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Office of Recovery Programs
State Small Business Credit Initiative Program
United States Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20020

RE: TREAS-DO-2021-0009 - U.S. Department of the Treasury's Notice and Request for Information. State Small Business Credit Initiative.

To whom it may concern:

The Council of Development Finance Agencies (CDFA) and its SSBCI Coalition write to provide comments in response to the U.S. Department of the Treasury's (Treasury) Notice and Request for Information—State Small Business Credit Initiative (RFI). CDFA is a national membership association dedicated to the advancement of development finance concerns and interests. More than 100 CDFA member organizations participate in the SSBCI Coalition, including leading public, private, and non-profit practitioners with deep expertise serving small businesses and in the SSBCI program.

Detailed responses to questions posed in the RFI reflect the following broad principles, which CDFA and the SSBCI Coalition believe are key to ensuring the effective implementation of the current round of SSBCI funding (SSBCI 2.0).

- Provide for maximum flexibility within the confines of the statute and in alignment with the spirit and intent of the policy. States, territories, Washington, D.C., and Tribal governments (Eligible Governments) will need to tailor SSBCI programs and strategies to address the unique needs of local small businesses and ecosystems for delivering capital and technical assistance.

- Given the multi-year nature of the SSBCI program, Eligible Governments can position SSBCI funds to seed long-term economic recovery and resiliency strategies. In some circumstances, this may necessitate additional flexibility as it relates to timing requirements, the staging of private financing, and provision of technical assistance.

- Timeliness, consistency, and transparency as it relates to the provision of policy guidelines and program (administrative and reporting) requirements is paramount. Requirements should not be overly burdensome, but should allow for adequate analysis to determine whether SSBCI activity is meeting policy intent. Future clarification of program requirements should be applied on a forward-looking basis.

CDFA and the SSBCI Coalition appreciate the opportunity to provide the following recommendations, as well as the work of Treasury staff in issuing updated guidance. Please contact Toby Rittner, Katie Kramer and Rachel Reilly for more information.

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In response to question 1:
We ask Treasury to consider the following changes to the SSBCI policy guidelines (updated in 2014), which would expand access to capital for small businesses in the current economic environment. We believe these recommendations will support Eligible Governments' ability to: 1) leverage capital and 2) operate SSBCI programs efficiently and without disruption.

1) Support the ability for Eligible Governments to leverage capital.

- Expand the definition of "private financing" to allow for a more inclusive approach to assembling capital.

  An expanded definition of private financing will encourage robust participation from a wide-variety of capital providers and the development of innovative capital structures that meet the needs of small businesses. Specifically, we recommend that non-federal direct dollars, federal and non-federal indirect dollars, and private investment eligible for federal and non-federal tax benefits be included in the definition. Examples of these capital sources include, but are not limited to:
  - State, county, or local programs that have not been directly capitalized with federal funding,
  - Tax credit allocations associated with funding SSBCI transactions, and
  - Private equity investments eligible for federal Opportunity Zones tax incentives or state-level angel tax credits.

  These sources of capital are powerful catalysts for attracting traditional private investment. Leveraging these sources of capital should not supersede the priority of raising private, risk-taking investment which is a clear goal of the SSBCI program.

- Empower Program Administrators to respond to the needs of private capital providers.

  Third-party fund managers are uniquely positioned to crowd-in or source private Financing at the fund-level. The following two recommendations would provide the flexibility needed to efficiently attract additional sources of capital.

  - Provide a 90-Day Safe Harbor for the Match Requirement.

    Current SSBCI policy guidelines require a minimum 1:1 match of SSBCI funds and Private Financing. Providing a window of time for sourcing eligible investments is critical, especially as it pertains to Venture Capital (VC) Programs. Private investors may have timing considerations that necessitate the commitment of their investment prior to the formalization of SSBCI funds. Capital raised up to 90 days before the date an SSBCI investment closes should count toward the match requirement if VC programs can provide documentation that this investment was catalyzed by the commitment of SSBCI funds.

- Allow Program Administrators, especially community finance intermediaries, to hold SSBCI funds.

