen
- Complex business models offering a variety of financing products and services
- High cost of operations
- Low interest rates that fail to cover cost of operations
- Highly dependent on subsidies
- Obtain financing and grant support from a variety of sources— U.S. Treasury CDFI Fund, SBA, USDA, states, municipalities, commercial banks fulfilling CRA requirements, foundations
- Data on their performance and impact partially available from a variety of sources, but is fragmentary or incomplete as a time series and with respect to information on the institutions' financial status or impact

CDFI Loan Fund Institution Highlight: Grameen America

Grameen America (GA) opened its first U.S. office in New York City in 2008 and has grown to eleven branches. Since its inception, GA has more than doubled in size each year, growing from 500 borrowers at the end of 2008 to 9,295 by the end of first quarter 2012. During FY 2010, GA disbursed 4,153 loans, making it the most prolific non-profit microlender in the United States. From FY 2010 to FY 2011, the outstanding portfolio nearly doubled from US$3.3 million to US$6.4 million.[1] Unlike most microfinance providers in the United States that use an individual-lending methodology, GA utilizes the peer-lending model developed by Grameen Bank in Bangladesh:



- Focused on one core microloan product.
- Business-development training and TA are provided in weekly group meetings.
- Smaller average loan size, with maximum first-time loan of US$1,500 versus average of CDFI Loan Funds U.S. loan size of US$14,000.
- Center Managers have strong ties to and understanding of GA's client base.
- Focus on sustainability; interest rates of 15%, declining balance, no fees.

[1] This data is from a previous interview in 2012, we were unable to obtain data from our interview in October, 2013 and no data appears on their website

Source: Lieberman, Ira, Phil Goodeve and Jenifer Mudd. *U.S. MICROFINANCE AT THE CROSSROADS: Scale and sustainability: can lessons from international experience help guide the U.S. sector?* September 2012.

CDFI Loan Fund Institution Highlight: The Intersect Fund

The Intersect Fund is a non-profit microlender and certified CDFI based in New Jersey. It disbursed its first loan in 2009 and subsequently has provided more than 300 loans totaling more than $800,000 to owners of microbusinesses. The Intersect Fund provides business training, coaching and microloans to low-income, minority and women-owned businesses and helps individuals improve or establish their credit history. The CDFI targets storefront establishments (30% of its loan portfolio) and mobile or home-based businesses operating in the informal economy (70%). Most of its clients have minimum wage jobs in addition to their informal business. The Intersect Fund has flexible underwriting standards and cultural competencies that enable it to engage clients traditionally un-served by larger financial institutions and microlenders. It has seen rapid growth and since early 2012 their assets and portfolio have grown ten times with each of their three loan officers now disbursing 40 loans per month.

Loan Range	$100- $25,000
Average loan size	$2,500
APR	25% with fee
Loan loss rate in 2012	2.49%
50% + of borrowers have no credit score or a score < 600	

Source: Interview on October 21, 2013 and www.Intersectfund.org

CDFI Loan Fund Institution Highlight: Accion Texas

Accion Texas, Inc. (ATI) is a multi-state, non-profit micro and small business lender that offers loans from US$500 to US$250,000. It is part of the Accion U.S. Network that encompasses Accion Chicago, Accion NM-AZ-CO, Accion East and Online, and Accion San Diego. Over the years, management has worked to increase self-sufficiency levels either by augmenting earned revenues (for example, by moving into small business lending and therefore disbursing larger loans that generate higher levels of interest income) or reducing operating costs. Many of the efforts to lower expenses have been technology based:

- In 2004, the institution developed a proprietary scoring engine, using data from thousands of loans generated by the organization since 1994.
- In late 2006, ATI deployed its first web-based platform for loan applications, eliminating much of the paperwork involved in the loan-approval process and allowing for a quicker loan decision-making process.
- For a fee, ATI now provides its web-based platform (MMS™) to 12 microlenders across the country.

In 2007, management was nearing its internal self-sufficiency goal of 80%. However, with an opportunity to expand into Louisiana and other states in the Mississippi Delta region, management and the board decided that the chance to finance a larger number of underserved entrepreneurs was more important than achieving higher levels of self-sufficiency. As a result, operating expenses have increased as a percentage of earned revenue, owing to the start-up costs associated with geographic expansion, and self-sufficiency has fallen back to around 50%. Outstanding loans include both microloans and small business loans.

INDICATOR	2012	2011
New Clients	726	664
Number of Loans Disbursed	919	890
Amount Loaned	$17,994,771	$14,638,455
Active Portfolio	$28,507,359	$26,267,412
Portfolio Under Management	$1,274,683	$2,515,002
Total Portfolio[1]	$29,782,042	$28,782,414
Active Clients	2,204	2,268
Average Loan Balance	$13,513	$12,691
Portfolio at Risk[2]	3.30%	3.10%
Net Losses[3]	4.01%	6.44%
CUMULATIVE TOTALS TO DATE	**12/31/2012**	**12/31/2011**
Clients Served	9,076	8,350
Numbers of Loan Disbursed	13,132	12,213
Amount Disbursed	$139,136,874	$121,142,103

[1] Includes Accion Texas and Citi Portfolio
[2] Portfolio at risk = total value of outstanding loans past due more than 30 days divided by total portfolio
[3] Net losses = net losses for fiscal year divided by portfolio outstanding at year end

Source: Lieberman et. al. *Microfinance at the Crossroads.* 2012 and Accion Texas Annual Report 2012

CDFI Loan Fund Institution Highlight: Opportunity Fund and Financiera Confianza Partnership

In May 2010, Financiera Confianza (Confianza) launched its partnership with Opportunity Fund by introducing its "Opportunity Loan," allowing Confianza to offer larger loans at significantly reduced rates.

According to FIELD, "Confianza sources and processes the applicant, and then uses Opportunity Fund capital to fund the loan. The loan is serviced by Confianza but stays on Opportunity Fund's books. Confianza is paid a fee for its services, yet the risk is shared between the organizations in that fees are paid out towards the latter part of the loan being successfully repaid. While Confianza has found a way to diversify its client base and earn revenue, Opportunity Fund has found a means to scale its operation in other parts of California, and to benefit from an organization that could more quickly process and disburse quality loans. At the same time, Opportunity Fund has been able to deploy low-cost capital to which it has access." As of July 1, 2011, Opportunity Fund sets the terms and conditions and provides the capital for all loans originated by Confianza.

In a June 11, 2012 speech at the Clinton Global Initiative, Opportunity Fund CEO, Eric Weaver, stated, "Opportunity Fund is successfully expanding microlending in California. Over the past year, we provided $7.5 million in loans to 850 small business owners . . . These loans have helped California's entrepreneurs to keep and create 2,125 jobs. Our microlending increased by 90% statewide in the last 12 months, well ahead of our goal to achieve 60% growth."

The partnership with Confianza has allowed Opportunity Fund to quickly scale its microfinance operations, as evidenced by the increase in disbursements in 2012. Although CEO Weaver states that he expects the Confianza partnership to create efficiencies, he does not anticipate that his organization will ever reach the point where earned revenues cover 100% of expenses, partly because of the lower interest rates Opportunity Fund has set on loans sourced by Confianza.

Source: Lieberman et. al. *Microfinance at the Crossroads.* 2012

Credit Unions

- Includes: Low Income Credit Unions (LICUs), Community Development Credit Unions (CDCUs), and CDFI Credit Unions (CDFICUs)
- Tax exempt, non-profit, member cooperatives that take deposits and provide loans
- Although CUs provide business advisory services, micro, small business and agricultural loans, these are generally a small part of their portfolio
- Approximately 1800 LICUs that can receive funding from outside depositors as of 2013
- Approximately 200 certified-CDFI CUs as of 2012
- Regulated and report information to regulator—Federally and State chartered institutions
- Regulatory oversight limiting the extent of business loans
- Important potential source of micro and small business loans

Percent of Credit Unions Offering Micro Business Loans by Asset Size ($ millions)								
	$0-$20	$20-$50	$50-$100	$100-$200	$200-$500	$500-$1000	$1000+	All CUs
Micro Business Loans	1.77	5.1	14.1	20.7	28.7	37.7	51.9	10.1

Source: Credit Union National Association *Credit Union Report Mid-Year 2013* and NCUA's definition of low-income on www.ncua.gov

Institution Highlight:
Self-Help Federal Credit Union

The 2008 recession hit the Central Valley of California hard, resulting in skyrocketing foreclosures, plummeting real estate values, and huge increases in unemployment of up to 20% or more. A number of long established CDCUs that served predominantly Latino members were badly damaged by the economic distress that their members experienced. Instead of being dissolved or merged into other less-mission-driven institutions, the Center for Community Self-Help (CCSH), based in Durham, NC was able offer a solution.

In 2008, CCSH chartered a companion institution to its credit union in North Carolina. The new entity, Self-Help Federal Credit Union (SHFCU), was founded to serve California as part of a strategic initiative to combat predatory lending. Shortly after its establishment, SHFCU merged with one small CDCU, People's Community Partnership FCU in Oakland, CA. As shown in the table below, several other mergers followed, allowing SHFCU to end 2010 with more than 30,000 members and over US$200 million in assets. Much of this growth was enabled by major investments of equity-like secondary capital supplied by the Ford Foundation.

2012 Accomplishments:

- Served more than 81,000 credit union members and began serving an estimated 22,000 new people. Member savings increased to $836 million. Made $32 million in consumer loans (auto, home equity and personal loans).
- Lent more than $74.1 million to businesses and nonprofits in 2012 – more than Self-Help FCU has ever lent in a single year.
- Created or maintained more than 2,100 jobs. Financed the construction or rehabilitation of 300 housing units. Lent $20 million for foreclosure recovery. Lent $74 million to businesses, nonprofits, and community facilities.
- Lent $22 million to public charter schools and child care centers, creating or maintaining more than 10,000 spaces for mostly low-income children.

Source: Lieberman et. al. *Microfinance at the Crossroads.* 2012 and Self Help Annual Report 2012

Institution Highlight: ASI Credit Union

ASI Federal Credit Union (ASIFCU) helps people borrow money for transportation, home ownership, business, and education with loans of all sizes. As of FYE 2008, the entity had US$1.19 million in outstanding microloans. In August 2011, it began offering microloans in partnership with Kiva, a non-profit that connects individual investors with microfinance institutions in the United States and across the world. Partnership with this global organization gives them added financial security and the ability to make small loans that do not affect their lending cap.

As of July 2012, ASIFCU had raised US$342,500 via Kiva for loans to 39 entrepreneurs (average loan size US$8,782) during its 11-month partnership with the entity. In October 2011, ASIFCU also received a US$3 million grant from the U.S. Treasury's Healthy Food Finance Initiative to help entrepreneurs borrow money for grocery and restaurant businesses in New Orleans "food deserts" (places where people don't have easy access to fresh, healthy food).

Source: Lieberman et. al. *Microfinance at the Crossroads.* 2012

Community Development Banks

- 83 CDFI certified community development banks (CDBs) of which 35 are association (CDBA) members
- Private, shareholder owned, commercial and savings banks
- CDFI Community Development Banks average *$343 million* in assets, $210 million in loans outstanding.
- *Loan growth CDBA members 2011 (3.72%), 2012 (1.25%) and 2013 3rd qtr. 9.77%, Loans 3rd qtr 2013 CDBA members $289 million, all CDFI banks $210 million (Source: CDBA Members Peer Scorecard, 2013 Q3 YTD)*
- CDBs are deposit taking institutions
- Three received Treasury CDFI awards, but many borrow from the state designated Treasury Fund-SSBCI ($1.5 billion) and many more from the Treasury Small Business Loan Fund (SBLF) (nominally $30b fund of which $4b has been disbursed as of 2012 report) and SBA
- Regulated institutions
- Report detailed information via call reports
- Important source of small business lending

There are three community development banks that warrant notice because they illustrate banks that are lending to Main Street businesses that specifically support women, minorities, and low-income communities; cases follow.

Source: CDBA publication *CDBA Members: CB Peer Scorecard: 2013Q3 YTD*

Community Development Bank Highlight: OnePacific Coast Bank

In December 2010, OneCalifornia bank acquired ShoreBank Pacific and changed its name to One PacificCoast Bank. The merger greatly expanded the Bank's reach on the West Coast, and enhanced its capacity to serve its mission; to pursue economic justice and environmental sustainability by focusing on transformative sectors that need loan capital.

These target lending sectors include:

- Affordable Housing, Multi-family and Neighborhood Stabilization
- Sustainable Food, Fisheries and Agriculture
- **Low-Income Community Economic Development**
- Clean Tech, Green Energy and Green Chemistry
- **Women and Minority Owned Businesses**
- Resource Efficiency and Conservation in the Built Environment
- Upcycling, Recycling and Repurposing
- Rural Community Development and Support of Natural Resources
- Other Commercial and Industrial

OnePacific Coast Bank is comprised of two parts, OneCalifornia Bank (operating on a triple bottom-line) and OneCalifornia Foundation (a supportive nonprofit). The Foundation owns all of the economic rights of the Bank -- when profits of the Bank are distributed, they can only be distributed to the Foundation which is mandated to reinvest those proceeds back into the communities and the environment on which we all depend.

OnePacific Coast Bank is located on the west coast; based out of Oakland, CA with branches in Portland, Oregon, Seattle and Ilwaco, Washington.

	Assets 2013Q3 ($000)	Equity 2013Q3 ($000)	Employees	Branches		Asset Growth (%)	Loan Growth (%)	ROAA (%)	(%) Net Interest Margin	Non-Performing Assets (%)	% of loans to business 2013Q3
OnePacific Coast	306,631	33,314	53	4	2011Y: 2012Y:	(2.78) (1.63)	(3.76) 20.57	0.03 (0.67)	3.86 3.47	4.92 5.36	27.7

Source: www.onepacificcoastbank.com and CDBA **CB Peer Scorecard: 2013Q3 YTD**

Community Development Bank Highlight: Southern Bancorp

Southern Bancorp, a community development bank holding company, is located in Arkansas and Mississippi. It is made of a group of nonprofit development affiliates and a consortium of private foundations, governmental entities, corporations and concerned individuals that came together in 1986 through then Governor Bill Clinton and the Rockefeller Foundation. Southern's strategy for change involves geographically focused community planning and development efforts within 50 miles of Southern bank branches and it is one of the largest and most profitable rural development banking organizations in the United States. Its focus on rural development is best indicated by the fact that its offices are located in small rural communities, most with populations of 15,000 or less.

Southern has three transformational 20-year goals for the communities it serves. The goals are to reduce the gap between the county and national averages by 50% in the following metrics:

- Poverty Rate
- Employment Rate
- Educational Attainment

Since its formation, Southern has originated over $2 billion in development loans—primarily to individuals and organizations in the poorest areas of the United States. Southern has found that even $2 billion of invested capital is insufficient to drive fundamental community change without such capital investments being focused into specific geographic areas and matched to comprehensive community engagement in *education, housing, health care, leadership development, and economic development.* In order to focus more heavily on these sectors, Southern executed a major shift in its development strategy to concentrate its efforts in targeted areas of Arkansas and Mississippi, with the intent of effecting regional change community by community.

	Assets 2013Q3 ($000)	Equity 2013Q3 ($000)	Employees	Branches		Asset Growth (%)	Loan Growth (%)	ROAA (%)	(%) Net Interest Margin	Non-Performing Assets (%)	% of loans to business 2013Q3
					2011Y:	6.34	(0.19)	0.72	4.21	1.71	
Southern Bancorp	1,197,880	118,143	315	33	2012Y:	(2.57)	10.03	0.98	4.21	1.91	10.7

Source: www.banksouthern.com and CDBA **CB Peer Scorecard: 2013Q3 YTD**

Community Development Bank Highlight: Sunrise Community Bank

Until 2013, Sunrise Banks operated as three separately chartered banks - Franklin Bank, Park Midway Bank, and University Bank. In April of 2013, the organization's family ownership made the strategic decision to consolidate the banks and form Sunrise Banks, N.A.. Headquartered in St. Paul, Minnesota, Sunrise has seven branches that carry out the long history of serving inner city communities in Minneapolis and St. Paul.

Sunrise Banks is a certified CDFI because of their commitment to community development. Sunrise Banks originate small business, commercial real estate, and community facility loans in the twin cities' urban core with over 60% of its loans originated in low income communities year after year. In 2011, Sunrise Banks launched an Underserved Empowerment Journey that aims to provide responsible and affordable financial products to one million traditionally underserved consumers.

Sunrise offers business loans in the following sectors:

- Term Loans
- Working Capital Lines of Credit
- Commercial Real Estate
- Leasing
- New Markets Tax Credits Financing
- Small Business Administration (SBA) Loans

	Assets 2013Q3 ($000)	Equity 2013Q3 ($000)	Employees	Branches		Asset Growth (%)	Loan Growth (%)	ROAA (%)	(%) Net Interest Margin	Non-Performing Assets (%)	% of loans to business 2013Q3
Sunrise Community Bank	687,984	70,929	98	8	2011Y: 2012Y:	114.27 (18.32)	1.28 18.55	2.48 2.32	2.69 3.22	1.10 1.74	20

Source: www.sunrisebanks.com and CDBA **CB Peer Scorecard: 2013Q3 YTD**

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Analysis of Technology-Intensive Lending Companies

Introduction

Over the past several years a relatively new industry of technology-intensive, alternative lenders has emerged. This industry provides working capital to small businesses. The Wall Street Journal estimates the size of this industry in 2013 was approximately $3 billion. While this is still a small fraction of the total small business lending, most of these companies have only existed for five or six years. In this time, these companies are already on par (or slightly ahead) of community bank lending and are likely originating an order of magnitude more loans than CDFI loan funds - both of which have been around for decades.

