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Economic Growth, Tax and Capital Access**

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Good morning. Thank you for conducting this hearing on Opportunity Zones and the Small Business Economy. My name is Jennifer Vasiloff, and I am the Chief External Affairs Officer of the Opportunity Finance Network (OFN).

Opportunity Finance Network (OFN) is a national network of community development financial institutions (CDFIs). CDFIs are mission-driven community development banks, credit unions, loan funds and venture capital funds investing in opportunities that benefit low-income, low-wealth, and other under-resourced communities across America. CDFIs connect communities to capital that creates jobs, supports small businesses, builds affordable housing, and promotes safe borrowing and lending.

Currently there are more than 1,000 CDFIs certified by the Department of Treasury's Community Development Financial Institutions (CDFI) Fund. Nationwide, the CDFI industry has over \$185 billion in assets under management. With cumulative net charge-off rates of less than 1 percent, CDFIs lend prudently and productively in markets often overlooked by conventional financial institutions.

CDFIs are the "boots on the ground" experts in community development finance that have been operating in Opportunity Zones and other disinvested communities for decades. Since the Tax Cuts and Jobs Act of 2017 was signed into law, OFN has been working with our member CDFIs to identify ways for our industry to play a role in Opportunity Zones and to ensure this new source of capital has a positive community benefit. As soon as the Opportunity Zone provision became law, CDFIs across the nation began reaching out to investors, community residents and other partners excited about the potential of this new community development tool.

Many CDFIs devoted significant resources to exploring how to attract Opportunity Zone investors to the projects with high community development impact that CDFIs specialize in. **Regrettably, we have found that the Opportunity Zone tax incentive is not a good match for the kind of neighborhood revitalization deals of interest to CDFIs, particularly those targeting small businesses.** In our experience, most investors are expecting double digit returns, prefer real estate to small business investments and largely shun the more challenging geographies that need an infusion of capital the most.

The structure of the Opportunity Zone incentive may be more suited to investing in a new business locating in a qualifying census tract rather than an existing business. As important as launching a new start-up venture might be, the health and growth of existing businesses is also critically important, particularly businesses that employ community residents.



Opportunity Fund equity is a difficult fit for many existing small businesses that happen to be located in Opportunity Zones. From the investor side, the structure of the tax incentive and the proposed regulations that have been issued by the Department of the Treasury and the Internal Revenue Service are more conducive to real estate transactions or start-up businesses. A real estate transaction will provide the investor with certainty that their investment cannot relocate outside of the zone. A start-up business will have no issue meeting the original use test, allowing the investor to avoid having to reach the substantial improvement threshold for each asset of a company. From the perspective a small business, it is daunting to give up significant ownership in a business to an unknown investor and substantially improving all of a business' existing assets is unlikely to be a prudent expenditure. Some of these businesses would be better served by an affordable small business loan from a CDFI or other financial services institution - ineligible uses of Opportunity Fund capital.

As a result, relatively few CDFIs are moving forward with establishing their own Opportunity Funds. Among those that are, an even smaller number are planning to concentrate on investment into small businesses. This is reflective of the overall Opportunity Fund market. According to research compiled by Novogradac, only eight percent of the Opportunity Funds they surveyed plan to focus solely on operating business investment.¹

Two CDFIs that are trying to use the Opportunity Zone incentive for small business investment are Community Reinvestment Fund, headquartered in Minnesota and targeting the upper Midwest for their Opportunity Fund and AltCap, a CDFI serving the Kansas City market. These experienced small business CDFIs are launching Opportunity Funds with the goal of investing in operating businesses. OFN strongly supports their efforts and looks forward to highlighting their work, however both CDFIs have encountered significant obstacles and face competition from Opportunity Funds that are not as mission driven to benefit community residents and local businesses.