  Community Development Financial Institutions (CDFIs) and similarly positioned community loan funds serve an important role in expanding capital access for small businesses throughout the nation. These institutions are uniquely positioned to attract private financing, but their ability to do so may be constrained by restrictive financial covenants such as maintaining a minimum net asset ratio. Allowing Eligible Governments to proactively deploy SSBCI funds to these fund managers will help remove barriers to raising additional private financing at the fund-level. Title to the capital should remain with Eligible Governments, or the Eligible Government remains the beneficiary.

- Encourage follow on and cross over investments.

  Guidance for subsequent financing caused by, or resulting from, the initial SSBCI-supported OSCP financing has a profound impact on calculating the ultimate leverage associated with private financing. Eligible Governments should not be limited to recording subsequent private financing for venture capital investments, direct loans, or loans enrolled in loan participation programs only when the initial loan or investment involves subordinate, mezzanine, or equity financing. Further, Treasury should consider loan guarantee and collateral support programs eligible to count subsequent private financing for purposes of calculating private financing leverage, without explicit permission of Treasury.

2) Provide the certainty and clarity needed for Eligible Governments to establish and execute strategies for engaging private investors and meeting the needs of local small businesses, efficiently and without interruption.

   - Allow Eligible Governments to reallocate SSBCI funds within approved SSBCI programs without further consent from Treasury.

   - Apply future clarifications of policy guidelines and program requirements (administrative and reporting) on a forward-looking basis.

   - Provide clarity pertaining to conflict-of-interest rules.

   - Encourage collaboration between Eligible Governments and scaled delivery of capital by prequalifying certain SSBCI programs that multiple governments can opt in to.

- Limit timing disruptions between funding tranches.

  During the previous round of SSBCI (SSBCI 1.0), Eligible Governments were authorized to apply for additional tranches of SSBCI capital once 80 percent of funds had been delivered to small businesses. In some cases, the length of time between the request and receipt of funds took months which created uncertainty and disrupted investor engagement, outreach to small businesses, and access to financing. To prevent similar disruptions, we recommend the adoption of one or a combination of the following solutions:
  - Count funds “expended, transferred, or obligated” to small businesses as eligible for satisfying the 80 percent deployment threshold requirement.
  - Allow Eligible Governments to begin the approvals process once 70 percent of funds have been expended, transferred, or obligated to small businesses.
  - Provide a date-certain and/or deployment threshold by which it is agreed that Eligible Governments will receive the requested tranche of funds.

- Streamline the documentation required to enroll a loan or investment.

  Transaction volume will likely be significantly higher in SSBCI 2.0 relative to SSBCI 1.0 given an increased prioritization and need for micro-lending and servicing Very Small Businesses, as well as the increase in overall allocation. Streamlining the assurances section, including a blanket lender assurance for small business and micro lenders, will ease documentation burden and permit more investments to be provided to small business.

<u>In response to question 2:</u>
We ask Treasury to consider the following changes to the SSBCI policy guidelines (updated in 2014) in order to promote access to capital for diverse businesses, including those owned and controlled by Socially and Economically Disadvantaged Individuals (SEDI businesses) and Very Small Businesses. We believe these recommendations will support Eligible Governments’ ability to 1) create financial products that meet the needs of SEDI businesses and Very Small Businesses, as well as 2) encourage investment in those businesses supporting local community and economic development ecosystems.

1) Provide the flexibility needed for Eligible Governments to structure financial products that meet the capital needs of SEDI businesses and Very Small Businesses.

   - Extend time period for initial Match Requirement on Lines of Credit (LOC) provided to SEDI businesses and Very Small Businesses.
     - We recommend that any debt or equity obtained by the business within three years of receiving the LOC should be considered as leveraged dollars and counted

toward the initial Match Requirement. LOCs provide critically-needed capital to businesses with limited equity, and are often the first debt facility accessed by SEDI businesses and Very Small Businesses. It has been difficult to match private financing with this first-in source of capital, and the flexibility on timing will allow for the increased provision of this important source of growth capital.