In response to this rapid scale and targeted outreach to small business borrowers, we have conducted a macro-level benchmarking study to compare tech-intensive alternative lenders. In particular the objective of this analysis is to characterize the elements of a loan's unit cost that alternative lenders have reduced through technology or techniques in order to identify potential "best practices" for community lenders (e.g., CDFI loan funds, community banks, credit unions). This analysis relies on self-reported information from over a dozen interviews with nine companies and research of public material.

Discussion

The emerging, for-profit players are privately held, technology-intensive businesses. They use data and technology to streamline the lending process. In particular they develop credit technology to evaluate a small business borrower based on balance sheet, cash-flow and income statement analysis at scale and speed. They all have high up-front, technology development costs and were funded by venture capital or private equity. In general they fall into two broad categories

- Technology-intensive, business that lend off of their balance sheet (e.g., OnDeck, Capital Access Network)
- Financial technology companies that provide lead generation or specialized origination services (e.g., Demyst, Biz2Credit)

They are non-regulated, non-deposit taking institutions that must borrow to fund balance sheet growth. They are migrating from initial, high-priced lending capital to larger pools of lower cost capital. They are also migrating from high costs of customer acquisition through brokers to lower cost, direct customer marketing. While a typical product is a loan of $35,000 (9-month term) with 40% APR, there are a range of additional products on the market. The range of products include:

- Merchant Cash Advance: ranging from $5,000 to $150,000 with equivalent of 50% APR, a flat percentage of the business's credit card sales are automatically remitted each day.
- Short term loan: typical loan is under $50,000 with a 9-12 month term. While there may be demand for larger loans with longer terms, this style-product is popular with lenders because credit technology is still maturing; the lower dollar amounts and short repayment periods mitigate some risk.
- Long term loan: some lenders are beginning to focus specifically on $150-$200K products with 3 to 5-yr term payments. They are marketing to lower risk small business borrowers by offering the convenience and speed of alternative lenders and less than 20% APR pricing.

Continued: Discussion

They invest 60+% of their staffing in Technology and Marketing & Sales. As their business grows, the technology staff generally shrinks (or stays flat) as a percent of human capital costs, but marketing and sales grow as they increase direct marketing activities. Their early investments in technology allow tech-intensive, alternative lenders to scale efficiently. Their operations costs are approximately 2-4% of the cost of a loan. Technology-intensive, alternative small business lenders have 0.5 staff per $1 million loaned; community lenders have five staff per $1 million loaned.

While initially alternative lenders may have costs of capital between 12-20%, their strategy over time is to prove the success of their business model and then obtain additional tiers of lower cost capital at approximately 5%. Their early customer acquisition costs are also initially high due to broker fees of 10-15% of the cost of the loan. Over time they are establishing partnership and direct sales channels to bring these costs closer to 3% of the cost of a loan.

As shown by these shifts in cost, the business models of the emerging, for-profit players are rapidly evolving. Any strategy involving partnerships within this segment of the lending industry should be based on their capabilities (e.g., credit technology) and their likely future business model. As an example, while there are many alternative lenders using credit technology and lending off of their balance sheet, as they mature, some may become more “pure play” credit technology companies and offer services to other financial institutions to lend off of their balance sheets.

Alternative lenders have invested to streamline the customer experience. For most lenders only 10-20% of their borrowers use a complete online experience. However they believe this will shift generationally and culturally as society engages more online. Successful alternative lenders market and provide customer support in multiple languages. Most importantly they provide loan decisions and funding in under a week, often in under a day. In contrast community lenders typically require 10-30 days. This speed and convenience creates high customer loyalty (e.g., high net-promoter scores and high customer retention).

Looking Ahead

There are multiple ways that community lenders can bring innovation from the alternative lenders into their mission-driven lending business. Some of these promising areas are summarized below.

1. Partnering around customer acquisition and customer management. Together community lenders and alternative lending companies could create co-branded loan products. This builds on an alignment of both group's goal (if not mission) to provide small business with access to capital. Alternative lenders would provide financial technology that enables scale and convenience and the community lender would maintain the "high touch" relationship with the borrower. Together they can identify products and strategies to go to market.

This partnership plays to both group's strengths. Financial technology companies would generate a revenue stream through fees for pre-screening borrowers, document collection (through digital connection or uploading), and software-based underwriting. Community lenders could reach more borrowers at a lower cost. Community lenders would continue to be responsible for closing (lending on or off their balance sheet), post-closing and servicing.

2. **Product licensing.** If CDFIs and alternative lenders cannot “naturally” partner because of culture and/or the fragmented structure of the CDFI industry, an intermediary could assess alternative lender’s products, license the product and make it accessible to the CDFI network. This has the advantage of negotiating based on a larger group of CDFIs and achieving volume discount fees potentially greater than an individual CDFI would be able to negotiate. This also has the potential to attract funds more quickly and at a larger scale than CDFI’s would do individually.

Continued: Looking Ahead

3. Partnering to increase the credit-worthiness of the small business borrowing pool. Even by using more advanced credit technology in ways described in #1 and #2 above, there are likely to be a large number of declines that are not initially creditworthy. There is an opportunity for CDFIs and credit technology companies to partner and offer very targeted business development services. After a decline, a program could re-pull the underwriting data, identify the reasons for the decline, and begin a credit improvement program. It would not be an immediate "2nd look program" (and many may still not receive access to credit after the program), but it has the value of increasing the potential credit worthiness of the borrower and increasing the customer pool for lenders.

Alternative lenders would be willing to share the "high level" drivers of their underwriting model. They could (through incentive or mandate) modify the decline letter to provide a borrower with an "opt in" option for a program to offer guidance to improve the borrower's credit assessment. Community based non-profits would be well positioned to run the program because of their current position of trust within their community and their mission-focus. There may need to be a "triage" process for prioritizing who gets into the program so that the sheer number of declines does not overwhelm it.

4. CDFI's developing their own technology and techniques from scratch. This would allow CDFI's to retain full control of their customer relationship. However the technology companies invested tens of millions of dollars in developing their technology and are located in technology talent "hot spots" (e.g., NYC, SF). This is a high risk option for CDFI's.

This macro-level benchmarking provides high-level comparisons of tech-intensive alt. lenders.[1]

- The objective of this analysis is to characterize elements of a loan's unit cost that alternative lenders have reduced through credit technology or techniques.
  - *Includes credit technology's role to assess risk based on analysis of a business' balance sheet, cash-flow and income statement analysis.*

- The focus is on high level comparisons to identify potential "best practices" for community lenders (e.g., CDFI loan funds, community banks, credit unions).
  - *There is the potential that credit technology can increase the access to capital for CDFI's clients.*

- This analysis relies on self-reported information from over a dozen interviews with nine companies and research of public material.
  - *This analysis includes little economic or performance modeling.*

(1) This analysis is not intended and not appropriate to assess the overall cost structure or value of the technology-intensive, alternative lending companies.

Analysis of Technology-Intensive, Alternative Lenders

High-level peer comparison

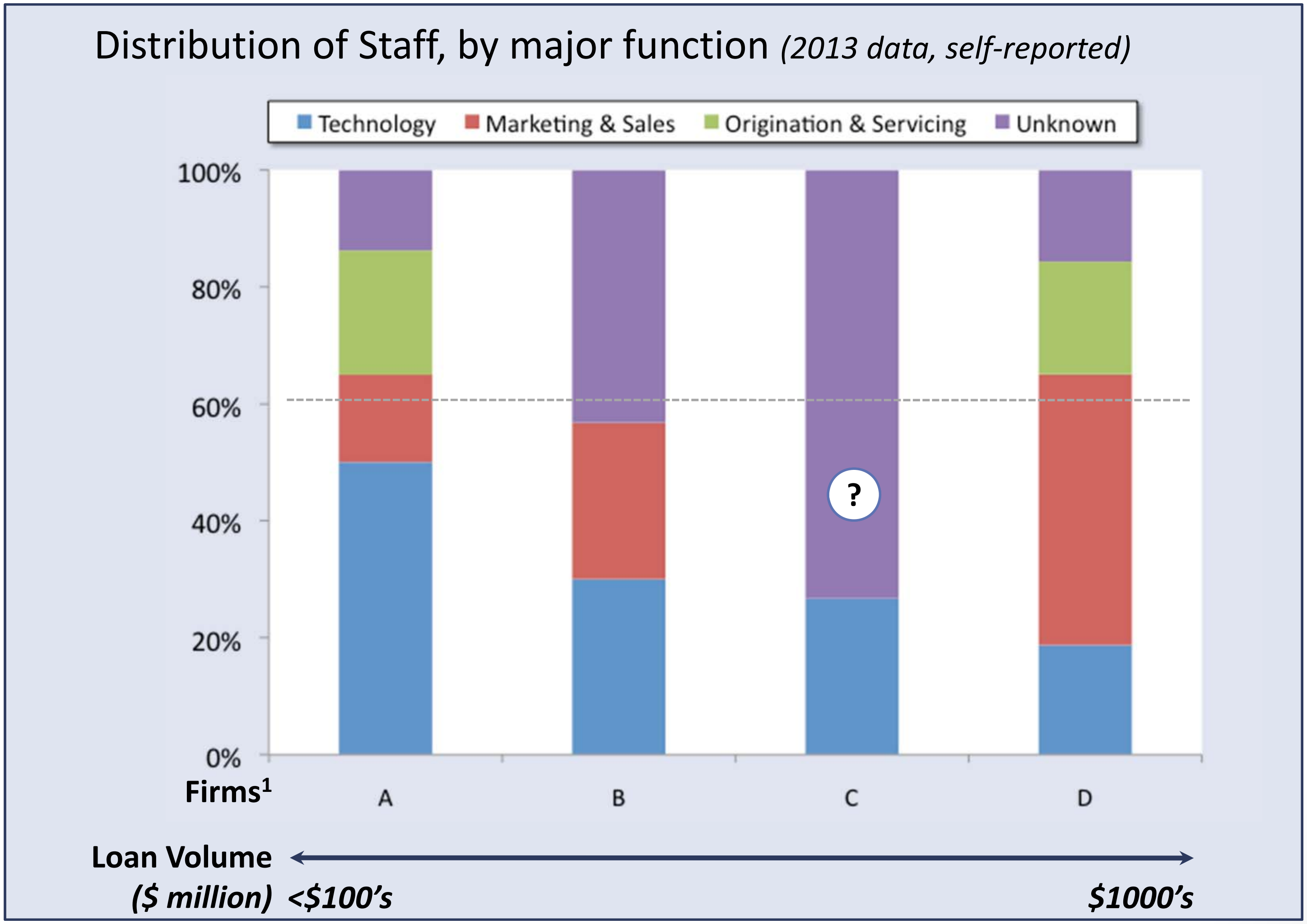
Existing models to partner with community lenders

Options to increase partnership

The emerging, for-profit players are privately held, technology-intensive businesses.

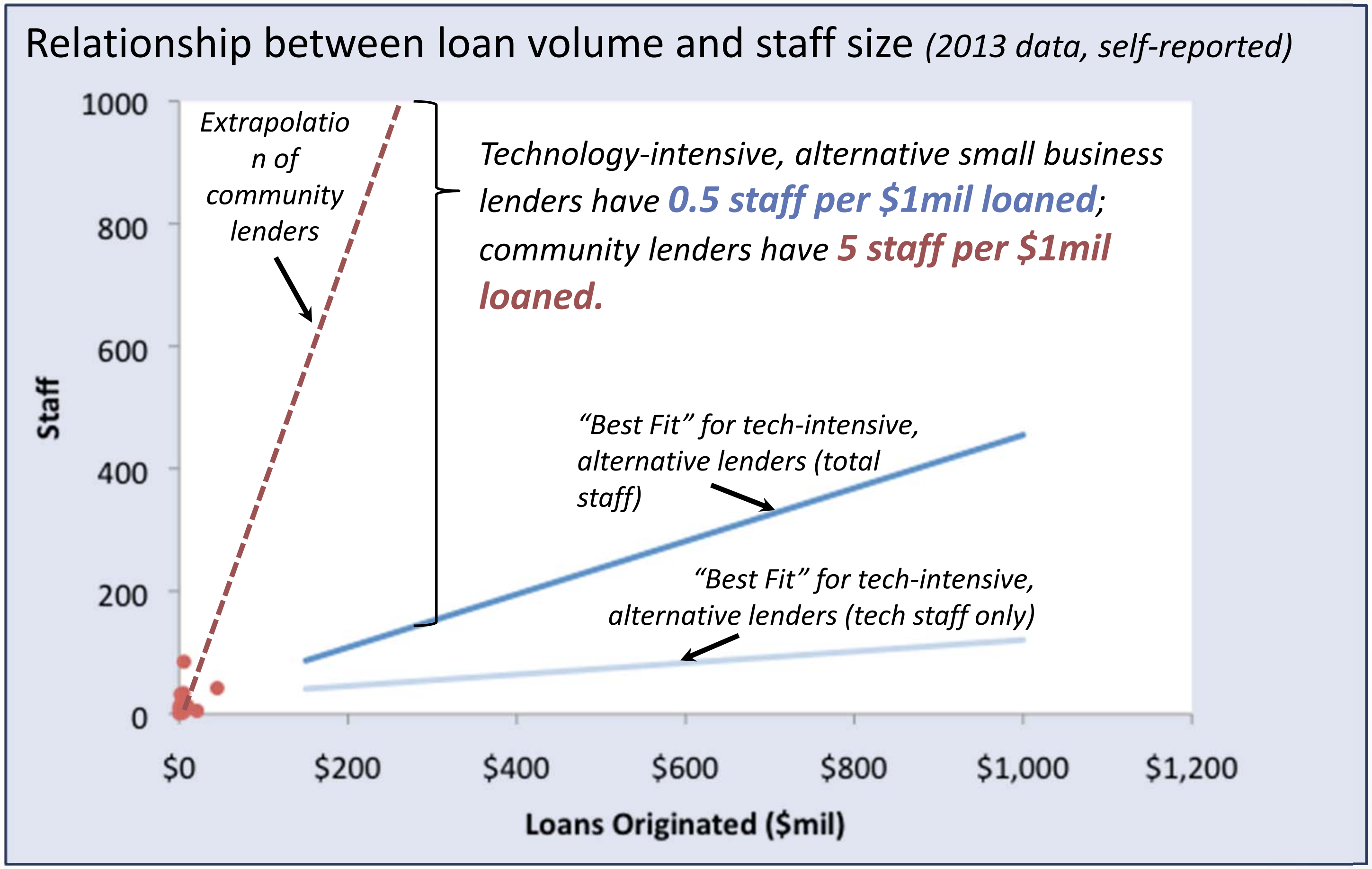
- Use data and technology to streamline the lending process
- Have high up-front, technology development costs…funded by venture capital or private equity
- Fall into two broad categories
  - Technology-intensive, lending-business (e.g., OnDeck, Capital Access Network)
  - Technology-based service-providers (e.g., Demyst, Biz2Credit)
- Offer a typical loan product of $35,000 (9-month term) with 40% APR
- Non-regulated, non-deposit taking
  - Must borrow to fund balance sheet growth
  - Migrating from initial, high-priced lending capital to larger pools of capital
- Very little detailed data publically available
- Investments are designed to create scale and sustainability

Tech-intensive, alternative lenders invest 60+% of staffing in Technology and Marketing & Sales…



(1) Firm names disguised for confidentiality; Source: 2River analysis

…these investments allow tech-intensive, alternative lenders to scale efficiently.



While the staff of community lenders certainly offer additional "high touch" services that alternative lenders do not, there are opportunities to improve efficiency.