Inadequate Data Collection Plan

Separate from the limited role the CDFI industry is likely to play, OFN is concerned that community residents, Congress and other stakeholders will have limited information on how the tax incentive has operated due to the anemic data collection currently planned by the Internal Revenue Service (IRS) and US Treasury. OFN has worked with colleague organizations including those testifying at this hearing to support comprehensive data collection that will show where an Opportunity Zone investment is being made, the results of the investment, and the impact on the targeted community. The data collection by Treasury should be significantly expanded to get the full picture of the impact of investments on communities. This data collection should include the:

- Size of the investment

¹ Novogradac, Michael "How Much Capital Have Opportunity Fund Managers Raised?" June 28, 2019, <https://www.novoco.com/notes-from-novogradac/how-much-capital-have-opportunity-fund-managers-raised>



- Location of the investment
- Type of investment
- Community impacts of the investment
 - Housing units created (affordable and market rate)
 - Permanent, seasonal and construction jobs created
 - Whether those jobs went to residents of the Opportunity Zone
 - Square footage of commercial real estate
 - Number of new small businesses created
 - Other appropriate measures based on asset class (childcare spots created, patients served via a medical facility etc.)

We also recommend that Opportunity Funds provide a brief narrative description of each project investment, which would include: the nature of the project; the benefits to the community; the degree to which the project was developed in consultation with the community residents and/or mitigated against displacement; and the extent to which the project connects with local workforce development efforts for low and moderate income residents. OFN supports the use of an online portal managed by the CDFI Fund for the collection of this data.

In the absence of an adequate federally mandated data collection protocol, OFN contributed to and strongly supports the Opportunity Zones Framework, created in partnership with the US Impact Investing Alliance, the Beek Center at Georgetown University, and the Federal Reserve Bank of NY, which identifies best practices, a reporting framework, and a shared goal of measuring outcomes. Opportunity Zones and Opportunity Funds require robust data collection in order to accurately evaluate the impact on target communities and to calculate the return on investment from the Federal government.² The Kresge Foundation, Urban Institute and Economic Innovation Group were all contributors to the framework.

OFN also supports the bicameral, bipartisan legislation that has been introduced to establish reporting requirements for Opportunity Fund investment. The legislation, HR 2593/S. 1344³, would require the Secretary of the Treasury to collect data and issue reports on Opportunity Funds and their investments. This legislation is an important first step to bringing much needed transparency to the tax incentive.

Opportunity Zone Designation is Not the Only (or Best) Measure for Community Need

The White House Opportunity and Revitalization Council, established by Executive Order in December of 2018, has been tasked with examining how to target other

² Prioritizing and Achieving Impact in Opportunity Zones, June 2019, <https://ozframework.org/about-index>

³ To require the Secretary of the Treasury to collect data and issue a report on the opportunity zone tax incentives enacted by the 2017 tax reform legislation, and for other purposes, HR 2593, 116th Congress (2019)



Federal resources across all agencies toward Opportunity Zones. The Council has already acted to modify 160 programs and grants to give preference to Opportunity Zones.⁴ These actions include modifying eight programs at the Small Business Administration, including the Community Advantage Program, the 7(a) Loan Program, and the 504 Loan Program. Beyond the SBA, other programs related to business development have been modified under the Department of Labor, the Economic Development Administration, the Department of Agriculture, among others. Additionally, both the Department of Housing and Urban Development and the Department of Commerce have issued Requests for Information soliciting comments on how they can further target their resources into Opportunity Zones.

It is essential to remember that only a quarter of the eligible census tracts were selected as Opportunity Zones. This means that for every community that could see the benefits of increased private investment through the Opportunity Zone tax incentive, there are three more with similar needs that do not have this new resource available to them. The Federal government must not neglect the communities that were not designated, their businesses, and their residents. When these tracts were selected, Governors did not know that other Federal agencies might target their resources and programs to these same tracts. It is unclear whether this information may have altered some of the designations or informed the strategies used to select and market Opportunity Zones.

Among the census tracts that were selected as Opportunity Zones, we do not currently have the data to indicate which areas are drawing private investment or how private investment is impacting those communities. Modifying the existing landscape of Federal resources in the absence of that data would be premature and potentially detrimental to investors and community stakeholders. It is also unclear what public sector support will be needed in each of the Zones to support private investment and the community. Targeting all Federal resources to Opportunity Zones without proper data collection will make it incredibly difficult to evaluate the success of the tax incentive and determine which community impacts are a result of private investment and which are a result of government action.

