Testimony

Little Hoover Commission

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To the esteemed members of the Little Hoover Commission, Chairman Nava and Vice Chairman Varner. I want to especially thank Commissioner Varner for inviting me to address the Commission.

It is my pleasure to address the Commission at this time in our history. I appreciate the great the work Commission has done over its 58-year history to promote the economy, efficiency and improved service in state operations. As you requested, my testimony will address three specific areas:

- The needs of small businesses
- How CDFI's help to serve small businesses in underserved communities and some solutions on…
- And how the state can work with non-profit and for-profit entities to support small businesses.

The pandemic has separated the wheat from the tares in the small business community. And certain groups of small businesses have been hurt far more than others.

I first want to create perspective on the small business landscape pre-pandemic:

Small businesses have long been the life blood of our economy. Depending on the industry, the U.S. Small Business Administration defines small businesses as those who employ 500 or fewer employees and have an average net income over two years of less than $5 Million. In California, Chapter 6.5 of the California procurement and contract Act defines small business as:

> an independently owned and operated business that is not dominant in their field of operation, have 100 or fewer employees, and average annual gross receipts of ten million dollars ($10,000,000) or a manufacturer with 100 or fewer employees and average annual gross receipts of fifteen million dollars ($15,000,000).

Pre-pandemic, the small business numbers were showing positive growth trends;

- In 2019, there were 30.2 Million small businesses in the US
- In California, there were 3.9 Million small businesses according to the office of Small Business Advocacy
- Pre-pandemic, small businesses employed almost half of the nation’s workforce
- Pre-pandemic, minority businesses made up more than 30% of the nation’s small businesses and employed over 7 Million Americans
- Pre-pandemic, minority owned businesses made up 23% of California’s small businesses and were growing at a rate of more than 10%, while non-minority small business growth was one percent

- Pre-pandemic, women owned businesses made up 12.3 Million businesses in the US and minority women business owners made up 47% of those numbers
- In California, pre-pandemic, women owned businesses made up nearly half of California's small businesses or 1.5 Million business owners.

While the growth trends had been positive for minority small businesses pre-pandemic, their vulnerabilities are evident in the pandemic:

  - Wealth and income gaps are the difference between whether a business can survive a shutdown, survive an economic downturn, survive a pandemic or not: Research from the Center for Responsible Lending (CRL) documented that "Many small businesses based in communities of color don't have wealth that helps with the shock of an economic downturn, thus they had no cushion when they came into the pandemic."
  - Adding to the vulnerabilities, according to a Federal Reserve survey, 21% of non-Hispanic black and African-American businesses were financially "distressed" at the end of 2019, based on metrics like earnings, profitability, and credit, versus only 5% of white-owned businesses. And most businesses in majority black and Hispanic neighborhoods had less than 14 days of a cash buffer (as of last year)
  - A Chase Bank Institute study reported that the lack of cash or reserves was even more severe: Small Businesses in all groups had limited cash reserve to sustain themselves over time:

- Businesses in Majority black neighborhood – 6% may run out of cash in less than a week; 89% - 7-14 days; 5% -14-21 days
- Businesses in Majority Hispanic neighborhood – 1% may run out of cash in less than a week; 88% - 7-14 days; 11% 14-21 days
- Businesses in Majority white neighborhoods – 29% may run out of cash 7-14 days; 57% - 14-21 days; 14% - more than three weeks.

While many small businesses received resources from the CARES Act through PPP Loans or EIDL loans, a survey conducted by an equal rights groups, Color of Change and US Unidos, reported that while 12% of the minority businesses applied for loans, 41% were denied. These businesses still need resources for them to survive.

- The American Banker reported that 70% of lenders tightened underwriting standards for loans to small businesses and demand from those clients plummeted by 29% between April and July.
- In that same report, nearly a quarter of small-business owners said they will have to close if economic conditions do not improve over the next six months. Another 22% warned they may not last a year.
- Over the past five years, just 23% of black-owned businesses got credit from banks—versus 46% for white-owned businesses. "Drilling down… "because of lack of collateral,

because of net worth, they tend to have less relationships with banks."

- Black-owned small businesses have historically been underserved by the Small Business Administration's traditional 7(a) lending program. In 2019 and 2018 fiscal years, only 3% of loan volume went to black-owned small businesses, while roughly half went to white-owned businesses.

- Research at the University of California, Santa Cruz, and a report by the National Bureau of Economic Research found that 41 percent of Black-owned businesses had a drop in business activity, and 32% of Latin X-owned businesses had a drop in activity, threatening their survivability.

AmPac has funded more than half a billion in loans for small businesses and we know that but for AmPac as a mission-based lender, these businesses would not have been served. Working with local governments to create flexible underwriting guidelines, serving as an SBA lender and being a CDFI where we can fulfill our core value to underwrite with a heart makes a difference for us to successfully serve small businesses.

This brings me to my second discussion point on CDFI's.

Given the landscape of small businesses both pre-pandemic and in this crisis, the role of Community Development Financial Institutions (CDFI) has been heightened. CDFI's were created to fill a financial service gap left by mainstream commercial banks. CDFI's share a common goal of expanding economic opportunity in low income communities by providing access to financial products and services for local residents and businesses. CDFI's can be banks, credit unions, loan funds, microloan funds, or venture capital providers. CDFIs help families finance their first homes, support community residents starting businesses, and invest in local health centers, schools, or community centers. CDFIs strive to foster economic opportunity and revitalize neighborhoods. Over the past 35 years, CDFI's have helped start more than 400,000 small businesses around the country, with 58% of the loans serving minority business owners.