- Allow Eligible Governments to fund the loan loss reserve deposit for Capital Access Programs at a higher rate than 1:1. This would permit the loan loss reserve pool to increase more rapidly, and in turn, increase the use of the program.

- Expand options for SEDI businesses and Very Small Businesses to refinance existing loans.
  - Providing maximum optionality for SEDI businesses and Very Small Businesses to retain existing banking relationships or build new ones is an important part of expanding capital access. We recommend Treasury grant flexibility to allow for same-lender refinancing prior to the maturity of existing loans, if doing so improves the cash flow of the business.

2) Determine that SEDI businesses and Very Small Businesses actively addressing health and economic disparities and expanding opportunity for populations and communities most negatively impacted by COVID-19 are eligible for SSBCI financing.

Fortifying the small businesses that are actively engaged in local community and economic development ecosystems is key to long-term economic recovery and resiliency. Many of these businesses are SEDI businesses and Very Small Businesses addressing health and economic disparities, and expanding opportunity for populations and communities most negatively impacted by COVID-19. Treasury can promote access to capital for these diverse businesses by removing uncertainty about whether they are eligible for SSBCI financing

Examples of these SEDI businesses and Very Small Businesses include, but are not limited to businesses:
- Engaged in the rehabilitation, development, and/or provision of rental and for-sale housing that is affordably-priced for low- and moderate-income households.
- Engaged in the rehabilitation, development, and/or provision of affordably-priced rental and for-sale facilities for business operations (i.e., non-residential uses).
- Engaged in the rehabilitation and/or development of public health or community facilities.
- Expanding access to clean and renewable energy solutions in distressed communities.

SSBCI financing should not be project-based, but within the intent of the program, be used to strengthen the balance sheet of these small businesses so that they can self-finance activities without having to access high-risk, high-cost sources of early-stage financing (i.e., predevelopment, acquisition, bridge, or construction loans). Establishing the eligibility of these SEDI businesses and Very Small Businesses may require reconsideration of "active" and "passive" activities.

Additionally, we offer the following suggestions to ensure that SSBCI financing and Technical Assistance is available to the small businesses with the highest level of need.

- We suggest Treasury utilize a geographic framework that prioritizes service areas based on the level of socioeconomic need in its allocation calculation for SEDI businesses.

  Many Eligible Governments have expressed concern regarding the ability to serve small businesses operating in economically disadvantaged communities, but not owned or led by socially disadvantaged individuals as defined in Section 8 of the Small Business Act (15 U.S.C. 637). Many of these businesses serve and employ socially and economically disadvantaged individuals, but still lack access to capital due to high levels of community distress, investor behavior, and years of divestment.

  Taking a place-based approach to capital allocation will ensure that SSBCI financing is accessible to small businesses in disconnected, capital-starved, and underserved communities across urban, suburban, and rural locations. We recommend using one or a combination of the following to establish the geographic framework: Qualified Census Tracts, Persistent Poverty Counties, HUB Zones, census tracts designated as Opportunity Zones, and census tracts negatively affected by the digital divide.

- We suggest Treasury encourage those in the SSBCI ecosystem to adopt best practices for identifying and serving SEDI businesses. These practices include those established during SSBCI 1.0[1] as well as non-SSBCI strategies recently implemented through pandemic-related small business rescue and recovery efforts throughout the nation.

  Specifically, we recommend Treasury guide SSBCI stakeholders to utilize innovative outreach, marketing, and engagement strategies and incorporate alternative underwriting models. Alternative underwriting models such as a global financial or a revenue-based analysis have been used by capital providers as a nuanced approach to evaluating requests for financing. The following outreach, marketing, and engagement strategies have been noted to better connect SEDI business with available financing and Technical Assistance (TA):

[1] U.S. Department of the Treasury. October 2014. *Using the SSBCI Program to Improve Access to Capital in Underserved Communities*. Available at: https://home.treasury.gov/system/files/256/SSBCI-in-Underserved-Communities-October-2014.pdf

- Partnering with networks and organizations that support SEDI businesses and are grounded within the communities where these businesses operate.
- Providing marketing collateral and financial documents in multiple languages.
- Utilizing social media, print, and radio mediums to market available financing and TA to targeted audiences.