With a full data set showing which Opportunity Zones are receiving investment, what types of investment they are seeing, and the impacts on the community of those investments, other Federal agencies can then make an informed decision about how to best tailor programs to support disinvested communities including those designated for Opportunity Zone investments.

Conclusion

In summary, the Opportunity Zone incentive is a poor fit for CDFIs – a missed opportunity to take advantage of the experience, mission commitment and expertise of this nationwide network of community development finance professionals. Unfortunately, new investments in small businesses incentivized by the Opportunity Zone tax benefit are likely to be disappointing also. OFN encourages Members of this

⁴ White House Opportunity and Revitalization Council, “*Completed Program Targeting Actions*” October 1, 2019
https://opportunityzones.hud.gov/sites/opportunityzones.hud.gov/files/documents/OppZone_Agency_Completed_Actions_2019_10.01.pdf



Committee to support stronger accountability measures in the Opportunity Zone program and to consider other approaches to foster small business development in underinvested communities including those leveraging the nation's network of community development financial institutions. Included below are several specific recommendations of how the Federal government can support small businesses, particularly in low-wealth communities.



Additional Recommendations for Supporting the Small Business Economy in Low-Wealth Communities

Role of CDFIs in Small Business Lending

The 2017 tax bill creating the opportunity zone tax incentive was a missed opportunity to leverage the expertise and capacity of CDFIs already operating in communities eligible for opportunity zone designation. CDFIs are an important part of the small business lending ecosystem, providing capital to businesses that cannot access traditional financing. As mission-driven lenders, increasing access to affordable, responsible capital for business owners with limited options: women, people of color, start-up firms with limited revenue and less than perfect credit, is a key component of the CDFI lending strategy.

While other lenders have exited the market or charge high interest rates and fees to borrowers, CDFIs have figured out how to lend successfully in the most distressed markets by taking a localized approach to lending, adjusting their strategies and products to meet the needs of their communities, and by being accountable to the communities they serve.

For small business owners with financial impediments to securing financing like lack of collateral, cash flow challenges, modest business revenues, or imperfect credit, CDFIs address these issues in a variety of ways. CDFIs offer a variety of financial products including working capital, equity investments, bridge loans, senior and subordinated debt - sometimes at below market rates with lower and fewer fees. Often CDFIs can employ more flexible underwriting criteria, credit standards, collateralization and debt service requirements than what is otherwise available in the marketplace. While some of the challenges facing small businesses served by CDFIs are financial, others are related to business management practices. The experience of CDFIs has shown that both issues must be addressed for the business to be successful and grow. To that end, CDFIs provide financial education, technical assistance, and capacity-building development services to their borrowers, including business training and access to social and professional networks.

Beyond providing capital and technical assistance, CDFIs serve as an anchor in partnerships with community stakeholders including nonprofits, foundations, chambers of commerce, government agencies, and financial institutions, allowing them to connect entrepreneurs to a rich network of resources and opportunities. Many CDFIs also have referral relationships with local financial institutions, whereby a bank may refer a potential borrower who is not quite ready for conventional financing to a CDFI where the business owner can receive any needed training or technical assistance as well as financing. For many CDFIs, the goal is to help the borrower strengthen and grow their business, improve their financial position, and eventually be able to “graduate” to traditional financing from a mainstream financial institution.

The track record of CDFIs to date is impressive. Through OFN’s annual member survey, CDFIs in our network that have reported annual data between 2005-2016 and primarily lend to small businesses (including microenterprises) showed a 200% increase in small business lending from 2005 to 2016, while SBA 7(a) lending



increased 58% over the same period. CDFIs are also key financial partners during periods of economic contraction and have demonstrated the ability to increase lending countercyclically.

