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David Meyer
Certification, Compliance Monitoring and Evaluation Manager
CDFI Fund
1500 Pennsylvania Ave., NW
Washington, DC 20220

Dear Mr. Meyer:

Thank you for the opportunity to provide comments to the CDFI Fund on the current policies and procedures to certify an organization as a CDFI. SSTI strengthens initiatives to create a better future through science, technology, innovation and entrepreneurship, and the organizations we work with focus on using these tools to solve real problems and improve economic prosperity. We are pleased to provide input on how the CDFI Fund might adapt its certification process to work with more equity providers, facilitating an alternative source of capital for target populations throughout the country.

Our primary concern with the CDFI certification process is the lack of equity financing that is currently available to target populations. The participation of venture capital[1] funds through the program has always been limited. The CDFI Fund's report in June 2016[2] found that just 14, or about 1 percent, of all certified institutions are venture capital funds, representing $209 million in available funding—about 0.2 percent of all CDFI assets.

The lack of equity financing available through CDFIs is concerning for four reasons:

> First, as the CDFI Fund is well aware, many new businesses, particularly in low-to-moderate income areas, struggle to access traditional debt financing. Equity is an attractive alternative to debt for many startups, particularly those with low current cash flow or a longer route to robust sales than a traditional lender could be able to support without charging onerous interest rates or demanding excessive collateral.
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> Second, after trailing off following the dot-com bubble of the late 1990s, venture capital is again growing as a source of business financing, both in the U.S. and across the world.[3] To the extent

[1] In order to align with the CDFI Fund's terminology, our comments will primarily use the term "venture capital" when talking about equity financing through CDFIs. However, we would like to note that seed investments may be more appropriate in many cases, and equity-focused CDFIs may also want to pursue angel investment structures, depending on the needs of the target population.
[2] CDFI Fund. (2016, June). *Snap Stat: Sizing Up Certified CDFIs*. Available at: https://www.cdfifund.gov/Documents/Snap%20Stat%20June%201,%202016.pdf.
[3] EY. (2016). *Back to Reality: EY Global Venture Capital Trends 2015*. Available at: http://www.ey.com/Publication/vwLUAssets/ey-global-venture-capital-trends-2015/$FILE/ey-global-venture-capital-trends-2015.pdf.

that CDFIs wish to provide financing options that reflect those available in private markets, equity should be a greater portion of the total available assets.

Third, America is still producing fewer new companies than at any point prior to the Great Recession.[4] This is particularly concerning because startups create the majority of net new jobs in the country. According to an analysis by the Economic Innovation Group, America's failure to return to 2006 levels of startup creation has cost the country 924,000 new jobs.[5] To the extent that access to alternative financing structures is part of the solution for this problem, CDFIs should play a role providing the solution.

Fourth, and perhaps most in alignment with the purposes of CDFIs, the recent resurgence of venture capital is not being applied equitably across geography or demography by the private markets. According to a new report published by the Martin Prosperity Institute, the top four metros account for more than 59 percent of all venture capital investment in America.[6] Similarly, a study of the 2014 Census Survey of Entrepreneurs recently found that less than 10 percent of venture capital in that year was investment in black- and Hispanic-owned businesses and just 13 percent to female-owned businesses.[7] The target population focus of CDFIs is explicitly designed to address this sort of disparity. However, while more than $107 billion is available from CDFIs to help level the playing field for access to debt financing, CDFIs are essentially not providing any resources to alleviate similar pressures on businesses seeking equity investments.

Greater inclusion of community-minded equity funds could help the CDFI Fund address each of these reasons for concern with the program's relative lack of support for investment capital. These types of funds do exist and are demonstrably able to assist target populations. Launch NY, a recently-certified CDFI in upstate New York, has provided seven investments (out of a total of ten) to startups in low-to-moderate income areas in the last year. Oklahoma's successful i2E is working to prepare Native American and other rural businesses for seed investments. Innovation Works, a Pittsburgh-based certified CDFI, has provided investment support to 312 companies, leveraging $1.7 billion in follow-on funding since 1999.

Many other funds actively make investments related to expanding capital access to underserved markets and may be interested in CDFI status if the program were more prominent or expanded for equity investors. Village Capital is an investment fund targeting socially-positive companies in non-traditional markets; they have made 55 investments to different companies that have reached more than 10,000 smallholder farmers, affected nearly 300,000 low-income patients and offset more than 50 billion pounds of carbon dioxide emissions. Public-private partnership programs supported by the U.S. Department of Treasury's State Small Business Credit Initiative largely invested the program's venture capital dollars in

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[4] Harrison, J.D. (2015, Feb. 15). "The decline of American entrepreneurship – in five charts." *Washington Post*. Available at: https://www.washingtonpost.com/news/on-small-business/wp/2015/02/12/the-decline-of-american-entrepreneurship-in-five-charts/.

[5] Economic Innovation Group. (2017, Feb.). *Dynamism in Retreat: Consequences for Regions, Markets and Workers*. Available at: http://eig.org/wp-content/uploads/2017/02/Dynamism-in-Retreat.pdf.

[6] Florida, R. & King, K.M. (2017). *Spiky Venture Capital: The Geography of Venture Capital Investment by Metro and Zip Code*. Martin Prosperity Institute. Available at: http://martinprosperity.org/media/Startup-US-2016_Spiky-Venture-Capital_Revised.pdf.