The American Rescue Plan Act of 2021 (The American Rescue Plan) prioritizes provision of TA to SEDI businesses, and therefore a portion of TA allocation should be directed to providers with proven success engaging these businesses and structuring programs that meet their unique needs.

- We suggest Treasury take a similar approach to ensure the SSBCI allocations are effective in supporting Very Small Businesses, including nonemployer firms.

  According to the Federal Reserve Banks' *Small Business Credit Survey: 2021 Report on Employer Firms*[2], 73 percent of U.S. small employer firms have between one and nine employees. Building the technical capacity and balance sheets of Very Small Businesses, which represent a majority share of the small business sector, is critical. The American Rescue Plan prioritizes provision of TA to Very Small Businesses, and therefore a portion of TA allocation should be directed to providers with proven success engaging these businesses and structuring programs that meet their unique needs.

<u>In response to question 3:</u>
We ask Treasury to allocate TA capital to Eligible Governments and interpret provider eligibility in a way that ensures established TA ecosystems can be leveraged and TA allocations support programs that are tailored to meet the unique needs of local small businesses.

The American Rescue Plan states the Secretary may:

- Provide funds to States to carry out a technical assistance plan under which a State will provide legal, accounting, and financial advisory services, either directly or by contract with legal, accounting, and financial advisory firms.
- Transfer amounts to the Minority Business Development Agency, so that the Agency may use such amounts in a manner the Agency determines appropriate, including through contracting with third parties.
- Contract with legal, accounting, and financial advisory firms (with priority given to business enterprises owned and controlled by socially and economically disadvantaged individuals).

[2] Federal Reserve Banks. 2021. *Small Business Credit Survey: 2021 Report on Employer Firms.* Available at: https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2021/2021-sbcs-employer-firms-report

1) Defer to Eligible Governments that elect to carry out a technical assistance plan.

Eligible Governments interested in and well positioned to carry out a technical assistance plan should receive the resources necessary to adequately do so. Eligible Governments need the flexibility to tailor TA to run alongside SSBCI and other small business support programs. Local TA ecosystems are already established throughout the nation.

Eligible Governments will be able to use the TA allocation to support programs and providers with an existing finance network, demonstrated success connecting small businesses to capital, deep expertise in multiple stages of business formation, knowledge of debt and equity financing solutions, and expertise in the industries and geographies where targeted recipients are concentrated.

2) Interpret "legal, accounting, and financial advisory firms" to include all small business TA providers that provide these services.

Eligible Governments should have the flexibility to contract with established small business TA providers that provide legal, accounting, and financial services, amongst other critical supports. The following TA needs have been identified, and Eligible Governments should be empowered to work within local ecosystems to deliver these services.
- Financial literacy
- Financial management and capital restructuring
- Business planning services
- Access to business data sets and market research
- Grant writing and document preparation services
- Customer acquisition and engagement strategies
- Product development, commercialization, and technology transfer
- Talent acquisition and human resources
- Long-term advisory and mentoring services
- Long-term financial planning and strategies for accessing additional capital
- Connections to alternative sources of capital
- Networking opportunities and peer knowledge sharing
- Services traditionally offered through incubator or accelerator programs

Additionally, we offer the following suggestions:

- We encourage Treasury to disburse TA allocations as soon as possible in order to allow small businesses to begin benefiting from these services. Doing so may also serve the dual purpose of supporting the development of financing pipelines for SSBCI programs.

- We encourage Treasury to use a formula allocation when apportioning TA funds to Eligible Governments. Similar to the preliminary allocations for SSBCI 2.0, we believe it makes sense to establish a minimum amount. Less populous states may have a greater per capita need for TA funding given that they may lack TA infrastructure, and SSBCI funding can be used to fortify and strengthen those structures.