OFN Member CDFIs exhibited average growth rates in business lending of 7.2% during recessionary years (2007-2009) and 13.2% during post-recessionary years (2010-2016); substantially higher than SBA 7(a) lending where rates averaged -13.6% during 2007-2009 and 17.3% during 2010-2016.⁵ In other words, CDFIs increased their small business lending during the recession – and substantially increased lending after the recession – while SBA 7(a) lending, also intended for borrowers that do not qualify for conventional loans, decreased during the recession and shows similar growth rates as CDFIs in the sample following the recession.⁶

Not only did OFN member CDFIs increase business lending during 2007-2009 while SBA 7(a) lending decreased, CDFIs averaged a 4.1% net charge-off ratio compared to 13.9% in the SBA 7(a) portfolio during this period. During post-recessionary years (2010-2016) CDFIs averaged a 2.3% net charge-off ratio compared to 1.2% in the SBA 7(a) portfolio. Over the entire 2005-2016 period, CDFI business lending net charge-off ratios averaged 2.9% compared to 6.5% for SBA 7(a) lending. These trends show that CDFI business lending portfolios offer more stable and better overall performance, avoiding the erratic loss ratios of other business lending portfolios.

CDFI Small Business Lending in Rural and Native Communities

OFN member CDFI lending to businesses has also increased in rural and Native communities: lending in rural areas increased 90% from 2005 to 2016 and lending to businesses in Native areas increased 39% from 2010 to 2016.⁷ Even during the financial crisis, while SBA 7(a) lending to rural areas decreased during recessionary years, CDFI business lending to rural areas held steady. CDFI business lending in rural areas shows average growth rates of 0% during 2007-2009 and 14% during 2010-2016 compared to -6% and 14% in the SBA 7(a) portfolio, respectively. Overall, CDFI business lending to rural areas increased 90% from 2005 to 2016 while SBA 7(a) lending increased 63 percent.

In addition to providing financing and technical assistance to individuals and businesses in distressed communities, CDFIs can also be partners in addressing bank closures in rural areas. When Regions Bank was faced with the possibility of closing branches and creating a banking desert in two low-income communities in rural Mississippi, they turned to a CDFI and OFN member Hope Enterprise Corporation/Hope Credit Union. Regions donated the bank branches to Hope, along

⁵ Opportunity Finance Network, Database of Annual Member Survey Data, Accessed July 9, 2018.

⁶ U.S. Small Business Administration, "Open Data", Released 2018. Accessed July 6, 2018. <https://www.sba.gov/about-sba/sba-performance/open-government/foia/frequently-requested-records/sba-7a-504-loan-data-reports> .

⁷ Lending figures for Native areas are not available prior to 2010.



with a \$500,000 technical assistance grant, enabling Hope to reopen and continue to provide access to much needed financial services and credit in those communities.⁸

Federal Support of Small Business Lenders

The Federal government has several existing tools that can increase the supply of capital to mission driven lenders like CDFIs, who are adept at channeling those resources into distressed communities. The subsidy and credit enhancements provided by Federal programs make CDFI business lending financially viable. For lenders, transaction costs are similar whether the loan amount is \$10,000, \$100,000 or \$1,000,000, causing most financial institutions to focus their attention on the higher dollar loans. CDFIs on the other hand, are committed to meeting the credit needs of their borrowers, who seek smaller loans and have nontraditional financing needs.

Existing Federal programs are complementary resources that work together, allowing CDFIs to offer a variety of financing tools to meet the needs of businesses seeking financing, whether it is a \$500 microloan to a new entrepreneur, \$100,000 to help a business grow, or multimillion-dollar financing for larger businesses to purchase equipment or real estate. CDFIs are key partners for underserved businesses along the spectrum.

The following are recommendations that will preserve and expand key Federal programs that increase the availability of capital for small businesses:

- **Full funding for the Department of Treasury’s CDFI Fund’s Financial Assistance and Technical Assistance program** to allow certified CDFIs access to flexible, patient capital needed to provide financing to underserved businesses, and to provide critical technical assistance and development services to help small businesses grow and thrive. The CDFI Fund programs have helped CDFIs deepen their reach into highly distressed communities. The Department of Treasury’s CDFI Certification criteria requires CDFIs to originate at least 60% of loans and investments in eligible distressed census tracts or to underserved populations, and CDFIs continue to exceed that target. In FY 2018, the CDFI Program surpassed the 60.0 percent threshold for the percentage of both the dollar amount (73.7 percent) and the number of CDFI loans (72.1 percent) made to eligible distressed communities and underserved populations.⁹ Further, in the FY 2017 award round, 29% of award recipients primarily served rural markets, well above the 14% of Americans currently residing in rural areas.