Source: 2River analysis, AEO "Unit Cost Survey

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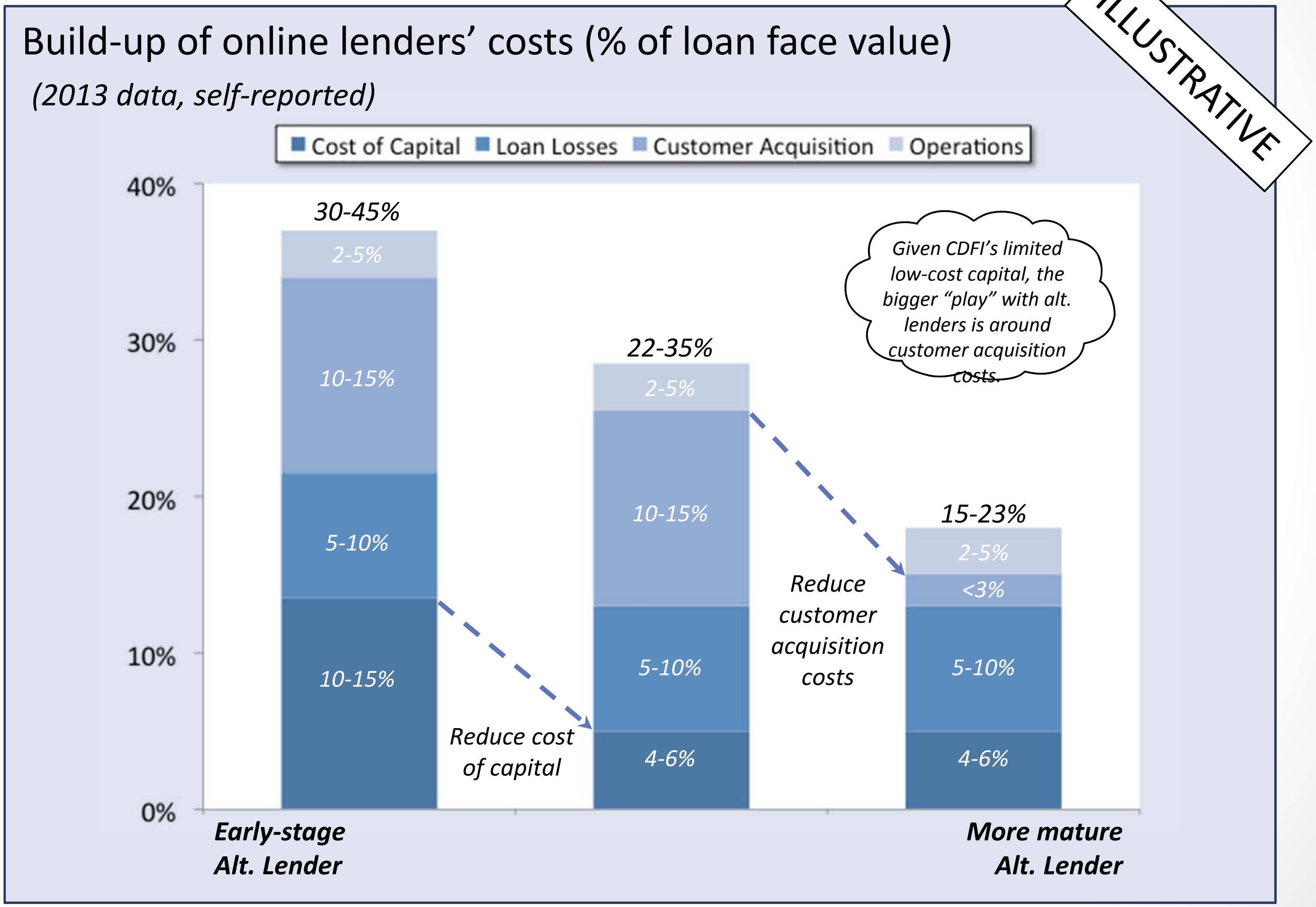
Online lenders' early investments in technology and data establish low operations costs…

Description of Basic Cost Drivers

Operations	*•Origination and servicing expenses (e.g., credit collection, customer support, payment processing, credit scoring and screening)*
Cost of Capital	*•Financing expenses the lender pays for credit facilities that they then deploy to fund small businesses' capital needs (also includes cost to open the facility, cost for unused credit,…)*
Customer Acquisition	*•Sales and marketing expenses for acquiring borrowers through direct methods (e.g., marketing campaigns).* *•Costs of borrower acquisitions (e.g. broker commissions, partner referral fees).*
Loan Losses	*•Adjustments for defaults and losses over the life of the loans and expected net recoveries (this analysis does not reflect losses due to prepayments).*

…as their business matures, they address costs of capital and customer acquisition costs (loan losses are managed as a business decision).

Initially lender's costs may be 30-45% of a loan's face value, but costs decrease over time.



Source: 2River analysis

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Focus is on reducing customer acquisition costs & maximizing the customer's experience.

High Customer Acquisition Costs

- Customer acquisition, originally based on high priced brokers and ISO's (over 10% fees)…
- …migrates to direct marketing to borrowers (e.g., partnerships, telemarketing, online).
- The ultimate goal for many alternative lenders is direct marketing in partnership with financial service-providers (e.g., Wells Fargo, Intuit) who are closer to small-businesses.

Streamlined Customer Experience

- Only 10-20% of borrowers use complete online experience
  - *Remainder choose a "higher touch" offline experience*
- Marketing and customer service in multiple languages
- Loan decisions and funding in <1 week (some cases <1 day)
- Market success requires high customer retention to off-set acquisition costs (typical is 2.5 loans per borrower).[1]

(1) The design of the loan product (e.g., 9-month terms) also contributes to borrowers seeking 2.5 loans (on avg.) to obtain the full capital needed.

Online alternative lenders use technology and data to create scale efficiently…

Hi-tech, Online Lenders	Community Lenders[2]
Origination: 2013 Loan portfolios ranged from $100's millions to over $1 billion.	**Origination**: Annual loan portfolios typically less than $2 million.
Cost Drivers: Lending costs are driven by cost of capital, customer acquisition costs, and loan loss rates.	**Cost Drivers**: Lending costs are driven by labor costs and "high touch" activities.
Staff Ratios: Less than 0.5 staff for every $1 million loaned – 20% to 50% of staff are technologists.[1]	**Staff Ratios**: 5 staff for every $1 million loaned – staff offer a range of services.

…but continue to have inherent costs in their business for "high-touch" customer activities.

(1) Technology staff includes engineering, data scientists, analytics staff, general IT
(2) AEO "Unit Cost Survey"
Source: 2River analysis

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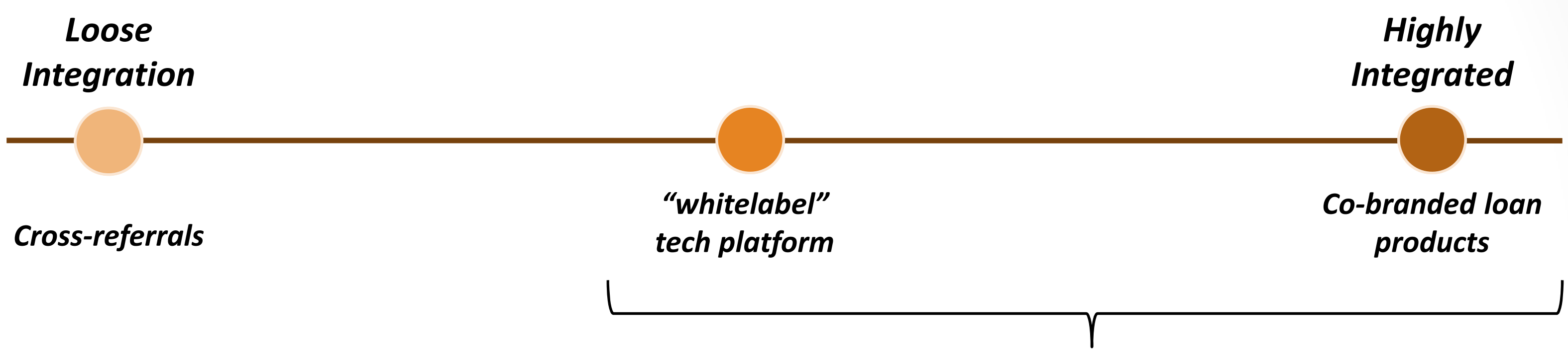
Existing models to partner with community lenders

Options to increase partnership

There are multiple levels for alternative, online lenders to integrate products and/or services with community lenders.



•Community lender refers borrowers to alternative lender – may pre-negotiate some aspects of loan product.

•*Easy integration but low value to borrower & community lender.*

•**Tech platform:** responsible for pre-screening borrowers, document collection (through digital connection or uploading), and software-based underwriting.

•**Community lender:** responsible for underwriting (with or without assistance of software-based underwriting), assisting borrowers with services to prepare for credit, closing, post-closing and servicing.

•*Examples discussed on following slides.*

As an example, Accion-Texas integrates technology into their MMS platform to offer products and services.[1]

MMS streamlines applications, underwriting, and document preparation

- Borrowers complete all information online before submitting (eliminates issue of partially completed applications).
- Scoring engine based on demographic (e.g., location of business) and credit variables (e.g., debt-to-income) – returns red-yellow-green score.
- Underwriters reviews all web applications before applicant receives a decision.
- Focus is on developing customer relationships

"High Tech-High Touch"

MMS integrates additional capabilities

- Piloting "Promise Loan" (an aptitude test) – if MMS scoring engine is green would not require additional underwriting.
- Piloting use of Demyst's scoring technology (based on borrower's social footprint) – could reduce time for a loan to close from 30 to 15 days.

PRO's	• Community lender maintains connection with SB borrower (low risk of losing a good applicant). • Tech company establishes additional revenue stream without declining their capital ratios.
CON's	• Community lender may not fully realize benefits of tech company's infrastructure investments • Community lender serving as a "technology service provider" demands high levels of expertise in technology, programming, and portfolio management.

Note: the scope of this analysis could not determine the performance or effectiveness of MMS but introduces it as another model for integrating technology.

As an example, Accion-East partners with Biz2Credit for origination services using their online platform.

- Biz2Credit provides lead generation services to increase client acquisition.
- Ancillary benefits include insights from "side by side" comparisons with other alternative sources of capital – this helps…
  - Create additional understanding of the demand and the CDFI's place in market
  - Benchmark processes (e.g., underwriting approach) with others
- Lesson #1: CDFI's processes must match the speed of the technology (e.g., lengthy underwriting processes create a bottleneck when technology increases the rate of client acquisition)
- Lesson #2: CDFI's must balance credit technology's speed with the client's needs (e.g., qualifying and funding borrowers quickly might be profitable but does not provide time to educate clients that need further development).
- Lesson #3: CDFI's mission requires different "economics" (i.e., a CDFI cannot simply price in higher defaults that may be typical of high-speed underwriting because high defaults hurt borrowers and contradicts their social mission).

Implications for others adopting similar model…

PRO's	• Community lender receives advantage of tech company investments to reduce operational costs. • Tech company increases revenue and client base without high broker costs.
CON's	• Community lender's customers connect through technology company (requires ongoing relationship management to achieve desired outcomes). • Community lenders will balk at fees for access to the technology.

Analysis of Technology-Intensive, Alternative Lenders

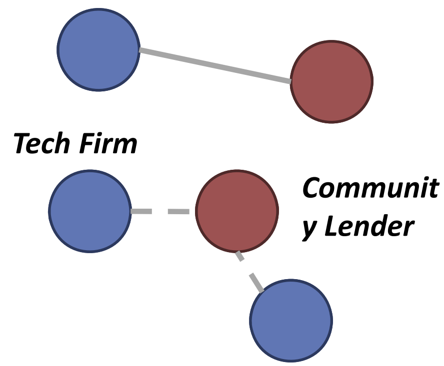
High-level peer comparison

Existing models to partner with community lenders

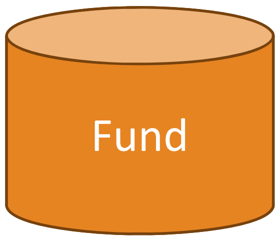
Options to increase partnership

Expand partnership of technology firms and community lenders by offering low-cost capital.

Self-organize into partnerships…[1]



…access low-cost capital from privately managed loan fund.



<u>There are many models for partnership between community lenders and tech-companies to build on…</u>

- *Integrate technology as part of community lender's process*
- *Integrate different technology for loan products, as desired*
- *Together identify products & strategy/material to go to market*

<u>Streamline the fund's due diligence process to attract more scalable capital</u>

- *Easier to assesses partnerships of Tech-Community Lenders based on defined products and markets*

Partnership builds on alignment of goals (if not mission) to combine unique characteristics of each group.

(1) *CDFIs and tech companies may not "naturally" partner because of culture and/or the fragmented structure of the CDFI industry. In this case, an intermediary could vet the alt. lender's products and make them accessible to the CDFI network.*

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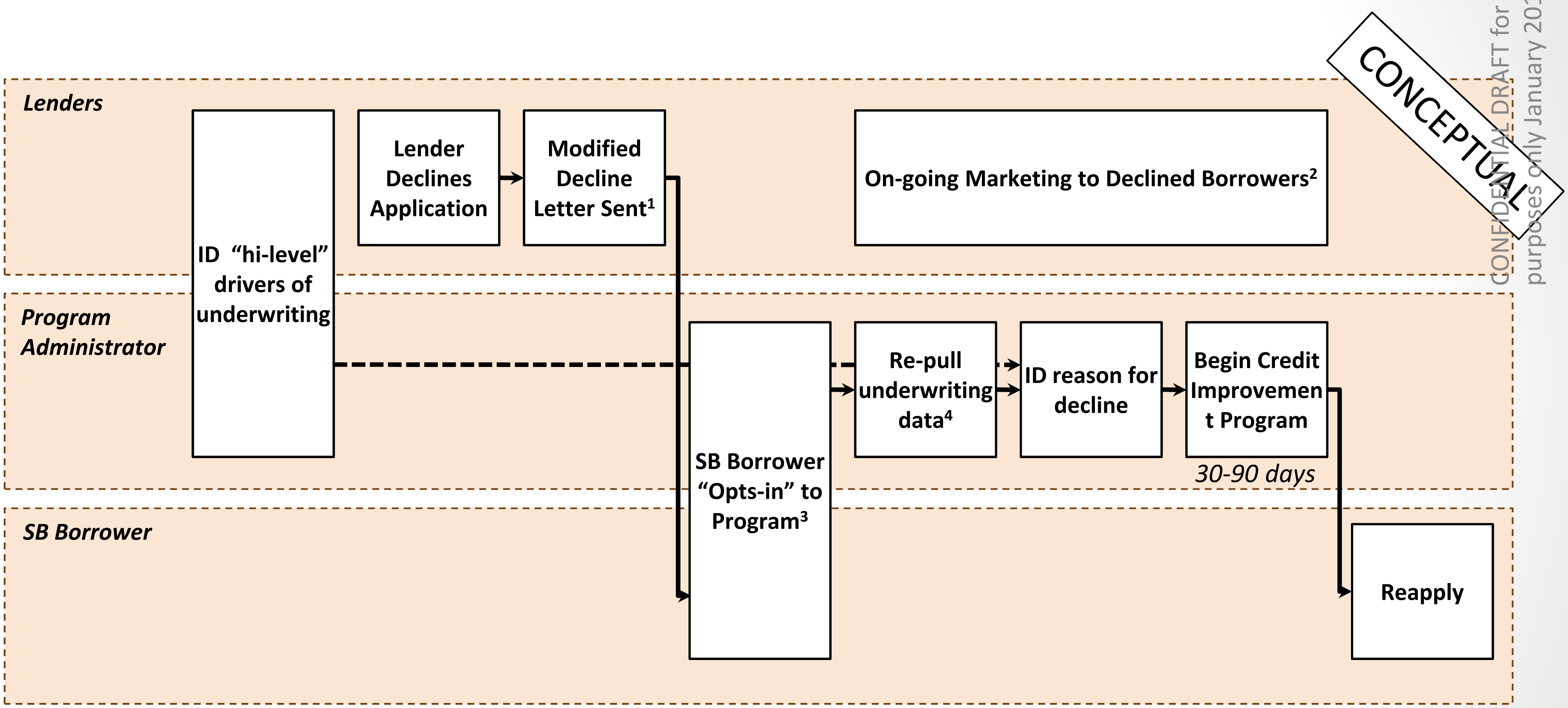
Create a partnership to increase the credit-worthiness of the small business borrowing pool.



(1) *Decline letters currently mandated; modify regulation to include "opt-in" for SB borrower to participate in this program*

(2) *Lenders currently market to declined borrowers; this would increase the ROI on that marketing by making the borrowing pool more credit-worthy*

(3) *Program needs to manage borrower's expectations – it is not an immediate 2nd look and many may still not receive access to credit after the program. The program will offer guidance to improve credit assessment without "gaming it".*

(4) *Lenders not likely to share underwriting data b/c of liability and agreements with 3rd party data providers. Some may share broad guidance to help the SB borrower improve finance – some branding or other consideration to the lender might incentivize this.*

There are opportunities for CDFIs and alternative lenders to partner and close the gap in small businesses' access to capital.

- Credit technology has provided borrowers with a high level of convenience…
  - …this will likely become an expectation from CDFI's clients too.
- Credit technology, although still developing, offers small businesses increased access to capital at scale and speed…
  - …CDFI's micro- and main street clients can benefit from this technology.
- Alternative lenders' higher rates are not simply because they are "for profits" but also because there are high costs from being a new industry…
  - …managing cost of capital and customer acquisition costs is necessary to make the loans accessible to micro- and main street clients.
- Developing credit technology from scratch is not for the "faint of heart"…
  - …typically includes investments of millions of dollars and access to top-software and engineering talent.

CDFI's can be part of a solution to close the gap by ensuring "high touch" borrowers are also included.

Technology-Intensive Lender Highlight: Progreso Financiero

Progreso Financiero was founded in California in 2005 and now also serves Texas via 83 stores. Its focus is to meet the financial needs of underserved Hispanic customers. Their clients have an average annual gross income of $27,360 and 92% have either "thin" credit or no credit file at all.

Loan Range	$500-$2,500
Average Loan	$1,000
Consumer Loans	90% of portfolio
Business Loans	10% of portfolio
Products	Small Dollar Loan ($250-$3,500)
	Prepaid Debit Card
	Remittance transfers (loan and cash)
	Life Insurance (up to $150,000)
	Auto Finance
	Small Business Financing

Loans are disbursed either via check or on a purchase card accepted by Progreso's retail partners (i.e., 7-Eleven, Wal-Mart, and CVS Pharmacy), which have, in aggregate, 40,000 locations. Cash-based payment options are available at all Progreso stores and partner locations, though customers with bank accounts can choose to pay via electronic funds transfer.