CDFI's use a combination of government funds and private donations to seed businesses or housing projects that traditional banks will not fund. One large CDFI in Missouri, following the riots, described the CDFI as the "National Guard for small businesses," dispatched to fill a void that banks are unable to fill. There are 1,000 CDFI's operating across the nation today. The Federal Reserve Bank of New York acknowledged the role of CDFIs to bridge gap for small businesses. "Many small businesses report difficulty utilizing the programs for various reasons, including a lack of prior relationships with designated lenders or mismatches in business needs and prescribed use of program funds. To bridge financing shortfalls, CDFIs have provided smaller-dollar financing, including business loans ranging from $2,000 to $10,000 — amounts far below the average loan size of about $239,000 from the Paycheck Protection Program under the CARES Act. In addition to establishing relief funds for local businesses and individuals experiencing loss of income, CDFIs have offered loan deferments, forbearances, and modifications with flexible terms to address the immediate needs of their borrowers. They also provide technical assistance and financial coaching to support borrowers."

AmPac can attest to the significant role that we have played for small businesses with PPP loans and coaching small business owners as they have navigated through the pandemic. Our office took more than 200 calls a day, remotely, in March when the Governor issued the Executive Stay Home order. Our clients and small businesses in the community were looking for help and they could not get help from their bank of 10, 20 or 30 years. They were frustrated; they were scared, and they were looking for solutions. With the help of Congressional leaders, AmPac joined other CDFI's to lobby to become a PPP lender so that we could answer the call. From mid-April to August 8th when the program ended, we approved more than 200 PPP loans; funding over $3 Million in loans with an average loan size of $13,000. Our lowest loan was $1,500 to a Hispanic woman owned business who had a party planning retail store. The notes of gratitude we received both rewarding and heart-wrenching. In our portfolio, we offered deferments and loan forgiveness to small businesses committed to pivot but needing time to do so.

This brings me to my final point describing solutions for how the state can work with non-profit and for-profit entities to support small businesses. We believe that CDFI's can play a pivotal role in supporting small businesses through these harried times.

- Coming alongside the State's I-BANK Financial Development Corporation (FDC's), CDFI's can obtain the State Guarantee for lending capital to small businesses. Having the 95% guarantee from the FDC provides additional collateral support to the transaction, especially when the typical underwriting trends are lacking. With the guarantee, CDFI's will reduce their risk, so that they can focus their attention on coaching and technical assistance to assist with the small business' long-term recovery.
- Where CDFI's provide the greatest value to small businesses is technical assistance and coaching from the perspective of a lender. The State could provide grant funds to CDFI's to support its training and coaching efforts to give the business the maximum opportunity to succeed. Providing a loan to small businesses becomes a relationship and CDFI's seek to provide ongoing workshops and training to nurture businesses. AmPac is doing a webinar series in partnership with a bank entitled, "Pivoting During the Pandemic." We have targeted our PPP clients, our micro loan clients with our local government partners, and our clients who are on deferral. We did a six-part series with a local CPA firm on PPP forgiveness that averaged 150 attendees because small businesses needed help navigating the regulations. Grants funds to support CDFI's efforts to coach businesses and provide technical assistance will help to protect the state guarantee and gives businesses the tools they need to thrive, not just survive.
- CDFI's struggle to raise affordable capital so that they can lend to small businesses. Learning from the PPP program, the

Federal Reserve created a Liquidity Facility to allow CDFI's to borrower funds at 35 basis points to make PPP loans to small businesses. I-Bank could partner with CDFI's by creating a liquidity facility that allows CDFI's to borrower low interest capital so they can make low interest loans to small businesses. I-Bank could also assist in creating a secondary market for selling loans backed with the State guarantee so that CDFI's can obtain additional liquidity.

Small businesses remain the life blood of our local economy. Small Businesses is AmPac's business. For thirteen years, we have made small business dreams come true. We firmly believe that small businesses make communities better and families stronger and we are committed to serving as a Champion for them. We are dedicated to lending to the businesses that traditional banks can't or won't help, while supporting the small business to establish a banking relationship that they can grow and flourish with. Small Businesses are resilient. History is a great teacher – in 2008 during the great recession, small businesses lost jobs, declining 60%. A decade after the crisis, small businesses created more than 62% of all new jobs. It will take time, but small businesses are a great bet and we have our money on them and their full recovery.

CDFI's have played a pivotal role in recovery efforts for small businesses throughout the State of California and throughout the country. CDFI's have partnered with local governments to administer local loan programs, like

AmPac did with the County of Riverside. CDFI's have also obtained public and private funds to make PPP Loans. However, as we all know, this recovery will be long, and efforts will have to be intentional. A CDFI partnership with the State for liquidity capital, state guarantees, and grant funds will go a long way in saving California small businesses.

Chairman Nava, Vice Chairman Varner and all the Commissioners, I want to thank you for the opportunity to speak to you this morning. I would be happy to answer questions or provide clarifications.