⁸ “Hope Credit Union to Expand Presence in the Mississippi Delta”, June 25th, 2015. Accessed July 9, 2018. <https://hopecu.org/2015/06/hopeforthedeltarelease/>

⁹ U.S. Department of the Treasury, “Community Development Financial Institutions Fund Congressional Budget Justification and Annual Performance Report and Plan FY 2020”, March 2019. Accessed October 16, 2019 <https://home.treasury.gov/system/files/266/11.-CDFI-FY-2020-CJ.pdf>



While these results are impressive, additional resources for the CDFI Fund will further stimulate financing to small businesses in rural and Native communities. The CDFI Fund programs are highly oversubscribed: applicants on average have requested more than four times the available amount of funding each year. In the FY 2019 application round, the CDFI Fund received 546 requesting more than \$579 million. In the CDFI Program alone, 499 organizations requested \$373.28 million in CDFI Program Financial Assistance (FA) and Technical Assistance (TA) awards, while the CDFI Fund has only \$160 million in funding to award in FY 2019.¹⁰

The Native CDFI Assistance (NACA) Program has catalyzed dramatic growth in lending to Native communities. Native CDFIs seen their assets grow fivefold since 2001, in large part due to the CDFI Fund, which has provided over \$93 million in capital, training and technical assistance to Native CDFIs.¹¹ The NACA program is similarly oversubscribed: in FY 2019, 53 organizations requested more than \$29 million in NACA Program FA and TA awards, significantly more than the \$16 million available in appropriated funds.

- **Full funding for the Department of Agriculture’s Rural Development Small Business Lending programs:**
 - *Intermediary Relending Program (IRP)* provides local intermediaries, such as CDFIs, access to low-cost, long-term flexible capital up to 30 years to address challenges in rural communities. CDFIs then relend this money to businesses and economic development projects which create jobs in rural communities.
 - *Business and Industry Loan Guarantee Program* is a loan guarantee program designed to assist help credit-worthy rural businesses obtain needed credit.
 - *Rural Microentrepreneur Assistance Program (RMAP)* provides loans and grants to non-profit organizations, like CDFIs, which provide technical assistance and microloans to rural small business owners.
 - *Rural Business Development Grants (RBDG)* are competitive grants that support targeted technical assistance, training and other activities leading to the development or expansion of small and emerging private businesses in rural areas that have fewer than 50 employees and less than \$1 million in gross revenues.
 - *Value-Added Producer Grants (VAPG)* - The Value-Added Producer Grant (VAPG) program is a competitive grant program administered by

¹⁰ U.S. Department of the Treasury, CDFI Fund Releases Application Demand for FY 2019 Round of CDFI Program and NACA Program”, September 3, 2019. Accessed October 16, 2019 <https://www.cdfifund.gov/news-events/Pages/news-detail.aspx?NewsID=353&Category=Updates>

¹¹ Derrick Rhayn, “In Indian Country, Native CDFIs Work to Restore Food Sovereignty”, Nonprofit Quarterly, April 17, 2018. Accessed July 9, 2018. <https://nonprofitquarterly.org/2018/04/17/indian-country-native-cdfis-work-restore-food-sovereignty/>



the Rural Business-Cooperative Service of USDA that provides funding to independent agricultural producers, groups of independent producers, producer-controlled entities, organizations representing agricultural producers, and farmer or rancher cooperatives to create or develop value-added producer-owned businesses. These grants may be used to fund business and marketing plans and feasibility studies or to acquire working capital to operate a value-added business venture or alliance.