Despite having evolved into a multi-channel delivery firm (via the internet, direct mail, store locations, a large agent network, access to third-party ATMs, and prepaid debit cards) the company estimates that it has only penetrated 1% of its target market for credit products.

Source: Lieberman et. al. *Microfinance at the Crossroads.* 2012

Technology-Intensive Lender Highlight: Capital Access Network

- Founded in 1998, Capital Access Network (CAN) is largest non-bank lender in the United States. They expect to originate $1B of small business loans in 2013.
  - Average loan is $35,000 (they offer loans up to $150,000)
  - Average term is 12-18 months (they are starting to look at longer terms)
  - Average rates is 40% APR; range is as low as 9.99% up to 70% APR
  - Approve 70% of their applicants
  - OnDeck is a competitor (but 4-5x smaller).
- 70% of CAN's small customers renew their funding at the end of the term = 2.5 loans per customer on avg.
- They have refined their predictive scoring models over 12 years. CAN then invested in the technology to collect large behavioral and financial data on its applicants. They built the "most predictive scoring model that exists". Of CAN's 450 staff, 120 are in data systems and technology.
- As part of underwriting, they track how the borrower will invest the loan. They want to determine if the business will generate a strong ROI to justify borrowing at the higher rate and reduce the risk of default. Their businesses on avg grow 30-35% after taking the funding.
- CAN believes that borrowers that are just below a bank's risk threshold are an unmet need. They want a larger loan (e.g., $200K) and may not qualify for a bank loan due to a lower FICO score and/or they don't have collateral (like a florist or doctor's office). They might respond to direct mail, but when presented with pricing above 30%, they don't accept it because it is too high.

Technology-Intensive Lender Highlight : On Deck Capital

General information: Founded in 2006, On Deck Capital provides Main Street small businesses with convenient access to capital. Their average loan is $35,000 with an eight month term. Their fees and interest rates are 20- 40% APR and in 2013 they will originate $500,000,000 in loans.

Underwriting Method: On Deck underwrites based on cash-flow analysis rather than traditional credit-scoring. Their technology platform supports loan origination and automated underwriting through applicant-provided information and integration with 3rd party data sources (e.g., bank accounts).

Data Collection: The system integrates data from bank statements, monthly deposits, and credit card transactions. Automated underwriting is based on cash-flow, elements that make up a credit-file and all other activity that a small business does either on- or offline (e.g., secretary of state filings, tax filings, online presence…).

Pilot Project: On Deck is piloting their technology with Justine Peterson, a certified CDFI. On Deck originates, underwrites and services the loans while the CDFI (in this case Justine Peterson) provides the capital. In the pilot, On Deck closes 2+ loans per month. The cost of this service is approx. 4% per transaction.

Source: Interview on December 3, 2013 and www.ondeck.com

Technology-Intensive Lender Highlight : Funding Circle USA

Funding Circle USA was created in October, 2013 in a merge between U.S. based Endurance Lending Network and Funding Circle UK. Funding Circle USA is a technology driven, for-profit lender that uses an online marketplace to connect small businesses to small scale, accredited investors to secure funding.

Loan range	\$25,000 - \$500,000
Term	up to 36 months
Interest Rate	10.99%-16% plus 3% fees
	fixed, fully amortizing

Funding Circle USA operates as a for-profit institution which means they are fully self-sustaining and their model demonstrates the important role that technology is playing in lowering costs for both the lending institutions and the customers. Their data platform is reducing the problematic and time consuming process of collecting and sorting information while simultaneously streamlining the evaluation of data by using a specially designed credit algorithm. This underwriting algorithm assesses a business' assets and cash-flow and includes data on the "quality" of the business' income. It also uses non-traditional data sources for every loan that account for personal factors about the potential customers and reduces fraud.

Source: Interview November 27, 2013 and www.fundingcircle.com

Technology-Intensive Lender Highlight : Biz2Credit

Biz2Credit was founded in 2007 and provides a technology-based service to match small business borrowers with sources of capital (Biz2Credit itself does not provide capital). Biz2Credit has partnerships with over 1,200 lenders (including CDFIs and community banks). The size, interest rate and term of the loans vary based on the lenders.

They have developed a technology platform for loan origination and automated underwriting. An applicant answers a set of screening questions and the system identifies the type of loans the applicant might qualify for. The applicant then authorizes the system to access 3rd party data sources (e.g., bank accounts) to collect data for automated underwriting or to pass that data on to their lending partner for underwriting. The system integrates data from multiple 3rd party sources.

Biz2Credit has partnered with Accion East to provide loan origination and underwriting services. They process 40% of Accion East's loan volume (100 loans per month). Turn-around time is 10 days (versus 3-4 weeks offline), average loan size is 40-50% higher than loans originated offline, default rate is less than 1% (compared to 4% for offline loans), and the online loans require 66% less manual underwriting than offline loans. The fee for this service is a one-time fee of $10,000-$25,000 plus a 2-4% transaction fee.

Source: Interview in December, 2013 and www.biz2credit.com

Technology-Intensive Institution Highlight: Demyst Data

The absence of data has lead the industry to decline and Demyst was founded to help identify which loan applicants are incorrectly declined. They identify the declines by capturing real time social, online, and alternative data alongside traditional data and then pull it all together to create a score that categorizes the loan applicant. In essence, Demyst works as the pipeline that cleans the data. The company does not own any of the information because they are agnostic about the origin; collecting data from many different sources. Demyst operates on three main beliefs:

1) The importance of actionable access to high quality customer information,
2) That information and liquidity symmetry equate to financial access,
3) That data and analytical technology are key to financial services innovation and inclusion.

These core ideas root the company's mission so that it focuses on investing in the richest emerging sources of customer information, technology to clean data at scale, and advanced real time predictive analytics.

Founded	2010	
Clients	Small business lenders	
Three Step Methodology	1) Compliance: Automated customer monitoring allows manual reviewers to focus on areas of highest risk.	
	2) Underwriting: Demyst uses online and internal data sources to rank prospects and predict outcomes.	
	3) Segmentation: Demyst uses historical data to build strong predictive models with minimal inputs.	

Source: Interview on November 12th, 2013 and www.demystdata.com

AEO Association for EnterpriseOpportunity THE VOICE OF MICROBUSINESS

LIPAM International

Business Development Services

Institutions that Provide Advisory Services Only

Introduction

Just as a loan can help a microenterprise grow its income, so can knowledge too. This has made the taking of some sort of a training course to be usually required of the microenterprise before receiving its first loan. Many funders require that the microfinance institution offer training to their clients as a condition for a loan or donation.

With low-income borrowers, the training course serves to cement loyalty to the lender as well as among the group's members where there are solidarity guarantees. Responsible lenders also teach their prospective clients about the interest rate and the other loan conditions, and they emphasize the importance of the business as the source of the cash flow with which to repay the loan and keep growing the income of the microenterprise.

In many cases, the microfinance institutions tried to teach entrepreneurship to their clients only to find the latter knew much more about business than the MFIs do. This would lead to heightened respect for those persons who, while at the margin of society, can extract economic survival from a minute business endeavor. Some MFIs thus decided to wave the entrepreneurship course; others, however, continue to see in it a means to guide prospective borrowers; and to separate the truly apt and committed business person from the mere curious or otherwise doubtful prospect.

As some of the enterprises prosper and grow, there is often a need for non-financial inputs in order to keep adding capacity to the business and not just debt. Similarly, the need for those inputs might be triggered by problems at the enterprise. Those inputs, which are something other than money, are usually known as business development services, or BDS.

This section summarizes BDS, its types, providers, ways of delivery, challenges and the main insights from our meetings with BDS providers.

NOTE: Compared with microenterprises, BDS usually play a greater role in small enterprises. This is mainly because small enterprises are usually formal and more sophisticated in their operation than the microenterprises and need greater inputs of training and technical assistance.

Business Development Service Providers

- **What are Business Development Services (BDS)?**
  - BDS are non-financial services for entrepreneurs (Main Street business persons)
  - BDS include training courses, one-on-one mentoring, advice, assistance with operations and business incubation
  - BDS topics span financial literacy, entrepreneurship, business plans, management practices, marketing, bookkeeping, technology/IT, legal & tax, linkages with other businesses, how to get a loan, etc.
  - BDS aim at helping an entrepreneur start a business, or at improving the performance of a business, and may prepare businesses to qualify for financing.

- **Who are BDS Providers?**
  - BDS are provided by over 800 Microenterprise Development Organizations (MDOs), as well as USDA intermediaries
  - While many of those MDOs also make loans (CDFIs), some providers focus exclusively on BDS (no loans)
  - In addition, government entities (SBA, state, local) provide or support BDS
  - Universities and businesses also provide or support BDS
  - BDS providers which are MDOs are mostly dependent on grant financing

NOTE: The MicroTracker website in FIELD at the Aspen Institute contains information on BDS provided by Microenterprise Development Organizations. For FY2012, there were 216 MDOs reporting the provision of BDS to over 48,000 businesses and 117,800 individuals. The total number of business and individuals receiving some sort of BDS was likely a significant multiple of the MDO figures.

Continued: Business Development Service Providers

- **Delivery**
  - Traditionally, directly through in-person classes and meetings
  - Increasingly, remotely through the Internet and on-line meetings
  - About 111,000 persons received BDS from MDOs in 2010 (FIELD Study)
  - No data on the many persons receiving BDS from non-MDO providers
- **Challenges**
  - No industry estimates on the effectiveness of BDS
  - No data on the demand for BDS
  - Most BDS providers lack scale
  - BDS providers rely on grants to cover their budgets
  - CDFI self-sufficiency often suffers when provision of BDS added as product in addition to loans
  - Many BDS providers develop their own training materials

NOTE: BDS providers which are MDOs are usually small; FIELD's MicroTracker reports their median staff size in FY2012 at 3 full time employees. Providing quality training and advice is expensive; technology is helping BDS providers become more efficient.

Insights from Meetings with BDS Providers

1. Banks turn down applications because the entrepreneur isn't ready for a loan; financial literacy, business training and financial planning should precede a loan application
2. When banks refer their loan denials to BDS providers, the latter can provide BDS and improve the entrepreneur's chances of getting a loan when he/she next applies
3. Many CDFIs would benefit from referring their clients to entities which specialize in BDS, rather than try to provide both loans and BDS
4. Partnerships between loan providers and BDS providers can work well to mutual advantage
5. Centralization can reduce the cost of developing BDS materials and tools, which can release funding for the needed local delivery of BDS
6. Technology can help BDS providers reach all entrepreneurs
7. Loans should cover their own costs, and grants should favor BDS
8. Lenders should seek to improve the quality of their loan portfolio by referring their borrowers to BDS providers for assistance in performance improvement
9. Seeking grants consumes a lot of time and effort for BDS providers and creates major uncertainty about funding
10. Many BDS providers strive to cover a part of their cost through the revenues they generate from providing BDS

BDS Institution Highlight: Goodwork Network

Founded	2001	
Entity Type	501(c)3 nonprofit	
Products	Business development services to minority- and women-owned businesses. No loans provided.	
Customer Base	Annually serving approx. 600 clients; of those 200-250 receive extensive technical assistance and training.	
Methodology	GWN has evolved a system where it categorizes clients into 5 groups: 1s having very few resources and little knowledge and 5s being loan-ready.	
	Level 1 – very low capacity to do business	
	Level 2 – some drive to do business	50% of clients enter at these two levels
	Level 3 – both drive and skills to do business	
	Level 4 – in business already and supporting themselves	~100 clients are at these two levels
	Level 5 – doing well in business and ready for expansion and a loan	

The ultimate goal is for clients to graduate upwards through the pipeline. The end result is surprisingly that the majority of their clients end up not needing the financial assistance they originally expected or do not graduate all the way to level 5; only 10-12 clients received loans in 2Q and 3Q 2013 combined. These recipients of loans tend to be long term clients of GWN and handle capital more successfully and responsibly than other borrowers; this is shown by comparisons of delinquency rates. For Levels 4 and 5 clients, a service which is often more valuable than a loan is for GWN to help these clients identify potential business customers and provide recommendations. Some of Level 5 candidates purchase accounting and similar services from GWN and their payment helps GWN cover part of its costs.

The biggest issue is client eligibility for loans; there is enough un-deployed capital but there is a serious lack of qualified candidates. GWN addresses this issue with their focus on business development services, however there is no referral system with lending institutions, making it harder for GWN to connect with the people who need financial education.

Source: Information and data collected from interview with GWN and from www.goodworknetwork.org

Institution Partnership Highlight:
Rising Tide Capital and The Intersect Fund

Rising Tide Capital and The Intersect Fund have created an advantageous partnership that shares customers while allowing for each institution to hold the comparative advantage for their services. Competition is not an issue because both institutions believe that the industry must be divided between financial services and technical assistance; the two cannot be blended for optimal results for the customers. In light of this mutually held opinion, the two institutions have begun to separate their work along that line and have created a referral system to better address the needs of disadvantaged entrepreneurs in New Jersey.

Rising Tide Capital	The Intersect Fund
Offers all technical assistance services; education and business development courses that entrepreneurs need to become loan-ready. Services are fee-based with scholarships available for those who are eligible.	Enters when an entrepreneur is loan-ready; focuses specifically on low-end financial products from $500-$5,000. (Their loans can go up to $20,000.)

Each institution's emphasis on maintaining one core product reflects the development pattern in international microfinance which ultimately allowed the industry to scale and reach sustainability before expanding product lines and business models.

Source: Information gathered from interviews with Rising Tide Capital 11/4/13 and The Intersect Fund 10/21/13

Institution Partnership Highlight:
The Appalachian Center for Economic Networks (ACEnet)

Founded	1985	
Entity Type	not-for-profit	
Products	*Business Incubation*	Staff encourages entrepreneurs to 1) network with each other and 2) share information and generate joint ventures. A shared kitchen and bottling plant facilitate launching businesses that add value to farmer products.
	Loan Funds	ACEnet Ventures provides loans ranging from microloans of $1500 to equipment and real estate loans up to $350k.
	Building Business Capacity	1) Business counseling, training, ecommerce, and market access programs. 2) Overall business planning and financial systems training to both new and expanding sectoral businesses. 3) Workshops on bookkeeping and accounting software applications, and preparing and analyzing financial systems.
	Product Development	Assist entrepreneurs in producing the most appropriate product for their target audience.
	Marketing and Distribution	Provides practical, hands-on training to firms developing market strategies.

ACEnet states that its mission is "to build networks, support innovation, and facilitate collaboration with Appalachian Ohio's businesses to create a strong, sustainable regional economy."

Source: http://www.acenetworks.org and interview on November 15, 2013

BDS Institution Highlight: MicroMentor (MercyCorps)

Founded	2001
Entity Type	501(c)3 nonprofit
Products	One-on one mentoring services to emerging entrepreneurs nationwide are provided by experienced entrepreneurs on a volunteer (free) basis. No loans provided.
Customer Base	Annually serving approx. 800 clients. Prospective clients find MicroMentor on the web and through advertisements, or via referrals by lenders and other community institutions.
Methodology	On the MicroMentor website, the mentors create their profiles describing their business expertise. The entrepreneurs create their mentoring requests describing the goals they want to achieve with a mentor. Interested mentors send their "offers" to the entrepreneurs, explaining how they can help the entrepreneur achive his/her goals. The entrepreneur has two weeks to accept an offer. Once the entrepreneur accepts the mentor's offer, MicroMentor then exchanges contact information for the entrepreneur and the mentor via email. MicroMentor facilitates and monitors the match, but does not make it. MicroMentor provides both mentors and clients with guidelines and other resources to facilitate the mentoring relationship. Both mentor and entrepreneur are expected to provide feedback to MicroMentor as the mentoring progresses. This information is used to gauge quality and record results. MicroMentor reports that its website is capable to handle many more matches and its is working on getting the word out to both mentors and entrepreneurs to use it.

Mentors are not allowed to give help with financing; they provide guidance and advice on the preparation of the business plan which the entrepreneur will present to the bank.
So far, banks have not shown interest in promoting the use of mentors for improving the quality of their loan portfolios.

Source: Information collected from interview with MicroMnetor and from www.micromentor.org

Salient BDS Examples in the U.S.

Many websites contain or facilitate access to BDS resources available online.

- **Better Money Habits (literacy in finance)**
  A production of Bank of America in partnership with the Khan Academy
  http://www.bettermoneyhabits.com/en/videos/credit-debit.html?cm_mmc=EBZ-CorpRep-_-Taboola-_-text_link_creditvsdebit-_-Taboola_Desktop_Textlink_CPC_CC_CreditVsDebit#fbid=xUFfvpXN70k

- **Community BDS providers interviewed by the team**
  ✓New Jersey www.risingtidecapital.org
  ✓New Orleans www.goodworknetwork.org
  ✓Ohio www.acenetworks.org
  ✓Oregon www.micromentor.org
  ✓South Carolina http://communityworkscarolina.org
  ✓California http://centrocommunity.org

- **FASTTRACK**
  An Internet course of the Kauffman Foundation that helps persons start or grow their businesses http://fasttrac.org/

- **LaIdea** provides Latino entrepreneurs in the Americas with BDS. Hosted by ACCION
  laidea@accion.orgus.accion.org

Continued: Salient BDS Examples in the U.S.