[7] Liner, E. & Bhandari, R. (2017, Feb. 16). "America's got talent – Venture capital needs to find it." *Third Way*. Available at: http://www.thirdway.org/report/americas-got-talent-venture-capital-needs-to-find-it.

markets with the lowest per-capita rates of private venture capital investment;[8] for example, Alaska and West Virginia used the opportunity provided by the program to facilitate equity capital access for startups in their states. Across the country, dozens of venture development organizations investment in companies that are underserved by the private equity investment market, and many of these companies would be eligible for CDFI activity on the basis of the business's location in a distressed census tract or due to a qualifying status of the business owners.

With the presence of clear mission-relevancy for both the CDFI Fund and venture development organizations, the question that must be answered is: why are so few equity investors participating seeking, or achieving, CDFI certification?

To a certain degree, the problem is one of knowledge. We recommend that the CDFI Fund be more active in making investment funds aware of the CDFI opportunity. Because such few funds participate in the program, there is a wide perception among these organizations that the program is a poor fit for investment capital. Deliberate outreach is an important means to achieve greater participation. Beyond simple awareness of the program, the relative lack of certified venture funds yields a lack of public information about hurdles specific to this section of the market. Credit unions, loan funds and other debt providers interested in achieving CDFI certification can receive information and other support from a wide range of governmental, corporate and non-profit entities. Few, if any, comparative resources exist for venture funds. To be certain, this lack of support is not the sole burden of the CDFI Fund, but until a greater range of venture funds have become certified, collaborations between the CDFI Fund and other organizations seems to be the best way to generate the initial knowledge venture capital funds need to apply successfully for the program.

Indeed, the lack of experience with the CDFI certification process for venture capital funds is such that we have struggled to define the exact barriers beyond knowledge. However, our conversations with current and prospective CDFIs have pointed to structural challenges as likely barriers.

The first type of structural challenge relates to the stated mission and board makeup of many venture development organizations. We recommend that the CDFI Fund not increase or substantially alter the current standards of accountability as they relate to advisory boards. Venture development organizations are often established and supported by communities to serve markets that are vastly underserved by investment capital—but not necessarily by debt capital. As such, the mission and board members of venture development organizations may not reflect the same community development focus expected by the CDFI Fund, but this does not mean that the funds are at cross-purposes with the certification program. Indeed, many of the funds are making a significant portion, if not super majority, of their investments and technical assistance to qualifying entrepreneurs. The venture development organizations need to understand, well in advance of applying for status, how the CDFI Fund's definition of community development and underserved markets differs from the definitions that may be being applied by the venture development organization. In many cases, the venture capital funds will need a board of experienced investors to help with decision-making, and changes to the certification rules should not disrupt this process. These organizations can meet the current standards but may need more information

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[8] Center for Regional Economic Competitiveness & Cromwell Schmisseur. (2016, Oct.). *Program Evaluation of the U.S. Department of Treasury State Small Business Credit Initiative*. U.S. Department of Treasury. Available at: https://www.treasury.gov/resource-center/sb-programs/Documents/SSBCI%20Program%20Evaluation%202016%20-%20Full%20Report.pdf.

about how to do so. A change in the standards would place another barrier to venture capital participation in the program.

Another structural challenge for venture capital funds may be the CDFI Fund's rules related to the ownership and structure of subsidiaries and affiliates. Most investment funds are structured as separate limited liability corporations from the organization or individual raising the fund. This is a reasonable and recommended practice. The CDFI Fund should be certain that certification rules for venture capital funds do not penalize the funds for utilizing this structure. Additionally, the CDFI Fund may consider further flexibility within this rule for venture capital applicants. Many venture development organizations structure different funds for specific purposes. For example, a single organization may operate a general purpose fund, a biotech fund and a fund for female entrepreneurs. This is particularly common when partnering with other investors, who may have specific expertise or may be seeking specific types of impacts. In order to maximize the number of funds able to become certified, the CDFI Fund could consider allowing venture capital CDFIs to specify which of its subsidiaries or affiliates apply to the determination of CDFI eligibility. The organization would not be able to move entirely outside the scope of the CDFI Fund's mission, due to the requirements for adequate community development investment history and accountability of relevant funds. At the same time, the organization would not be made ineligible by its operation of a general investment fund (which in most cases would be targeting underserved markets for an economic development purpose) that is effectively catalyzing the fundraising for the CDFI-eligible investments.

Finally, we recommend that the CDFI Fund consider accepting a lower Threshold Target Market Test for venture capital applicants. This could be accomplished in practice through the CDFI Fund's stated willingness to accept explanations for reaching a lower threshold, or through a lowering of the standard from 60 percent to 50 percent. This should be a temporary change targeted to making more community-minded venture capital funds eligible for the program. Once more funds have been certified and can demonstrate to other organizations the value and means of acquiring certification, there may be no reason to continue with a lower test. In the meantime, a lower threshold would help account for the fact that many of the funds potentially interested in CDFI status were established to deal with the general geographic disparities of investment capital—a purpose that is in alignment with the CDFI Fund's intentions, although outside its main mission. By applying a waiver-based approach to lowering the threshold, the CDFI Fund could apply this standard to development-driven entities but still hold profit-driven entities to the higher standard.

We are greatly encouraged by the CDFI Fund's interest in assessing the certification process and thank you again for your consideration of our feedback. We would be happy to provide additional information and stand ready to serve as a partner for the CDFI Fund in working with venture development organizations and other equity funds.

Sincerely,

Dan Berglund
President and CEO
SSTI