- We encourage Treasury to consider whether TA funds can be used to acquire back-office, servicing, business planning tools or data sets for participating small businesses.

- While we acknowledge that The American Rescue Plan alludes to directing TA to small businesses participating in SSBCI and other State or Federal programs that support small businesses, we encourage Treasury to identify flexibility that does not tie the provision of TA to receipt of SSBCI funds or funds from other government programs. Businesses should be able to access TA without demonstrating prior receipt of government funding or demonstrating a future commitment of government funding. Specifically, we believe this may suppress the participation of SEDI and Very Small Businesses. SEDI businesses and Very Small Businesses may have faced real or perceived barriers to accessing government programs in the past. Further, the provision of TA may help prepare businesses for maximizing SSBCI financing and thus should preempt the receipt of SSBCI funds.

<u>In response to question 4:</u>
We ask that data collection for regular reporting is not overly burdensome, yet allows Treasury to ensure compliance and glean insights on program results in real-time and on an on-going basis.

1) Reporting requirements should be clearly outlined as soon as possible so that Eligible Governments can establish systems-based approaches to efficient data collection, tracking, and reporting.

2) Reporting requirements should not be overly burdensome for program participants including recipients of SSBCI financing, program intermediaries, TA providers, and Eligible Governments.

3) The data points collected through regular reporting should allow Treasury to glean insights on capital deployment and management, characteristics of the small businesses being served, and socioeconomic data about the communities in which those small businesses are located. For example:
    - Transaction-level data
    - Program-level data
    - Business-level data
        - Number of employees
        - SEDI business or Very Small Business
        - Firm age
        - Revenue size of firm
        - Credit risk (low, medium, high)

    - NAICS code
    - EIN
- Community-level data
    - Census tract

4) Data points should be aggregated and anonymized at the Eligible Government-level, and made publicly available through regular reports that provide the following information:
    - Transaction data at the portfolio-level
        - Capital deployed and leveraged by program
    - Business data at the portfolio-level
        - Businesses served by number of employees
        - SEDI business served as a percentage of portfolio
        - Businesses served by firm age
        - Businesses served by revenue size of firm
        - Credit risk of businesses served as a percentage of portfolio
        - NAICS code as a percentage of portfolio
    - Community data
        - Businesses located in a distressed, underserved, or undercapitalized community (i.e., Qualified Census Tract, Persistent Poverty County, census tract designated as an Opportunity Zone) as a percent of portfolio
        - Businesses located urban, suburban, and rural communities as a percent of portfolio

5) Treasury should track business-level data that can be used to determine the capacity and financial health of recipients of SSBCI 2.0 TA and/or financing on a forward-looking basis through 2030 or beyond. Understanding the trajectory of these businesses is key to analyzing results of the SSBCI program, and articulating these results to the public and policymakers.

<u>In response to question 5:</u>
During the process of sourcing comments and review of this response, we received the following requests for clarification.

- Will the amounts for target loan and transaction cap be increased for the OSCP ($5 million and $20 million, respectively) to reflect the current market and financing needs, increased overall amount of allocation, as well as the prevalent use of fund-of-fund structures?

- What is the definition of an “eligible nonprofit” that qualifies to receive SSBCI financing?

- Will there be considerations other than those outlined in Section 8 of the Small Business Act when determining whether a business qualifies as “socially and economically disadvantaged”?

- How will SEDI business funds be allocated to Eligible Governments?
- What requirements will be applied to Eligible Governments for tracking administration costs?
- Will the costs of managing a VC fund be an eligible use of SSBCI funds, not limited by the budget for administration?
- Will eligible loan proceeds include blue sky, transfer/purchase of stock, and in general, business intangible assets - all of which would be very beneficial for participating lenders to be able to request collateral support when financing the sale or transfer of a business from one owner(s) to another owner(s)?
- Will Treasury provide technical resources that Eligible Governments can use for competitive bidding when employing private vendors (i.e., sample RFPs or a list of components usually found in a RFP for the selection of managers who can achieve the multiple objectives of the program – technical compliance, private leverage, long term sustainability and economic impact.)?