- **MOOCs (**Massive Online Open Courses) offered by universities through Internet platforms such as Coursera, EdX, MIT OpenCourseWare, Stanford/ItunesU, Udacity.
  http://www.mooc-list.com/

- **SCORE** is a nonprofit association dedicated to helping small businesses get off the ground, grow and achieve their goals through education and mentorship. Score has been doing this for nearly fifty years.
  http://www.score.org/

- **Small Business Development Centers and Women's Business Centers** (SBA and states network; all over the country)
  http://asbdc-us.org/

- **TOOLKIT** developed by IBM and IFC to train entrepreneurs
  http://us.smetoolkit.org/us/en

- **Tools for Entrepreneurs**
  http://www.forbes.com/sites/jasonnazar/2013/05/28/30-terrific-tools-for-small-businesses

Mobilizing Capital

Overview of Current Sources of Funding for Main Street Lenders and BDS Providers

- **Government: Treasury, SBA, USDA, State and Local** provide significant concessional and long term funding but flows are unpredictable from year to year and conditions can be complex.

- **Large Commercial Banks** and their foundations provide significant grants and capital driven largely by CRA requirements.

- **Non-Bank Foundation's** support to the sector has diminished in the face of mixed results and unstable models.

- **Public Insured Deposits** are important for regulated institutions such as LICUs and CDFI banks, but are constrained by limited equity.

- **Privately Managed Intermediaries'** engagement is sporadic, discouraged by poor data and "crowding out" by government programs.

Funding for Main Street Lenders and BDS Providers

There are a diverse set of funding institutions: public, private, foundations, a limited set of intermediaries supporting main street lenders, primarily on a concessional basis.

Government Funding:

- **Treasury support**:
  - CDFI Fund—annual awards (as grants) for a diverse set of CDFIs
  - CDFI Fund support (grants) to build capacity in the sector—OFN and FIELD
  - State Small Business Credit Initiative (SSBCI) fund that supports state programs for small business credits ($1.5 billion)
  - Small Business Loan Fund (SBLF) that supports community banks (nominally $30b of which $4b disbursed)

SSBCI Program

- Supported 4,600+ small businesses nationwide with loans and investments totaling $1.5 billion
  - → Nearly two-thirds were for < $100,000, and the average was $327,000
  - → More than half of all funds were awarded to young businesses < 5 years old
  - → 80% of funds were awarded to businesses with 10 or fewer employees
- Funds have created or retained 53,000 American jobs
  - → 17,000 will be created within 2 years
  - → 36,000 jobs that were at risk will be retained
- 42% of funds went to low- and moderate- income community businesses
- 93% of lending institutions that made SSBCI loans to small businesses are smaller banks, credit unions, or CDFIs, defined as institutions with < $10 billion in assets
- In 2012, SSBCI funds had generated $6.58 in new small business lending for every $1 of federal support
- Over 70 new small business support programs have been created as a direct result of SSBCI's work

Source: State Small Business Credit Initiative: A Summary of States' 2012 Annual Reports

Continued: SSBCI

- SSBCI awards funds to State agencies for lending and investing through 5 programs:

Capital Access – Operates in 26 States

→ Supported origination of approx. 3,300 new small business loans totaling $200 million and the creation of 4,000 jobs and the retention of more than 18,000

→ Average loans size is $60,000

Loan Participation – Operates in 37 States

→ Supported over $807 million in loans in 2011 and 2012 and created over 5,000 jobs

→ Average financing per small business is $1.6 million; leverage $6.41 for every $1 federal support

→ States have deployed 26% of funding; highest percentage of funds deployed any SSBCI program

Collateral Support – Operates in 15 States

→ Supported 175 loans in 2011 and 2012 totaling $222 million

→ Average total financing per small business is $1.27 million; leverage $6.35 for every $1 federal support

Loan Guarantee – Operates in 19 States

→ Supported 465 loans in 2011 and 2012 totaling $189 million

→ Average total financing per small business is $406,000; leverage $5.58 per $1 of federal support

Venture Capital – Operates in 31 States

→ Supported investments in 237 businesses in 2011 and 2012 totaling $472 million

→ Average total financing per small business is $2 million; leverage $5.36 for every $1 in federal support

Source: State Small Business Credit Initiative: A Summary of States' 2012 Annual Reports

SBLF

- The SBLF was nominally a $30 billion fund but Treasury was limited to 1 year of disbursement and in effect the fund became a $4b facility that stimulates small business lending by providing Tier 1 capital to qualified community banks with assets of < $10 billion
  - → SBLF has awarded approx. $4 billion to 332 Community Banks and CDLFs
  - → Supports Main Street banks, community development loans funds, and small businesses
    - ✓ Small Business lending is defined by the Small Business Jobs Act as certain loans up to$10 million to businesses with up to $ 50 million in annual revenues
  - → Eligibility: must be an insured depository institution and have assets < $10 billion
    - ✓ If < $1 billion in total assets, bank may apply for SBLF funding that equals up to 5% of risk-weighted assets
    - ✓ If > $1 billion and <$ 10 billion, bank may apply for funding that equals up to 3% of risk-weighted assets

	Dividend Rate Over Time	
Time Period	Lending Increase	Dividend Rate
Dividend rates upon funding and for the next nine calendar quarters, adjusted quarterly (based on outstanding loans at the end of the second previous quarter);	Less than 2.5 %	5%
	2.5% or more, but less than 5%	4%
	5% or more, but less than 7.5%	3%
	7.5% or more, but less than 10%	2%
	10% or more	1%
Dividend rate for the tenth quarter after funding through the end of the first 4.5 years;	If lending has increased at the end of the eighth quarter after funding	rate set as above for the tenth quarter
	If lending has not increased at end of the eighth quarter after funding	7%
Dividend rate after 4.5 years (if funding has not already been repaid)		9%

Source: *Overview of the Small Business Lending Fund* from the treasury.gov

SBLF Institution Recipients

Institution				Qualified Small Business Lending as of 9/30/2013				
Name	City	State	SBLF Funding Outstanding	Baseline Level	Current Level	Increase/Decrease over Baseline	% Change over Baseline	Resulting Rate
California Coastal Rural Development Corporation	Salinas	CA	870,000	9,545,000	7,728,000	(1,817,000)	-19.04%	2%
Opportunity Fund Northern California	San Jose	CA	2,236,000	5,935,000	17,167,000	11,232,000	189.25%	2%
Valley Economic Development Center	Van Nuys	CA	661,000	9,581,000	30,102,000	20,521,000	214.18%	2%
Colorado Enterprise Fund, Inc.	Denver	CO	463,000	5,721,000	8,581,000	2,860,000	49.99%	2%
Access for Capital for Entrepreneurs, Inc.	Cleveland	GA	188,000	2,773,000	8,080,000	5,307,000	191.38%	2%
Community Ventures Corporation	Lexington	KY	1,045,000	3,451,000	9,942,000	6,491,000	188.09%	2%
Coastal Entreprises, Inc.	Wiscasset	ME	2,316,000	17,640,000	22,332,000	4,692,000	26.60%	2%
Nebraska Entreprise Fund	Oakland	NE	197,000	1,454,000	4,167,000	2,713,000	186.59%	2%
Citizen Potawatomi Communuty Development Corp	Shawnee	OK	490,000	6,505,000	12,213,000	5,708,000	87.75%	2%
Bridgeway Capital, Inc.	Pittsburgh	PA	1,820,000	18,674,000	24,636,000	5,962,000	31.93%	2%
Charleston Citywide Local Development Corp	Charleston	SC	1,000,000	1,799,000	3,206,000	1,407,000	78.21%	2%
Northwest South Dakota Economic Corporation	Sisseton	SD	1,000,000	11,758,000	13,010,000	1,252,000	10.65%	2%
ECDC Entreprise Development Group	Arlington	VA	320,000	1,402,000	2,947,000	1,545,000	110.20%	2%
Vermont Communty Loan Fund, Inc.	Montpelier	ME	1,247,000	12,787,000	16,226,000	3,439,000	26.89%	2%
Impact Seven, Incorporated	Almena	WI	4,000,000	13,344,000	23,260,000	9,916,000	74.31%	2%

Source: SBLF January 2014 Report on SBLF Participants' Small Business Lending Growth

CDFI Fund Financial Assistance Grant Awards: FY 2013 Recipients

Sample Awardees				
Financial Assistance Awardee Name	**City**	**State**		**Total Award**
ACCION Chicago	Chicago	IL	$	847,000
ACCION East	New York	NY	$	1,347,000
ACCION New Mexico	Albuquerque	NM	$	1,347,000
ACCION Texas	San Antonio	TX	$	1,347,000
Coastal Enterprise, Inc.	Wiscasset	ME	$	1,347,000
Colorado Enterprise Fund	Denver	CO	$	1,347,000
First State Community Loan Fund	Wilmington	DE	$	847,000
Metropolitan Consortium of Community Developers	Minneapolis	MN	$	600,000
Neighborhood Development Center, Inc.	St. Paul	MN	$	847,000
Opportunity Fund Northern California	San Jose	CA	$	1,347,000
People Incorporated Financial Services	Abingdon	VA	$	597,000
Self-Help Federal Credit Union	Durham	NC	$	1,347,000
Southeast Community Capital Corporation DBA Pathway Lending	Nashville	TN	$	1,347,000
The Intersect Fund	New Brunswick	NJ	$	300,000
Vermont Community Loan Fund, Inc.	Montpelier	VT	$	535,103
Women's Economic Ventures	Santa Barbara	CA	$	600,000
WomenVenture	St. Paul	MN	$	600,000
		Sub Total	**$**	**16,549,103**

Source: Compiled from the CDFI Fund's List of Award Recipients FY 2013

CDFI Fund Financial Assistance Grant Awards: FY 2013 Recipients

Credit Unions

Financial Assistance Awardee Name	City	State		Total Award
Alliance Credit Union	Fenton	MO	$	874,500
ASI Federal Credit Union	Hrahan	LA	$	1,347,000
Choices Federal Credit Union	St. Louis	MO	$	200,000
Electro Savings Credit Union	St. Louis	MO	$	1,347,000
First Light Federal Credit Union	El Paso	TX	$	1,347,000
GTE Federal Credit Union	Tampa	FL	$	1,347,000
Guadalupe Credit Union	Santa Fe	NM	$	597,000
Hope Federal Credit Union	Jackson	MS	$	1,347,000
Jefferson Financial Credit Union	Metairie	LA	$	1,097,000
Latino Community Credit Union	Durham	NC	$	1,347,000
Newrizons Federal Credit Union	Hoquiam	WA	$	495,000
Opportunities Credit Union	Winooski	VT	$	1,347,000
Poplar Bluff Federal Credit Union	Poplar Bluff	MO	$	589,000
Santa Cruz Community Credit Union	Santa Cruz	CA	$	847,000
(Self-Help Federal Credit Union listed under AEO members)				
Shreveport Federal Credit Union	Shreveport	LA	$	1,347,000
St. Louis Community Credit Union	St. Louis	MO	$	847,000
Syracuse Cooperative Federal Credit Union	Syracuse	NY	$	664,241
United Credit Union	Mexico	MO	$	597,000
		Sub Total	**$**	**17,583,741**

Community Banks

Financial Assistance Awardee Name	City	State		Total Award
First Eagle Bancshares	Hanover Park	IL	$	1,347,000
One PacificCoast Bancorp, Inc.	Oakland	CA	$	1,347,000
Southern Bancorp Bank	Arkadelphia	AR	$	1,347,000
		Sub Total	**$**	**4,041,000**

TOTAL FA	**$38,173,844**

Source: Compiled from the CDFI Fund's List of Award Recipients FY 2013

CDFI Fund Technical Assistance Grant Awards: FY 2013 Recipients

Sample Awardees				
Technical Assistance Awardee Name	**City**	**State**		**Total Award**
FINANTA	Philadelphia	PA	$	85,748
PathStone Enterprise Center, Inc.	Rochester	NY	$	100,000
Women's Economic Self-Sufficiency Team	Albuquerque	NM	$	58,825
		Sub-Total	**$**	**244,573**
Credit Unions				
Cascade Forest Products Credit Union	Vancouver	WA	$	86,470
East River Development Alliance Federal Credit Union	Long Island City	NY	$	100,000
Express Credit Union	Seattle	WA	$	100,000
FM Financial Credit Union	Flint	MI	$	46,272
North Coast Credit Union	Rocky River	OH	$	94,951
Nueva Esperanza Community Credit Union	Toledo	OH	$	92,680
South Central Missouri Credit Union	Willow Springs	MO	$	100,000
TMH Federal Credit Union	Tallahassee	FL	$	71,136
Unite Burlington Credit Union	St. Louis	MO	$	86,000
		Sub-Total	**$**	**777,509**
		TOTAL TA	**$**	**1,022,082**

Source: Compiled from the CDFI Fund’s List of Award Recipients FY 2013

Small Business Administration (SBA) Intermediary Program: Microloan

- **Microloan program** provides small short-term loans up to a maximum of $50,000 to primarily CDFI Loan Funds for lending
- Some grants available to BDS Service Providers for technical assistance
- Detailed reporting required on the portfolio per loan
- Institutions required to have a 15% cash loan loss reserve
- SBA makes loans of up to $750,000 to approved intermediary lenders which are nonprofit community based organizations (including tribal governmental entities) with at least 1 year of experience in making/servicing loans under $50,000 *and* 1 year experience in providing business management training and technical assistance to its micro-borrowers.
- Created to assist women, low income, minority and veteran entrepreneurs and others in obtaining small amounts of capital.
- Accomplishments as of April 2012:
  - ✓ Grown to more than 150 lenders
  - ✓ Loaned more than $538 million
  - ✓ More than 44,175 microloans made
  - ✓ 40% to start ups
  - ✓ 47% to Women-owned businesses
  - ✓ 45% to Minority-owned businesses
  - ✓ Average loan amount $12,055
  - ✓ Created/Retained > 155,270 jobs

Source: SBA 2012 Economic Development Finance Service Conference “Federal Program Update” April 26,2012 and SBA “The First 20 Years: Microloan Program Update” April 16, 2012

SBA Microloan Program

SBA microloan to micro borrower

- Loan maximum $50,000. Multi-party financing can be $150,000, but microloan max is 1/3 total
- For working capital, inventory, F & F, M & E
- No refinance
- No real estate financing
- Maximum term is 6 years
- Interest rates are fixed, with a max spread of 7.75%-8.5% over cost of funds
- Intermediaries usually require collateral as well as personal guarantee of business owner

SBA Loans to Microloan Program Intermediaries

- Term: 10 years
- Maximum individual loan size:
- $750,000 for 1st year participants
- $1,250,000 for subsequent years (as of 5/1/12)
- Maximum principal balance: $5,000,000
- Interest rate: base rate is the 5 year Treasury Bill Rate
- 2% buy down if lifetime avg. microloan is ≤ $10,000
- 1.25% buy down if lifetime avg. microloan is > $10,000

Source: SBA 2012 Economic Development Finance Service Conference “Federal Program Update” April 26,2012

SBA Microloan Program

SBA Grant Awards For Technical Assistance

- Up to 25% of intermediary's outstanding SBA debt
- 5% Bonus for Intermediaries with an SBA portfolio averaging $10,000 or less
- First year may be subject to a waiting period due to SBA budget cycle

Grant Funds Can Be Used to:

- Provide Technical Assistance
- Direct expenses that are:
  - Allowable
  - Allocable
  - Reasonable

Source: SBA 2012 Economic Development Finance Service Conference "Federal Program Update" April 26,2012

SBA Intermediary Program: Community Advantage

Community Advantage program provides guarantees of up to 85% to mission focused lenders for loans up to $250,000. It is part of the SBA 7a Loan Program. Some 400 loans closed in the second year of the program, for CDFI NGOs and Community Banks.

History

- Pilot program launched in February of 2011
- Pilot ends March 15, 2014 but may be extended or made permanent
- After initial launch, desirable modifications were identified

Who is eligible?

