LISC
LOCAL INITIATIVES SUPPORT CORPORATION

June 22, 2020

Honorable Jerome Powell
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20051

SUBJECT: Proposal to expand Main Street Lending Facility to provide access to credit for nonprofit organizations

Chairman Powell,

The Local Initiatives Support Corporation (LISC) is pleased to offer comments in response to the Federal Reserve's proposal to expand its Main Street Lending Facility to provide access to credit to nonprofit organizations. We applaud the Federal Reserve's efforts to provide support for nonprofit organizations. Not only do nonprofits represent a large segment of the U.S. economy -- the 1.57 million nonprofits throughout the U.S. employ 10% of the country's workforce[1] -- but they are the organizations that are serving the most vulnerable communities and populations in the wake of COVID-19. The strength of the nonprofit sector will dictate the pace of our nation's recovery. Support for their operations is critical.

BACKGROUND ON LISC

LISC is a nonprofit housing and community development organization and certified Community Development Financial Institution (CDFI) with offices in 35 cities throughout the country, and a rural network encompassing 90 partners serving 44 different states. LISC's work supports a wide range of activities, including affordable housing, economic development, building family wealth and incomes, education, community safety, and community health. In 2019 alone, LISC raised and deployed approximately $1.5 billion of capital into distressed urban and rural communities, including: grants and technical assistance to support non-profits; loans and investments to non-profit owners and operators of affordable housing; and loans and investments to support non-profit community facilities such as charter schools, health care centers, childcare centers, workforce facilities, and community centers.

[1] https://independentsector.org/about/the-charitable-sector/

COMMENTS

The comments that follow respond to, and are structured in general accordance with, the "Nonprofit Organization New Loan Facility" term sheet. We offer these comments from the perspective of a large nonprofit that relies upon bank financing to support our operations, as well as from the perspective of a lender whose primary customers are nonprofit organizations.

Eligible Lenders

The loan facility should be made available to certified CDFI loan funds. The term sheet limits participation in the loan facility to insured depository institutions. As the Fed recently did with its PPP loan facility, this facility should be made available to certified CDFI loan funds. There are over 1,100 certified CDFIs throughout the country, including close to 600 nonprofit loan funds – most of which experience incidences of loan losses and delinquencies comparable to or better than banks. These entities can serve markets and offer products that are often too risky for traditional banks. CDFIs also have significant experience financing nonprofit borrowers, particularly the smaller nonprofits working in distressed neighborhoods and which often have the most difficulty attracting bank capital. The Federal Reserve should be looking for more ways to partner with CDFIs to serve the underserved markets, rather than potentially displacing them from the markets they know and understand the most.

Eligible Borrowers

The borrowers should not be limited to 501(c)(3)s and 501(c)(19)s. Many mission-driven nonprofits are established as 501(c)(4)s or 501(c)(6)s, for example. The term sheet indicates that the Federal Reserve may allow other nonprofits to participate, but it's not clear what standards would be applied here. The assumption should be that all 501(c)s are eligible except those that the Federal Reserve excludes, and such exclusions should be clearly articulated.

Nonprofits with fewer than 50 employees should be permitted to receive loans. It is not clear why it is necessary for the Federal Reserve to require a minimum employment level, but in any instance, 50 employees seems excessive. According to the Independent Sector, there are 1,570,000 501(c)s that collectively employ 11.4 million workers – meaning that the average nonprofit employs just over 7 workers. Limiting participation to nonprofits that employ at least 50 workers will exclude the vast majority of nonprofits.

Revenues from donations. The requirement that no more than 30% of a nonprofit's revenues may come from donations strikes us as arbitrary and unnecessary, and may disqualify many nonprofits that otherwise would be very good candidates for loans from this facility, in accordance with the other stated underwriting criterion. Furthermore, to the extent the Federal Reserve keeps such a requirement in place, it may need to further define "donations" to ensure that pass-through grants are not counted among donations. The Federal Reserve should also consider looking at a three year average rather than a single year (2019), as currently proposed.

EBIDA (Earnings before interest, depreciation and amortization) is not a metric typically used to underwrite nonprofits. It is not clear why this is a consideration here, when there are other metrics that measure financial strength (e.g., total debt to net assets; total liabilities to net assets) that are more typically used to underwrite nonprofits, are more easily understood by lenders and non-profit borrowers, and are much more straightforward to calculate than EBIDA.

Loan Terms

These loan terms are not very favorable for CDFI borrowers. CDFIs rely on bank capital to support their lending operations. Banks are currently providing five year, interest only loans to CDFIs at a rate of 3%, which is not that dissimilar to the loan terms of this facility. If the intent of this loan facility is to encourage more favorable lending to nonprofits, and the Federal Reserve does not allow CDFIs to participate as lenders in this facility, then it should consider creating a lower rate product (e.g., 1 percent or less) for borrowers that are nonprofit CDFIs; perhaps with a requirement that these CDFIs on-lend to other non-profits that cannot otherwise access the loan facility (e.g., because they have fewer than 50 employees).

The minimum loan size of $250,000 should be lowered if the Federal Reserve determines to allow non-profits with fewer than 50 employees to access this facility.

Use of Proceeds should be defined to clarify if there are any restrictions on financing. It is not clear if the funds should be used for working capital or can be used for project finance.

Required Borrower Certifications and Covenants

Prepayment of other debt. It would appear as though one condition of accepting a loan from this facility is that the borrower has to agree not to prepay any of its other debts as long as the facility's loan is outstanding. It is not clear why the Federal Reserve would need to limit this activity, since presumably a borrower choosing to repay debt early has determined that this will improve cash flow and allow the nonprofit to provide more services.

Retaining Employees

Reasonable efforts. The Federal Reserve will likely need to provide additional guidance with respect to what is needed to demonstrate that a borrower has made "reasonable efforts" to maintain its payroll and retain its employees throughout the life of the loan; as well as the consequences should it fail to do so.

Fees

The borrower will likely pay a relatively large origination fee. It is notable that the lender fee to the SPV of 100 basis points may (and therefore likely will) be passed along to the borrower. This is on top of a 100 basis point origination fee the borrower is already paying. We would recommend that the Federal Reserve reduce the lender fee to the SPV by at least 50 basis points.

Facility Termination

The termination date needs to be extended. The facility is currently set to expire on September 30th, 2020. This does not strike us as a reasonable amount of time to line up non-profit borrowers and close transactions, particularly to the extent the Federal Reserve requires additional time to review comments and made amendments to the term sheet. Furthermore, we may be looking at a fairly long economic recovery period. We would therefore recommend that the Federal Reserve keep this facility open until at least December 31, 2020.

Thank you for consideration of our comments.

Sincerely,

Matt Josephs
Senior Vice President for Policy