- **Make permanent the Small Business Administration's Community Advantage program** for mission driven lenders which is set to sunset September 30, 2022 and raise the maximum loan amount to \$350,000. The Community Advantage program is currently a pilot program under the SBA's popular 7(a) program to meet the credit, management, and technical assistance needs of small businesses in underserved markets. Community Advantage provides mission-based lenders access to 7(a) loan guaranties as high as 85% for loans up to \$250,000. Since the program's inception, Community Advantage lenders have approved more than 5,800 loans for small businesses totaling over \$777million, and of the 99 active Community Advantage lenders, a large majority are certified CDFIs, helping the program reach businesses in underserved markets.¹²

With an average loan size of \$129,108, and a requirement that at least 60% of the number of loans made under program go to underserved communities, Community Advantage allows lenders to make those smaller loans of \$50,000 to \$250,000 that are often difficult for business owners to access. Lenders are also able to sell the guaranteed portion of the loan on the secondary market, generating unrestricted, earned income that can help mission-driven lenders finance even more small business lending.

This program meets a pressing unmet financing need for businesses poised for growth out of the microloan program but that might not be ready for traditional bank financing, but lenders need the certainty that a permanent Community Advantage program would provide.

- **Expand the Small Business Administration's Microloan Program** and provide additional technical assistance funds. The Microloan program is an important source of capital for microlenders to make loans up to \$50,000 to women, low income, veteran, and minority entrepreneurs, and other qualified small businesses. Under the Microloan Program, SBA makes direct loans to intermediaries that use the proceeds to make small loans to eligible businesses and provides grants to intermediaries and other qualified non-lending technical assistance providers to assist borrowers with marketing, management, and other business based training and technical assistance. Demand for the financing provided through the Microloan program has been increasing steadily: the number of businesses assisted by the program has

¹² [Congressional Research Service, Small Business Administration 7\(a\) Loan Guaranty Program, Updated October 15, 2019, https://fas.org/sqp/crs/misc/R41146.pdf.](https://fas.org/sqp/crs/misc/R41146.pdf)



increased by more than 12% since FY2013, and the number of jobs supported by microloans has increased by more than 31 percent.¹³

- **Reauthorize of the recently expired State Small Business Credit Initiative (SSBCI)**, a program created through the Small Business Jobs Act of 2010 to increase access to capital for small businesses by providing credit enhancements for small business lending, with a focus on reaching underserved communities. CDFIs made nearly 11,000 loans or investments supported by SSBCI funds, totaling \$835 million in new financing through 2016. A new round of funding could further stimulate small business development.
- **Strengthen strong small business borrower protections** that ensure business owners have access to information about the types of business loan products offered so business owners can make informed decisions. Small business borrowers deserve better information, clear disclosure, and understanding of financial resources and agreements. There are substantial disclosure requirements in the mortgage lending and consumer lending arenas, but no such protections or requirements exist for small business borrowers.
- **Support better research and data on access to capital issues in rural and Native markets** – There is limited comprehensive information available focused on analyzing the specific needs and challenges facing businesses in rural and Native markets. Congress should provide funding to study the specific challenges in these markets to identify targeted solutions that meet community needs.

Conclusion

CDFIs are critical intermediaries that deliver capital to businesses and communities that need it most, building credit and financial infrastructure that provides the financing needed to improve their economic well-being. At their core, CDFIs are about partnership, innovation, and creating opportunity in those communities that are often forgotten. But the work of CDFIs is not done alone: partners like the Federal government remain vital to continuing the powerful work of mission driven lenders like CDFIs. CDFIs are also a smart investment for the Federal government: small amounts of public subsidy are leveraged to amplify its impact. For example, the CDFI Fund has reported that for every dollar it awards to a CDFI, the CDFI leverages twelve dollars from non-Federal sources.

Additional investments in proven solutions and programs like those that support the work of CDFIs will stimulate the flow of capital to business owners, generating economic activity that can create jobs, catalyze community development and generate income and wealth.

¹³ U.S. Small Business Administration, FY 2020 Congressional Justification FY 2018 Annual Performance Report, https://www.sba.gov/sites/default/files/2019-04/SBA%20FY%202020%20Congressional%20Justification_final%20508%20%204%2023%202019.pdf.