- To be eligible, organizations must be one of the following:
  - SBA Microloan Program Intermediary
  - SBA Certified Development Company (504 Lender)
  - Non-Federally Regulated Community Development Financial Institution (CDFI) certified by U.S. Treasury

Differences between lenders who participate in the CA Loan Guarantee Program and the Microloan Program. Lenders:

- Can do larger loans ($250K)
- Can do longer terms (WC & M&E-10 yrs., RE-25 yrs.)
- Can refinance
- Can finance real estate
- Can sell the loan
- Borrower can have maximum CA loans outstanding of $250,000 which does not include SBA microloans

Source: SBA 2012 Economic Development Finance Service Conference “Federal Program Update” April 26,2012

SBA Community Advantage

Percent of Guaranty	• 85% guaranty for loans of $150,000 or less • 75% guaranty for loans greater than $150,000
Maturity	• Maximum of 10 years for working capital • Maximum of 10 years or useful life for equipment • Maximum of 25 years for real estate
Guaranty Fees	• 0.25% for maturities ≤ 12 months • For maturities > 12 months • 2.0% for gross CA loan ≤ $150,000 • 3.0% for gross CA loan > $150,000 • 0.55% on-going guaranty fee paid by lender

Key CA Program Features

7(a) Loan Program Key Differences

Maximum loan size	• $250,000
Maximum interest rate	• Prime + 6%
LLRF requirement	• 15% cash reserve on unguaranteed portion of loan • ***Under review***
Markets served	• 60% of the number of CA loans must be in underserved markets
Management and technical assistance	• Encouraged when appropriate but not required

Source: SBA 2012 Economic Development Finance Service Conference "Federal Program Update" April 26,2012

SBA Community Advantage Top Lenders

Top Community Advantage Lenders as of 10/21/13				
Lender / CDC	Lender State	# Loans Approved	$ Loans Approved	Average Loan Size
CDC SMALL BUS. FINAN CORP.	CA	90	12,389,600	$137,662
EMPIRE ST. CERT. DEVEL CORP	NY	67	8,882,500	$132,574
OBDC SMALL BUSINESS FINANCE	CA	62	7,928,000	$127,870
VALLEY ECONOMIC DEVEL CORP.	CA	42	6,357,000	$151,357
EASTERN MAINE DEVEL CORP	ME	32	4,826,500	$150,828
MONTANA COMMUN DEVEL CORP.	MT	20	2,347,200	$117,360
NORTHERN ECONOMIC INITIATIVE C	MI	12	2,257,300	$188,108
SHOREBANK ENTER. GROUP PACIFIC	WA	10	2,224,500	$222,450
ACCION TEXAS, INC.	TX	14	2,184,000	$156,000
TRENTON BUS. ASSISTANCE CORP	NJ	17	2,075,000	$122,058
PEOPLEFUND	TX	28	2,025,000	$72,321
FIRST ST. COMMUN LOAN FUND	DE	13	1,780,000	$136,923
	TOTALS	407	55,296,000	$140,525.58

NOTE: Total Average Loan size is the weighted average by $ loans approved

Source: SBA Interview October 31, 2013

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Continued: Funding for Main Street Lenders and BDS Providers

- **U.S. Department of Agriculture:** under four separate programs -- averaging some $50 million a year in low cost loan support for micro and small business lenders to rural communities—detailed annual reports by states, (awaiting data and overall analysis)
  1) **Intermediary Relending Program (IRP):** Provides capital to nonprofit revolving loan funds; Intermediary may borrow up to $2 million for first loan and $1 million thereafter; usually at 1% interest for 30 years; total aggregate debt capped at $15 million; maximum loan is $250,000 to the ultimate recipient.
  2) **Rural Microenterprise Assistance Program (RMAP):** Provides capital to revolving loan funds plus a 10% grant component for technical assistance; loans are at 2% interest per year for 20 years for $500,000 to maximum $4-5 million.
  3) **Rural Business Enterprise Grants Program (RBEG):** Provides grants for rural projects that finance and facilitate development of small and emerging rural businesses to assist with business development and education; no maximum level of grant funding, but smaller projects are given higher priority; generally grants range $10,000 up to $500,000.
  4) **Rural Economic Development Loan and Grant Program(REDLG):** Provides funding to rural projects through local utility organizations. Under this program, USDA provides 0% interest loans to local utilities which they, in turn, pass through to local businesses (ultimate recipients) for projects that will create and retain employment in rural areas.

NOTE: Additional data was requested from the USDA, but was not provided

Source: usda.com and interview November 25, 2013

Commentary on Funding for Main Street Lenders

In 1997, international microfinance institutions (MFIs) were estimated to be reaching 13mm clients with loans and other services designed to help the poor escape from poverty. This represented an insignificant fraction of the hundreds of millions of families living in poverty around the world, and a campaign was launched with the audacious goal of reaching 100mm clients with microcredit by 2005. That goal was more than met and the most recent estimates are that microfinance is reaching 200mm families representing over 600mm people.

While there are many ways in which most of the countries where microfinance has taken root differ from the U.S., the common perception that the differences were so great that there is little or nothing of relevance to the U.S. in the international experience is misleading. Throughout this period of rapid growth, international MFIs have faced intense competition from other for-profit but not mission driven institutions, including commercial banks, non-bank lenders. They have confronted major structural shifts – urbanization, rapid growth in incomes and formal sector employment, and technological developments like mobile banking and big data. They have lived through dramatic macroeconomic cycles and political instability, and regulatory change and uncertainty.

Indeed we have concluded that despite all the differences much of what MFIs grappled with internationally is quite relevant to the U.S. and that the key choices made in the successful microfinance campaign are directly applicable to the U.S. Key among them was the commitment to achieving scale notwithstanding the often painful choices that this required, among them placing a premium on efficiency and on financial sustainability, and implementing the necessary changes in organizational culture and staffing.

The commitment to scale was first and foremost a decision to be relevant given the magnitude of the problem of global poverty. But it also set in train a virtuous cycle of improving efficiency, widening access to financial resources, and engagement of new types of leaders and managers who introduced innovative and often disruptive advances in processes and technology.

While the push for scale has required constant vigilance to prevent the loss of the fundamental social character of microfinance, it has also enabled significant advances, all of which are sorely needed in the US community development finance industry as well, and specifically in small and micro business lending: greater responsiveness to clients; efficiency gains consistent with declining but still profitable interest rates; access to a wide array and greater volume of capital; introduction of sophisticated risk management; better data and research on impact.

Commentary on Funding for Main Street Lenders

An important element of the scale campaign was the deliberate creation of specialized investment managers and "microfinance investment vehicles" (MIVs). The first such dedicated vehicle was launched in 1995 with $20mm from foundations and governments. Today there are over 120 MIVs with nearly $7 billion under management, the bulk from private investors. These vehicles serve several purposes:

- Shifting the focus from annual program based funding to medium and long term institution building;
- Permitting the most efficient use of different types of capital from different investors, for example by leveraging government or foundation first loss grant funding;
- Building professional governance of institutions to support and supervise management in implementing growth plans while remaining true to mission;
- Creating demand and a market for better performance data, both financial and social;
- Access to sophisticated financial engineering to optimize balance sheets and reconcile needs of investors and institutions;
- Accelerating the diffusion of lessons learned and best practice;
- Helping manage investment risk by pooling investments in diversified portfolios; and
- Telling the "microfinance story" to the emerging enthusiastic but inchoate community of impact investors.

Commentary on Funding for Main Street Lenders

Each segment of the US community development finance industry can benefit from some or all of these influences of a specialized and dedicated investment management capability can provide. Specifically:

- CDFI banks need the reliable access to equity to fund steady balance sheet growth and strengthened governance;
- Credit unions need secondary capital;
- Loan funds need to improve leverage and efficiently utilize grant and first loss capital to mobilize more risk averse funding and pilot and penetrate new markets and products.

The international experience shows that a dynamic investment fund community helps accelerate the deepening and strengthening of the infrastructure supporting the development finance industry.

Continued: Funding for Main Street Lenders and BDS Providers

- **Large Commercial Banks** e.g. Citi Corp, Wells Fargo Bank and Bank of America and regional banks under Community Reinvestment Act (CRA) regulations-which require banks and saving associations to help meet the needs of borrowers in their entire communities, including low- and moderate-income (LMI) neighborhoods. Also, the foundations of these banks.

Community Reinvestment Act
•To fulfill their CRA obligations, commercial banks often make investments in CDFI loan funds and other financial entities serving LMI neighborhoods.
•Over time CDFI loan funds have become dependent on CRA-motivated debt from commercial banks.
•Thus, any CRA reforms that would weaken the regulation's impact could be detrimental to the CDFI loan fund sector.

Continued: Funding for Main Street Lenders and BDS Providers

- **Non-Bank Foundations**—e.g. Mott, Carsey, Kellog, Ford, etc. amounts
- **Intermediaries**—low level of intermediary activity. Historically Calvert Foundation, NCIF, PCG, OFN's Fund –mostly for non-business CDFIs, all are NGOs -- problem is that funding subsidization from public sources and low interest rates at present do not provide for a margin.
  - Is there a long run case for public/ private financial intermediaries to support the sector?

Professionally managed private investment leverages government capital and drives rapid performance improvements.

- **International microfinance found that combining private capital investment philanthropic and government funding through capital pools or co-investment increases total capital inflows, drives performance improvements and accelerates adoption of new lending and service models:**
  - Able to tap a full range of funding sources, and devote the scarcest grant capital to its highest and best use.
  - Encourages management to adopt solid business practices and ensure long term viability in the mix of products and services offered.
  - Provides for rigorous governance and brings a wider range of expertise to support and guide management.
- **As has been seen in international microfinance, the investment model is not without risks:**
  - Broadening the pool of investors can undermine the cohesion enjoyed by a more homogenous group of funders.
  - The "brand" can be at risk of being hijacked by opportunists who do not share the social mission.
  - "Mission drift" if commercial considerations assume preponderant weight.
- **But the risks of failing to adapt the model are great as well:**
  - Sub scale, leaving most potential clients to less scrupulous operators.
  - A different type of mission drift, as intermediaries have to chase fickle grant and program dollars each year.
  - Erratic funding undermines ability to provide reliable support to clients and communities over the long term.

Key Functions of Main Street Lender Investment Vehicles

1. **Raise Capital:**
   - ✓ Educate investors about the opportunity
   - ✓ Create pooled vehicles that offer diversification of risk
   - ✓ Offer structured vehicles that match different financial return / social return / risk appetites
   - ✓ Combine capital from public, philanthropic and private sources in structured vehicles to take best advantage of the capabilities of each source

2. **Build MSLIV Balance Sheets:** Provide Main Street lenders with instruments best suited to optimize their balance sheet structure: equity or quasi equity to absorb risk, subordinated or senior debt to provide leverage.

3. **Support Management:**
   - ✓ Nurture managers of early stage vehicles
   - ✓ Provide diverse and increasingly sophisticated expertise to more mature and growing companies
   - ✓ Promote knowledge sharing and best practice

4. **Strengthen Governance:** Help build engaged and committed boards and staff board committees with appropriate expertise.

5. **Build Liquidity:** Continuously build the pool of investors to provide liquidity necessary to ensure reliable access to capital as needed.

Continued: Key Functions of Main Street Lender Investment Vehicles and Managers

Building a dynamic MSLIV industry to supply capital and other critical support to lenders requires multiple components:

Managers

- Manager expertise in the full range of debt and equity instruments and financial intermediary analysis, and the challenges of investing in social mission.
- Managers with demonstrated track record of raising capital, investor relations, investing and returning capital.

Anchor Investors

- Anchor investors who can provide a foundation for fundraising and help absorb costs while vehicles are sub-scale.

Low Cost / Pro Bono Support Services

- Legal
- Accounting
- Custodial
- Administrators
- Tax and Reg advisory

Institution Highlight:
National Community Investment Fund (NCIF)

NCIF is a non-profit private equity trust fund created in 1996 to capitalize and strengthen the mission-oriented banking sector.

NCIF is the largest investor in the mission-oriented banking industry, with investments in 20% of all certified CDFI Banks. Over the years, NCIF has lent to or invested capital in 55 high-impact financial institutions. NCIF has $195 million of assets under management, including $173 million in New Markets Tax Credit allocations. We invest capital and facilitate the flow of funds from investors to banks.

The NCIF team of eight includes four investment professionals based in Chicago.
Investors and funders have included:

- Bank of America
- MBNA America Bank (now Bank of America)
- Washington Mutual Bank (now JPMorgan Chase)
- CDFI Fund
- The John D. and Catherine T. MacArthur Foundation
- The Ford Foundation
- W.K. Kellogg Foundation
- Fannie Mae
- The F. B. Heron Foundation
- Jewish Funds for Justice
- National Credit Union Foundation

Institution Highlight:
Calvert Foundation

- Calvert Foundation, a non-profit 501(c)(3) organization legally distinct from Calvert Investments, Inc. and the Calvert Funds, is a leader in community investment that provides innovative financial products to channel capital to underserved communities. Calvert Foundation was started when Calvert teamed up with the Ford, MacArthur and Mott foundations. Calvert Foundation serves as a facility for individual and institutions seeking to channel investment into disadvantaged communities with a simple goal—to help end poverty.
- Individuals can invest in low-income communities and families while benefiting from a professionally managed portfolio with security enhancements, diversification, rigorous due diligence, and ongoing monitoring of investments.
- Since 1995, more than 13,500 investors have invested $800 million in the Foundation's portfolio of nonprofits and social enterprises worldwide; the outstanding portfolio of loans is over $180 million of which 70% is invested in the US.
- Calvert offers Community Investment Notes, one the few opportunities for non-accredited investors to invest with professional management in CDFIs.
- Calvert lends nearly $90 million to CDFIs and CDFI originated projects

LIPAM International

Data & Information Analysis

Overview

Financial and social impact data on CDFIs, LICUs/CDCUs, and Community Development Banks that provide financing to micro and Main Street businesses is currently dispersed and therefore difficult to access. Similar information on privately owned for-profit institutions is also not easily accessible. Consequently, potential investors do not have the data needed to efficiently analyze the sector and its institutions.

Believing any structural reforms in the industry need to start with data and information analysis on the sector, we conducted research to determine if there existed in the U.S. an organization capable of developing a comprehensive database that would make both financial and social impact data available on a regular basis to potential investors.

As outlined in the following slides, CARS, Inc. has recently developed a data platform for CDFI loan funds that has, according to initial conversations with the CEO, the potential to serve as a comprehensive database for the U.S. micro and small business finance sector.

In a Knowledge Based Economy, Data & Information are Critical

- Financial and social impact data on CDFI loan funds, LICUs/CDCUs, and Community Development Banks that finance micro and Main Street businesses is dispersed

- Data on CDFI loan funds and other NGOs targeting the sector are not sufficiently detailed or available

- Likewise, information (e.g. on scale, profitability and impact) of privately owned for-profit institutions is unavailable

- Any structural reforms in the industry need to start with data and information analysis on the sector

Need for Comprehensive Database

One recommendation made in the September 2012 report *U.S. Microfinance at the Crossroads* was to consider the development of a comprehensive database for the U.S. sector similar to that available in international microfinance through the MIX Market, an affiliate of CGAP.

The Microfinance Information Exchange: The MIX Market
• Founded in 2001 as a nonprofit organization to promote information transparency in the industry
• Based in Washington, D.C. with regional offices in Azerbaijan, India, Senegal, and Peru
▪ Collects financial & social performance data from 2000 + MFIs world-wide (data taken from audits, internal financial statements, management reports & other company documents)
▪ Validates and standardizes that data for easy analysis by MIX users
▪ Allows users to access reports on, inter alia, individual MFIs; cross-market analyses by country, region, legal type; funding sources & trends; microfinance networks; service providers
▪ Enables users to view and download source documents directly from MIX to perform their own validation of the data

Source: www.mixmarket.org

What Data is Currently Available to Support a Comprehensive Database?

- **To determine if the underpinnings of a MIX-type resource currently exist in the U.S., we examined a number of data sets from various sources, including:**
  - AEO
  - U.S. Treasury CDFI Fund
  - Small Business Administration (SBA)
  - FIELD at the Aspen Institute
  - Opportunity Finance Network (OFN)
  - Federal Reserve regional banks (e.g., New York, San Francisco, Atlanta, etc.)
  - CARS, Inc. (CDFI Assessment and Ratings System)

Goal: *to identify sources of financial and social impact data being reported/collected/analyzed in a consistent, timely, standardized fashion - and that are readily available to the public either at no cost or for a fee.*

Key Findings re: Potential to Create Comprehensive Database

- **CDFI Fund:** in 2012, one-time public release of data collected on each institution that received financial or technical assistance grants from the Fund in 2004 through 2010. Includes institution-level data (financials, staffing, social impact metrics) and transaction-level data (loan terms, rates, delinquencies, repayment history). Raw data with no accompanying analysis.

- **SBA:** requires participants in its Microloan Intermediary Program to submit data on each loan made under the program. Has data from 1992 through 2013, but it is not readily available to the public. No publically available reports on the data.

- **FIELD:** publically available data via its MicroTracker (MT) database. Basic data at no cost, other data for an annual fee. Self-reported financial and social impact data submitted on voluntary basis by microfinance programs providing loans and/or business development services. MT data is spotty, as organizations are not required to report on all data points. FIELD analyzes and reports data via its website.

- **CARS, Inc.:** Data platform for CARS-rated and non-CARS-rated CDFI loan funds launched in 2013. Validated and standardized financial and social impact data publically available on a subscription basis. Source documents also available. Ability to collect data on a quarterly basis on any type of *audited* financial institution (e.g., CDFIs, credit unions, banks). Plans to start aggregating data for industry-level analysis in 2Q14.

