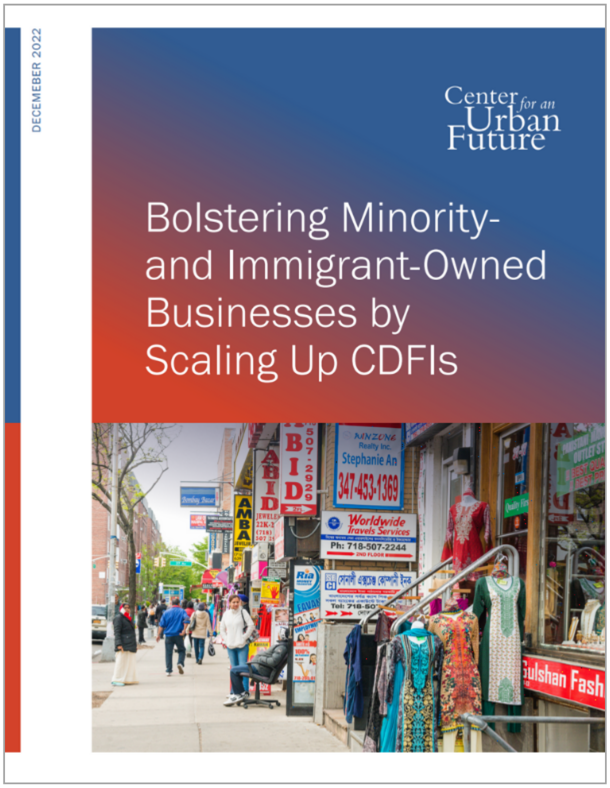

Report - December 2022

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

New city and state government policies and investments are needed to strengthen New York City's minority- and immigrant-owned businesses. Few would have a greater impact than expanding the reach of the city's Community Development Financial Institutions.

by Judith Messina and Eli Dvorkin

- The following is the introduction to *Bolstering Minority- and Immigrant-Owned Businesses by Scaling Up CDFIs*.
- Read the full report by clicking here (PDF).
- View the recommendations from this report by clicking here.
- Check out this two-minute video about the report.

The Untapped Potential of Community Development Financial Institutions (CDFIs)

Following nearly three years of a pandemic that has had a disastrous impact on small businesses in communities of color across New York City, there is broad consensus that new city and state government policies and investments are needed to strengthen the city's minority- and immigrant-owned businesses. Of all the solutions policy leaders should consider, few would have a greater impact than expanding the reach of the city's Community Development Financial Institutions (CDFIs).

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

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

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

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

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

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

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

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WHY CDFIS?

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

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

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

MOST CDFIS SERVE JUST A FRACTION OF THE SMALL BUSINESSES THAT WOULD BENEFIT FROM THEIR SERVICES.

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

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

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

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

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

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

GEOGRAPHIC GAPS LIMIT THE REACH OF CDFIS ON THE GROUND.

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

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

New York City Lacks CDFI Locations in Eastern Brooklyn and the Central Bronx

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

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

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

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

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

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

- Read the full report by clicking here (PDF).
- View the recommendations from this report by clicking here.

Endnotes

1. As the Federal Reserve noted in its 2022 Small Business Credit Survey, "Firms owned by people of color were more likely to apply for traditional financing than white-owned firms, but they were less likely to receive the funding sought." Federal Reserve Banks, *2022 Report on Firms Owned by People of Color*, June 2022, https://www.fedsmallbusiness.org/survey/2022/2022-report-on-firms-owned-by-people-of-color.

2. Next Street and Common Future, *New York City Small Business Ecosystem Assessment*, February 2021, https://nextstreet.com/research-and-publication/meeting-small-businesses-where-they-are-nyc.

3. Total dollar amount of Community Development Financial Institution (CDFI) investments that closed in 2017, as self-reported through the Community Investment Impact System and accessed through PolicyMap.

4. New York State of Opportunity and Empire State Development, *Community Development Financial Institutions Assistance Program Annual Report*, 2020, https://esd.ny.gov/sites/default/files/news-articles/2021-CDFI-Report.pdf.

5. Next Street and Common Future.

How To Help CDFIs Expand Their Reach and Deepen Their Impact

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

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

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

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

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

Create a unified CDFI network modeled on Philadelphia's Business Lending Network, simplifying the process for small businesses seeking financing and generating referrals to CDFIs citywide. New York City's underserved small business owners have no central place to turn to connect with CDFIs and understand their menu of services. New York City should simplify the process by setting up a capital consortium modeled on the Philadelphia Business Lending Network, enabling small business owners to express an interest in receiving financing from a network of approved lenders. A unified portal would allow small business owners to complete one form and be seamlessly matched with participating CDFIs or other community lenders that could support their capital needs and provide tailored technical assistance.

Help CDFIs reach more underserved communities with new supports for physical expansion and grants to deploy on-the-ground outreach teams.

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

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

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

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

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

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

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

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

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

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

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