Institutional Support

Institutional Support for Financial Institutions Servicing Main Street

- Several institutions largely focused on a specific constituency:
  - **Association for Enterprise Opportunity (AEO)**--primarily represent CDFIs as NGOs providing financial services to Main Street and Business Development Services
    - ✓ Advocacy
    - ✓ Research and Publications on the Sector
    - ✓ Technology and New Product Initiatives
    - ✓ Partnering
    - ✓ Annual Meeting –important forum for members and funding institutions to mix, good practice and knowledge forum
    - ✓ Understaffed and under-funded to meet its mission, large number of important initiatives

  - **Opportunity Finance Network (OFN)**—represents CDFIs of all types—business finance, affordable housing, health care, education, etc. *(Pending Verification by Jenifer)*
    - ✓ Advocacy
    - ✓ Capacity Building with Treasury support
    - ✓ Investment Fund
    - ✓ Annual Meeting important venue for CDFIs to meet (similar to AEO)
    - ✓ It is the dean of the institutions, but not specifically focused on micro and small business

Continued: Institutional Support for Financial Institutions Servicing Main Street

- **National Federation of Community Development Credit Unions** (NFCDCU) represents LICUs and CDFICUs *(Pending verification by Jenifer)*
  - ✓ Advocacy
  - ✓ Etc., etc.
- **Community Development Bankers Association** (CDBA)
  - ✓ Advocacy
  - ✓ *Small fund* (***name***) for co-participations with members
  - ✓ Annual Meetings

- **FIELD at the Aspen Institute**—not a members association but an NGO focused on a discrete set of initiatives for microfinance CDFIs
  - Scale Academy for 10 or so CDFI micro-funding institutions
  - Capacity building with OFN
  - Research and publication—cases/ papers on industry practice and emerging trends
  - Data analysis focused on CDFI-NGOs
  - Small scale—effective with limited human and financial resources at its disposal
- **CDFI Coalition – advocates for CDFIs (not interviewed)**
  - CEOs of other associations are on their board
  - Focused on joint advocacy
  - Thinly staffed

Highlight: CGAP

CGAP was established in May 1995 by the World Bank and eight other donor institutions. The Consultative mechanism was designed to allow donors funding microfinance programs around the world to confer with one another on good practice with respect to capacity building in the sector and funding for on-lending. The CGAP Secretariat,* housed in the World Bank but reporting to the Consultative Group (the CG), was established at the same time as the CG. It was intended to guide good practice amongst donor institutions and within the industry itself with respect to good practice followed by lending institutions in the sector, Micro Finance Institutions (MFIs). The CG had an Advisory Board representing leading practitioners around the world. The Secretariat had a small professional and support staff and managed a fund that provided capacity building grants to MFIs throughout the world, usually for three years in equal tranches. Some 75% of CGAP's funds were for capacity building grants to MFIs and networks of MFIs throughout the world and 25% of funds were for knowledge management—good practice notes, technical papers, and support for diverse meetings and workshops focused on microfinance.

Within three years of its founding CGAP represented 26 donor institutions and two foundations. At present CGAP represents over 30 such institutions and operates as the de facto global secretariat for the microfinance sector. With the extension of funds to the microfinance industry by the international financial institutions (the IFIs) such as IFC and IFC's bilateral equivalents and the emergence of a large number of microfinance funds in the late 1990s and thereafter, CGAP ended its grant program for MFIs and became a knowledge institution for the industry. Key additions to CGAP were the MIX Market, an affiliate of CGAP, and the Gateway, an on line website that allows one to connect with current information, research, reports and events on microfinance throughout the world. The MIX Market started as the MicroBanking Bulletin, a benchmarking vehicle for MFIs, and developed as a world wide data base on MFIs in over 100 countries throughout the developing and transition world, available as a public good to MFI staff to benchmark their performance, for researchers and analysts who want to consider investing in microfinance institutions on a country, regional or global level. The MIX staff organize regular surveys on key issues in microfinance such as social impact and write analytical reports on the sector based on MIX data. GGAP has an extensive knowledge program focused on emerging products and technology in the sector such as mobile banking.

*Ira Lieberman, the Team Leader for this program created the CGAP Secretariat and managed it for 5 years while employed by the World Bank.

Capacity Building

- **Capacity building and training in the sector is episodic**.
    - The Treasury, through the CDFI Fund, has supported a capacity building program through OFN together with FIELD.
    - FIELD maintains the Scale Academy Program and the Emerging Leadership for Microfinance (ELM) Program
    - Annual meetings of the associations, such as AEO and OFN, have sessions on best practice and other areas of interest to the sector.
    - A capacity building program, that targets employees new to the microfinance sector, exists at the University of New Hampshire supported by the Carsey Institute, AEO and other players

Highlight:
The Boulder Institute

BI has been in operation for some 20 years and has provided vision and capacity building for the international microfinance industry during this period. For many years BI has supported on average 250-300 students a year from international MFIs in two three-week sessions during the summer. BI runs its French and English Program from the ILO Institute in Turin, Italy in the summer and its Spanish Program in Latin America during the winter (Latin America's summer.) There are some 40 faculty associated with the program and an English, French and Spanish section of Boulder. Robert Christen is the principal who owns and manages Boulder with a support team. Robert spent time managing programs for Accion International, he worked for CGAP as a Senior Advisor to CGAP, and was the Director of the Gates Foundation Access to Credit Program. He founded and has managed Boulder since its inception.

Source: www.bouldermicrofinance.org

Conclusions

Observations

Micro and small businesses represent over 90% of business establishments and are responsible for over 25 million direct jobs in the U.S.A. These firms which we define as Main Street Business, are often called family or life style businesses in that they are the primary source of income for the family unit and help ensure that the family is fed, clothed, and that the children are educated. Many of these businesses, especially those operating in poor communities, those owned and operated by women or immigrants (such as in the Latino community), those recently retired or forced to retire due to the recent recession, or by returning veterans, find it difficult to access capital other than from family and friends.

Those institutions providing funding and business advisory services to the sector include community development finance funds (CDFIs) which are mostly NGOs, credit unions and community banks; for a variety of reasons these institutions have had difficulty scaling-up to meet the perceived demand in the sector. We estimate unmet demand at between $44 and $52 billion in unmet demand annually (see section on data analysis).The CDFI funds as not-for-profits are generally not sustainable and have high costs due to their business models and interest rates which fail to cover their operating costs. For CDFIs to be relevant they will need to charge interest rates consistent with the sustainability of an efficient operation. At present these institutions are highly reliant on subsidized funding from a variety of sources.

Credit unions and community banks operate as for profit institutions subject to supervision. While return on assets may be low for CDFI credit unions, if they are not profitable and don't maintain minimum capital levels they are subject to intervention by their supervisors. Community banks are similarly regulated.

CDFIs raise funds from a variety of sources including several funds under the direction of the U.S. Treasury[1], from the Small Business Administration (SBA), the Department of Agriculture, foundations and commercial banks and their foundations, primarily funding under CRA requirements. Historically there has been little private capital in the sector. CDFIs, particularly the not-for profit funds, spend a great deal of their time raising capital. Both community development banks and credit unions raise deposits as their primary source of funding. Some Low Income Credit Funds raise funds from the Treasury's CDFI Fund. Recently, Community Banks have raised funds from the SBA's Community Advantage facility.

[1]Historically these funds have come from the CDFI Loan Fund. But due to the 2010 Jobs Act passed by the Congress, the Treasury in recent years has provided funds to states in an amount of $1.5 billion from the SSBCI which is then down-streamed to various funding institutions and the Small Business Loan Fund (SBLF) in an amount of $4.0 billion primarily for community banks but also a select number of CDFIs.

Observations

In the last several years, for-profit lenders have entered the sector using internet technology and data mining techniques and have been able to scale their operations rapidly. These relatively young firms have invested heavily in technology and their initial cost of operations are high, particularly the cost of client acquisition. Hence they are required to charge high interest costs to breakeven or generate a modest profit. But with scale and time their costs will come down, they will be able to charge lower interest rates and they will be profitable and valuable to meeting the needs of Main Street business. A logical way to scale up the provision of finance from the sector to Main Street Business is the linkage of technology players with CDFIs. It is not feasible for each CDFI to develop its own technology platform. Some initial efforts to create such linkages are underway, however much more needs to be done.

There is little in overall data on financing by the sector to Main Street business as the CDFI Fund, the SBA, Department of Agriculture each require beneficiaries to report; the SBA on a loan by loan basis, but each institution maintains their own data bases with little by way of analysis available to the industry or the public. For profit lenders are privately held and do not provide information on their sources of finance or their loans. There is an urgent need for a centralized source of information on funding to Main Street Business, as opposed to the fragmented data bases currently available.

Business development services (BDS) are perceived as valuable to improving the performance of Main Street Business. There are many such BDS providers, primarily as not-for-profit institutions relying on grant funding. Many of the CDFIs offer BDS to their clients but this increases their cost of operations, as there is little in the way of cost recovery. There is also little in the way of metrics and more can be done to provide sources of BDS good practice programs from a central depository (cloud based)or data base. Again technology and the use of the internet, including the provision of on-line distant learning courses, could be valuable. Linking BDS providers to a network of CDFIs and high technology providers would complete the loop in scaling up support to Main Street Business.

There is a need for a shift in strategy by funders and lenders to institutions providing access to credit for Main Street Business. Our recommendations propose an integrated / coordinated change in strategy.

Conclusions

- **Who is the Industry Serving and Why**
  - Micro and small businesses represent over 90% of business establishments in the U.S.
  - A vibrant micro and small business community is critical for disadvantaged populations and communities
  - Critical for dynamic job growth and for closing the wealth gap
  - More robust infrastructure support for Main Street businesses, including financing and business development services, can significantly improve the prospects of the disadvantaged
- **Large Unmet Funding Gap**
  - Though there is inadequate industry data, the use of credit cards, the emergence of merchant advance lenders, predatory money lenders and other newly emerging for-profit lenders, suggests that there is a large unmet need
- **Inadequate Industry Data**
  - There is no ability to determine on an industry-wide basis whether funds in the sector flow to deep seated areas of poverty or disadvantaged populations
  - No comprehensive database for the industry
  - To engage larger and more diverse funding sources significant improvements in industry data are required

Conclusions

- **Community Development Financial Institutions**
  - **Loan Funds** as NGOs focused on microfinance and small business with very few exceptions have:
    1) Failed to scale to meet demand
    2) Have complex business models
    3) Are too costly to operate without substantial subsidy. As structured the sector falls short of the need.
  - **Credit Unions** have significant potential to serve micro and small business, but are essentially focused on other loan products.
  - **Community Development Banks** have substantial potential to serve Main Street business and are receiving substantial funding from the Treasury through SBLF ($30b fund)
  - There is an urgent need for structural and policy reform in the sector.

Conclusions

- **For-Profit lenders are leading the way in technology and data mining to promote scale**
  - There are a number of for-profit, privately owned financial intermediaries, that are addressing the needs of the micro and small business sector
  - They are focused on scale-outreach, agility, quick response to credit requests, and profitability via a variety of models and interest rates that vary greatly
  - This is "disruptive" technology and a few private for-profit lenders have already eclipsed CDFI Loan Fund scale
  - A few CDFI Loan Funds are beginning to awaken to the potential of technology to change their model and improve efficiency
  - Without technology adoption by a network of CDFIs (and it cannot be done CDFI-by-CDFI) the CDFI micro credit industry will increasingly lose relevance

Conclusions

- **Business Development Services**
  - ➢ BDS plays a critical role in the promotion of small and micro business
  - ➢ BDS data is inadequate and provides little evidence of impact
  - ➢ There are no generally accepted metrics
  - ➢ There is significant duplication in preparing BDS materials
  - ➢ While recognizing the importance of “high touch” community presence there is substantial scope for utilizing standardized materials facilitated by technology
  - ➢ Potential to enhance efficiency and productiveness by partnering with financial institutions

- **Interest Rate Culture**
  - ➢ For CDFI Loan Funds to be relevant, they have to charge interest rates consistent with sustainability of an efficient operation
  - ➢ A deep seated culture of subsidized rates is impeding the industry
  - ➢ Cost recovery interest rates are not incompatible with social mission

AEO Association for EnterpriseOpportunity
THE VOICE OF MICROBUSINESS

LIPAM International

Recommendations:

Access to Credit for Main Street

Goals: The Vision for the Industry

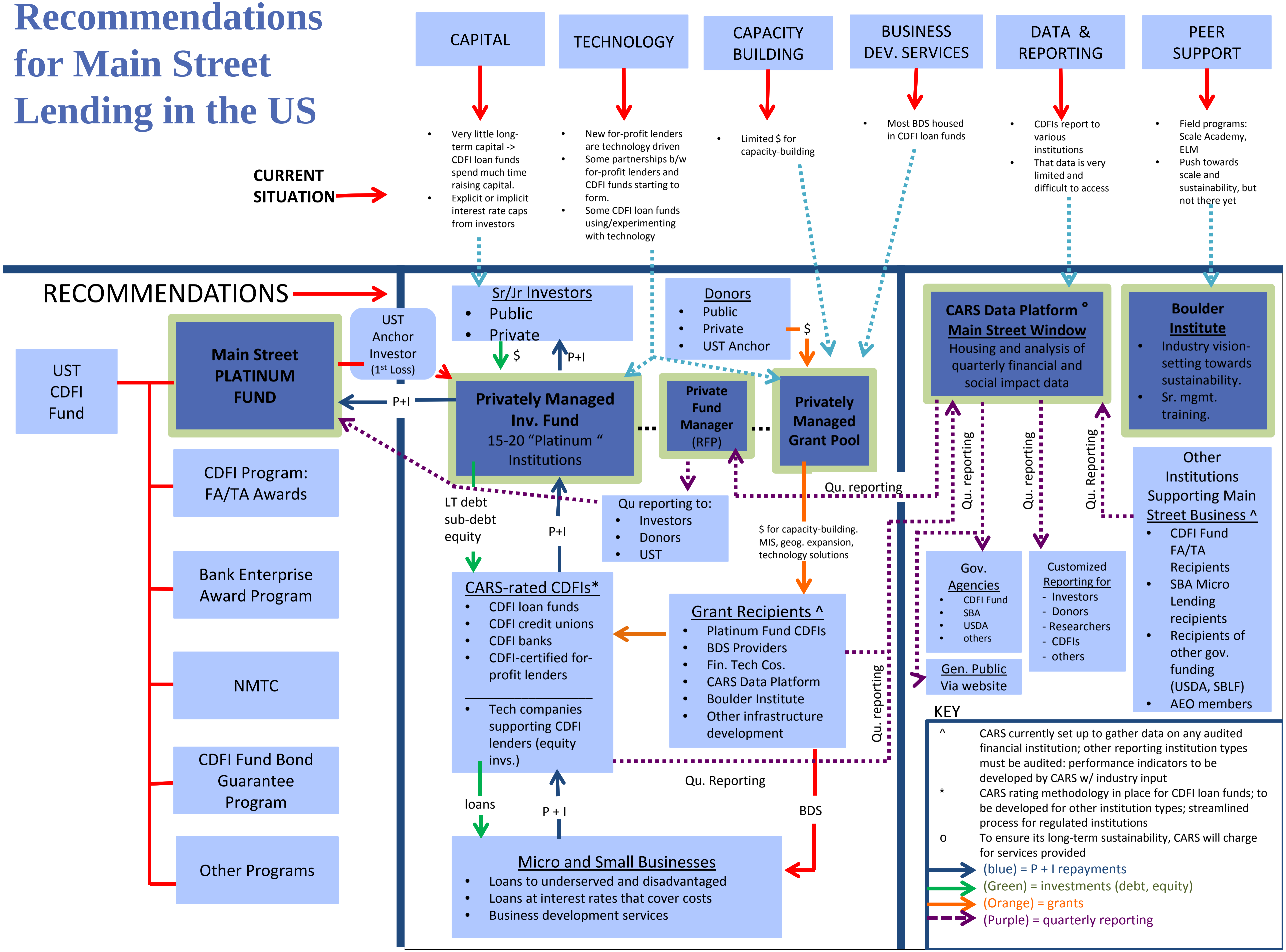
Our vision for the industry includes dramatic scaling-up (500%) over the next 5 years and providing support for the creation of 30 investible institutions which will attract private sources of capital to augment existing public sources of capital and CRA credit provided by commercial banks. This will require joint venture operations between CDFIs and technology providers, as well as support from independent BDS providers.

- Increase the scale of micro and small business lending by 500% over 5 years
- After 5 years have a set of up to 30 investible institutions in the sector that are able to attract substantial private capital while remaining committed to micro and small business sector
- Bring private debt and equity capital into the sector through privately managed investment funds
- Provide capacity building support and a vision for these institutions
- Require independent, third party ratings and create an integrated data platform for these institutions
- Fully integrate and exploit emerging technologies to achieve scale and lower operating costs
- Attract for-profit financial institutions that are scaling on the basis of data mining and new technologies
- Identify anchor investors for the program, starting with the CDFI Fund as a basis for attracting a wide range of private investors

Overview: Recommendations

1. Create CDFI Fund complementary funding window for Main Street businesses
2. Establish privately managed investment funds
3. Promote interest rates that cover costs of operations
4. Launch technology support program
5. Develop comprehensive, integrated data platform
6. Coordinate on-going capacity building program for sector
7. Enhance business development services

Recommendations for Main Street Lending in the US



Discussion and Observations on Recommendations

We propose that the Treasury, supported by AEO and other institutions as appropriate, develop a comprehensive, integrated, strategy to support scaling up access to finance for Main Street Business. We envisage the Treasury as the anchor investor through the CDFI Fund or else a special purpose vehicle similar to the Small Business Lending Fund (SBLF). If part of the CDFI Fund, we would recommend a subset of CDFIs funded, under a "Platinum Window" of the Fund, continuously for up to five years as long as the CDFIs meet certain specified goals for expanded funding to Main Street Business. Starting with 15-20 CDFIs, we propose that this special facility support up to 30 such CDFIs after the 5 year funding period, with CDFIs being added each year after the initial 2 years, while some funds not meeting growth targets would be required to drop out. These institutions would need to provide a business plan for eligibility to the facility that demonstrates their ability to scale and increase sustainability over the five year period, including the willingness to charge interest rates that would cover their cost of operations. CDFIs would be required to exit the facility after 5 years as new institutions are brought into the facility.

We would propose that all such CDFIs funded under the Platinum Window be rated and report performance data—financial, operational and social impact data, through an independently contracted and developed data platform. CARS is in the process of developing such a data platform and could ideally serve as both the rating agency and data platform provider, subject to appropriate due diligence. Other data platforms would also be evaluated.

We recommend that private for-profit technology firms be included in the program, with an equity window supporting these firms similar to the approach taken by the SBLF. These firms would be matched-joint venture with the CDFIs to provide an efficient and timely source of underwriting. If the firms draw equity from this facility, they would also need to be rated and report their results on a regular basis.

Continued: Discussion and Observations

In order to close the loop or create a complete network there would be linkages to independent BDS providers with the idea that over time the CDFIs would shed their BDS facilities and utilize independent providers to meet these needs.

While Treasury funds would anchor the proposed facility, we suggest that the Treasury give consideration to contracting out management of the Platinum Fund to privately managed fund facilities who would leverage up Treasury funds. This would catalyze private funding into the sector.

We would also propose that the CDFIs and private technology investors operating under the facility be supported by a capacity building program. The Boulder Institute has supported capacity building for the microfinance sector internationally for twenty years and is now based at the Maxwell School at Syracuse University. It would serve as an ideal institution to support capacity building within these institutions, but perhaps more importantly would support the development of a common vision to develop the sector. (see Boulder case slide 106).

The key to our recommendations is to promote the scaling of select CDFIs and for profit technology companies as an integrated network. Anchor or core funding from the Treasury would be leveraged-up by private investment funds. Foundation support would be highly valuable in supporting the organization of the program-- AEO, CARS, Boulder, BDS providers and other institutions assisting in the development of the program.

Create a Funding Window within the CDFI Fund

- The CDFI Fund at the U.S. Treasury should work with AEO and others to create a complementary funding window to focus a set of awards on 15-20 CDFIs (Loan Funds, Credit Unions, Banks and For-profits) that commit to scale up their support to micro and small businesses

  - The program should be a five year program with capacity building, multi-year grants of up to $2 million provided to these institutions

  - Selection would be by competitive application process—selection criteria should be totally transparent
    - ✓ Be rated/evaluated by CARS
    - ✓ Each of the institutions should then report quarterly financial and operational results to CARS electronically. In addition, they will be required to report at a detailed level that shows outcomes such as the number of micro and small business loans that can be monitored and social impact, such as the number of jobs created by key demographic and geographic categories that can be evaluated
    - ✓ Participating institutions should be encouraged to evaluate private sector technology institutions so that they can lower the cost of underwriting and improve their timeliness in granting credits. Joint ventures between CDFIs and private sector technology institutions should be considered as part of the grant screening criteria
    - ✓ Linking BDS providers to the program should be encouraged and also be part of the grant screening criteria

Continued: Funding Window within the CDFI Fund

- The Treasury Small Business Loan Fund, the SBA, CRA lenders and foundations should be encouraged to join the program so that adequate financing is available to organize the program and for portfolio expansion
- A set of incentives should be created to monitor performance by participating CDFIs – to account for additions and drop outs from the program. Institutions which are 10% or more behind their proposed Business Plan for micro and small business lending during the first two years of the program should be dropped from the program. Institutions that are 15% or more ahead of their own projections in any given year should be eligible for additional CDFI Fund funding if they have not reached the maximum of $2m.
- The Program should consider additional institutions in year three, so that with attrition the program can achieve as many as 30-40 sustainable and investible institutions, assuming funding is available from the Federal budget
- The program should be evaluated after year three
- The program should begin on January 1, 2015

Privately Managed Investment Funds

- Treasury should also promote an indirect channel of capital through privately managed investment funds
- Treasury should provide anchor investment to these privately managed funds selected through a competitive process which would heavily weight their ability to raise matching capital
- These investment funds could take on management of the complementary fund window of 20 and up to 30 institutions (approximately 10 institutions per fund)
- Fund managers would operate under normal fee arrangements and incentives
- These funds should include a dedicated technology-focused equity fund to promote emerging technology intensive solutions to scale and cost
- Selection criteria for all fund managers would include the following:
  - Demonstrated track record in social and impact investments
  - Demonstrated ability to attract capital
  - Operating within a viable asset management firm
  - They agree to report their financial and operational results to Treasury through CARS to be kept confidential
- At the end of 5 years there would be 3-4 fund managers managing a range of debt and equity vehicles mobilizing private capital to the sector

Continued: Privately Managed Investment Funds

- International microfinance found that professionally managed investment funds bring several benefits:
  - Combines the full range of capital providers
  - Devotes the scarcest grant capital to its highest and best use
  - Encourages management to adopt solid business practices
  - Ensures long term viability in the mix of products and services offered
  - Provides for rigorous governance
  - Brings a wider range of expertise to support and guide management

Promote Interest Rates to Cover Costs of Operations

Based on recommendations from our research and from FIELD the following actions pertain to pricing:

- Microlenders need to develop a clear pricing strategy, including a rationale for their rates.
- Funders should consider whether their expectations with respect to a program's scale and sustainability are reasonable and consistent with rates being charged.
- The industry should support market research that could illuminate pricing sensitivity.
- The industry should promote pricing transparency rather than placing restrictions on pricing

Source: Lieberman et. al. *Microfinance at the Crossroads.* 2012

Create an Integrated Data Platform

- **Integrated Data Platform.** The Treasury and other funding institutions such as SBA and CRA lenders and the various associations should support data collection, analysis and reporting to the CARS Platform so that a data facility such as the MIX Market (see Box slide 98) can be replicated as appropriate.

  - The CARs Platform has already been created and the second stage launch will occur in the 2nd quarter of 2014 so that data from other sources could migrate over the course of the year.
  - CARS would also need to be available for ratings, reporting, and data analysis for the new complementary fund window for 2015.
  - Funding for start-up, data acquisition, etc. should be provided by the Treasury, foundations, CRA lenders and their foundations.
  - CARS will charge for its services so that the data platform operates on a self-sufficient basis after year three.

Build Capacity for Sustainable Institutions

- Continuous capacity building and training for the sector is essential for realizing the vision and goals

- We recommend that AEO coordinates a capacity building program for the sector, focused on senior management of CDFIs, through the Boulder Institute (BI) based at the Maxwell School of Public Policy at Syracuse University.
  - This capacity building program should be focused on the complementary funding window institutions
  - The existing Boulder program should be open to CDFI management and senior staff in 2015.
  - A one or two week complementary program, coordinated through AEO and Treasury should be required for up to 30 institutions joining the Main Street funding window by 2015, timing to be decided.
  - The start-up of Boulder for the U.S. Industry should be funded by the Treasury, CRA lenders and foundations for three years; thereafter, it should operate on a self-sufficient basis.
  - Boulder charges a fee for its three week, in-residence program. Historically donor institutions have provided scholarships to support many of its students. Ideally that practice will continue in the U.S.

Business Development Services

In parallel to the Platinum CDFI funding facility, we recommend that the Treasury, supported by other funders, support the creation of a "Platinum Grant" facility for 15-20 BDS providers in year 1, rising to as many as 30 by the end of year 5 for a period of 5 years.

Grants would range up to $1.5 million per year for 5 years based on the scope and performance characteristics of the BDS provider.

This group of BDS providers would form a virtual network which would be expected to scale-up their operations, increase their level of sustainability (% of budget covered by fees) and represent emerging good practice in the sector.

The facility would be:

- Awarded to independent BDS providers or those part of CDFI Funds which operate as a separate business unit; and particularly to BDS providers who partner with CDFI Funds;
- Applicants would be expected to submit an application for funding based on their present metrics—e.g. how many micro and small businesses advised per year over the last three years by: (i) numbers of businesses by size micro or small; (ii) numbers mentored by categories—urban poor, rural poor, women owned, minority owned, recently returned veterans (last 5 years), age 50 plus; (iii) types of BDS provided and results obtained (e.g. additional income generated, jobs created or supported, loans obtained as a result of BDS);

Continued: Business Development Services

- Other criteria: (i) nature of the courses or mentoring offered—BDS provider discusses methodology and provides detailed outline of curriculum; and,_ (ii) number of full time staff and budget and percentage of overhead covered by course fees

- Funding would also be available for BDS institutions proposing innovative pilot programs or the adoption of new technology to increase the effectiveness of their outreach to clients;

- Business Plan provides projections for proposed scaling of services, metrics targets, and increased sustainability of BDS. Those BDS providers which lag their projections by greater than 10% or more at end of year three would be required to drop out of the program;

- BDS firms which are part of the facility would be expected to report performance vs, agreed metrics every quarter for the first three years and thereafter every six months._Program would be evaluated at end year three;

- The facility would support the development of tools/apps to facilitate dissemination of BDS materials. Also supported would be capacity building training for senior staff of the BDS providers and to create a shared vision of the BDS network

- The facility would create a data base or platform shared in the Cloud so that network members could showcase and offer the sale of their programs/ curriculum (a la Apple App Store or Amazon) to other BDS providers both within the network of 15-30 independent BDS providers and to outside BDS providers

- The facility would provide members with up to date knowledge on emerging technology to enhance program content and delivery

- **AEO would have a role in the governance of this facility.**

Interviews Conducted

Organization Name	Name	Date
Accion East	Paul Quintero	2/12/2014
Accion Texas	Janie Barrera	11/15/2013
Accion Texas	Celina Pena	12/4/2013
Accion U.S. Network	Gina Harman	10/22/2013
ACEnet	Angie Maiden	11/15/2013
AEO	Connie Evans, Tammy Halevy, Gar Kelley	11/20/2013
American Dream Fund	Joel Hornstein	11/15/2013
Biz2Credit	Rohit Arora, Andrew Loulousis	11/11/2013 and 12/3/2013
BOC Network	Nancy Carin	11/14/2013
Boulder Institute	Bob Christen	11/7/2013
Calvert Foundation	Jennifer Pryce, Catherine Godschalk	11/21/2013
Capital Access Network	Glenn Goldman	12/9/2013
CARS	Paige Chapel, Jon Schwartz	11/19/2013
CDBA	Jeannine Jacokes	11/25/2013
CDFI Fund	Donna Gambrell, Jodie Harris, Will Girardo	11/12/2013
Centro Community Partners	Arturo Noriega and Naldo Peliks	1/17/2014
CGAP	Tilman Ehrbeck	10/24/2013
CommunityWorks, Inc.	Deborah McKetty	11/6/2013
Demyst Data	Mark Hookey	11/12/2013 and 12/5/2013
FIELD at Aspen Institute	Joyce Klein	10/31/2013
Funding Circle	Sam Hodges	11/27/2013
Fundwell	Chinwe Onyeagoro	2/17/2014
Goodwork Network	Phyllis Cassidy	11/6/2013
Grameen America	Katherine Rosenberg, Howard Axel, Becky Asch	10/21/2013

Organization Name	Name	Date
IFC	Wendy Teleki	10/17/2013
IFC	Martin Holtmann	10/29/2013
Intersect Fund	Rohan Mathew	10/21/2013
LearnVest	Joe Shure	1/20/2014
MicroMentor	Samantha Albery	11/4/2013
MIX	Marten Leijon	10/17/2013
NCIF	Conference	11/14/2013
NCUA	Bill Myers	1/24/2014
Next Street	Barry Davis, Amir Kirkwood, Monica Munn	10/22/2013
NFCDCU	Melanie Stearn	10/28/2013 and 1/20/2014
OFN	Mark Pinsky	1/17/2014
On Deck Capital	Tim Schuermer	11/14/2013 and 12/3/2013
Opportunity Fund	Marco Lucioni	1/13/1014
Opportunity Fund	Eric Weaver	10/21/2013
Rising Tide Capital	Alex Forrester	11/5/2013
SBA	Jody Raskind	10/31/2013
Self-Help CA	Steve Zuckerman	10/22/2013
Self-Help NC	Karen O'Mansky	10/25/2013
Trillium Asset Mgmt	Matt Patsky and Paul Hilton	11/5/2013
U.S. Treasury	Jessica Milano, Jason Tepperman	10/31/2013
USDA Rural Development	Robert Fry and Mark Brodziski	11/25/2013
VEDC	Roberto Barragan	1/6/2014
Formerly of TIAA CREF	Scott Budde	1/14/2014

Team Biographies

<u>Ira W. Lieberman,</u> (Team Leader)

Ira has some 40 years of experience bifurcated between 20 years in the private sector and 20 years working on economic development and in the not-for-profit sector. He has been deeply involved and committed to microfinance since 1995. In 1995, he started the Consultative Group to Assist the Poorest Secretariat (CGAP) based in the World Bank representing some 26 donor institutions and foundations. During the five years he was CEO of CGAP he had oversight over some $40 million dollars in grants to build capacity in some fifty microfinance institutions around the world and various regional microfinance networks. CGAP also produced an extensive body of research on the sector during this time including "best practice" notes and technical notes. After CGAP, Ira served as acting Small Business Director for the World Bank Group-- World Bank and International Finance Corporation. He launched the IFC's Small Business Department and chaired the Donor Committee for Small Business. He also worked for the Open Society Institute (the Soros Foundation) and as a Senior Economic Advisor to George Soros to assist the foundation in restructuring its microfinance program. At present, Ira serves on several boards of directors of funds/ foundations involved in microfinance and small business lending. In addition, over the last several years, Ira has carried out various advisory assignments for microfinance institutions and networks. He has also done research and published on various aspects of the microfinance industry. Ira has a BA from Lehigh University, an MBA from Columbia University and a Ph.D. (D.Phil.) from Oxford University.

<u>Paul DiLeo</u>

Paul is President and Founder of Grassroots Capital Management, PBC an impact investment manager based in the US that currently manages or advises five impact investment funds. Paul has been engaged in development finance since the early 1990s, launching an investment fund in Russia, small business financing programs, the Gray Ghost Microfinance Fund, and Grassroots Capital Management, and is currently looking at opportunities in the northeast U.S. Paul has undertaken numerous program and institutional assessments over the years, ranging from mission driven companies in the US and India to assessments of ProFund (the first microfinance investment fund), World Bank programs in Bosnia and an IADB initiative in El Salvador. Most recently Paul has written extensively on how best to design and deliver on the potential of social and impact investing. Before his work in development finance, Paul worked for 12 years at the US Treasury and Federal Reserve focused on international finance and capital markets. Paul has a BA from the University of Massachusetts and an MA from Boston University in International and Development Economics.

<u>Jenifer Mudd</u>

Jenifer is an independent consultant working in the fields of community development finance and microfinance. Her current clients include CARS, Inc., where she has served as a CARS™ analyst since 2006, assessing the financial strength and performance, as well as the social impact, of community development finance institutions across the U.S. Since 2005, she has also provided various on-going services to the Calvert Foundation, including assistance with the management of the international microfinance investment portfolio, underwriting investments for the same portfolio, managing sub-advisor relationships, and helping the foundation launch its MicroPlace.com initiative with eBay. She recently co-authored a paper on the status of the microfinance sector in the United States for Calmeadow Foundation, conducted two social impact studies on the U.S. CDFI small business lending and community development banking sectors, and designed a tool for a U.S. microfinance network to assess its member organizations' financial health and positioning for growth.

Before establishing her consulting practice in 2005, Jenifer worked for the European Bank for Reconstruction and Development (EBRD) in London, where she managed a $150 million micro and small business lending facility channeled through the commercial banking sector in Southeast Europe, Central Asia, and the Caucasus. She received her B.A. from Duke University.

Team Biographies

Jose M. Ruisanchez

Jose is an independent consultant with a rich diversity of experience in the financial sector—banking, capital markets, venture capital and micro and SME finance (see below). Jose worked for the International Finance Corporation, part of the World Bank Group, and was its Vice President for Latin America and the Caribbean. He has had extensive experience in the microfinance and small business sector serving on Pro Fund's Board of Directors (Pro Fund was the first microfinance equity fund focused on investments in Latin America), as an early investor in *Banco* Sol Bolivia, part of the *Accion* International Network, and conducting various pre-and investment appraisals of MFIs for investors such as *Compartamos* in Mexico and Acleda in Cambodia. He has advised the IFC on its small business program and currently advises the Danish Fund for Microfinance on its investment strategy.

Jose is a graduate of Georgetown University and has an MBA from the Sloan School at MIT.

Keith Catanzano

Keith is an industry leader and subject matter expert in advanced analytics with a focus on modeling and simulation, data modeling, and operations research. He has over seventeen years' experience designing and developing simulations, statistical models and gaming techniques for the US Government and Fortune 500 companies. Keith co-founded 2River Consulting Group (2River) to support profit and sales growth of mid-market businesses by developing strategies and operating plans that are information and analytics driven. He helps his clients increase operational efficiency, measure and understand risk, and reach informed strategic direction. He has innovated the use of fact-based analysis to create effective performance improvement strategies in the public and social sectors and the financial industry. Prior to co-founding 2River, Keith spent 15 years with the global strategy and technology consulting firm, Booz Allen Hamilton. Keith was a Vice President in the Analytics practice where he advised government, private and non-profit sectors on how to design and employ advanced analytical solutions to solve complex problems and enhance operations. His US Government Clients have included the Department of Defense, National Aeronautics and Space Administration, the Intelligence Community, and the Department of Homeland Security. Keith has also consulted with Fortune 500 pharmaceutical, A&D, and transportation companies in applying modeling, simulation and analytics.

Alana Heath, Program Associate

Alana brings experience working in the international sustainable development industry and has worked extensively in northern India. Her work started in education for under privileged children and then shifted to project development focusing on renewable energy. In 2012 she founded Alta Solar Project, a rural electrification project that provides a practical and affordable solar lighting option for the poorest residents of the remote region of Ladakh. Most recently she has been working on economic development projects focusing on the United States and Africa and as an analyst at the Microfinance Information Exchange (MIX) Market.

She received her B.A. from Georgetown University.