PARTNERS IN COMMUNITY BUILDING

Mainstream and Community Development Financial Institutions

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The Community Development Financial Institutions Project

Over the past two decades, several types of community development financial institutions have been created to address the need for access to financial services and development credit in disadvantaged communities. These institutions use capital and credit to revitalize housing, create and retain jobs, and meet the credit needs of people with limited or no access to conventional financial institutions. The Institute's Community Development Financial Institutions project, funded by the Ford Foundation, examines the roles and activities of these institutions, the issues they face, and the types of support and policy needed to sustain them and enable their growth.

This publication examines the range of existing partnerships possible between mainstream financial institutions and CDFIs, how these relationships have begun and evolved, and the benefits such partnerships provide.

Other publications in this series include:

- **Community Development Financial Institutions: Investing in People and Communities**
- **Lenders of First Resort: Community Development Loan Funds**
- **Banking Services for the Poor: Community Development Credit Unions**
- **The Business of Self-Sufficiency: Microcredit in the United States**
- **Banking on Communities: Community Development Banks in the United States**

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Section I: Why Partnerships?

The Role of CDFIs in Community Development

Access to capital and credit is indispensable to healthy communities. Without it, jobs, affordable housing, and economic opportunity disappear. Yet all too often, businesses and people in communities that most need credit cannot obtain it because they fail to meet standard underwriting criteria or because their communities lack credit and financial services.

Disinvested communities cannot recover without access to credit and services from conventional financial institutions. But many community financing needs also require a special kind of lender: an institution willing and able to adapt policies to borrowers, to accept unconventional collateral, and to provide education and other support to help borrowers *utilize* credit effectively. Such a lender's first commitment must be to the long-term development of communities and individuals—not to maximizing profits.

Community Development Financial Institutions (CDFIs) fit this description. They find ways to make loans that conventional institutions would deem unbankable, and they link financing to other development activities in communities that are underserved or neglected by mainstream lenders. CDFIs come in a variety of sizes and structures. CDFIs may offer loans, subordinated debt, equity, credit enhancement, and basic financial services. Some serve the inner city, while others focus on rural areas, and still others lend to targeted groups—women, minorities, low-income families, or social service providers. CDFIs may also support specific types of projects, from affordable housing construction and purchase to microenterprise and small-business development, job training and industrial retention.

Over the past 20 years, more than 300 CDFIs have made significant and measurable contributions to revitalizing distressed communities. Community development financing has evolved into an industry in its own right, and its practitioners have amassed a market knowledge and lending expertise that mainstream institutions find increasingly valuable. The Community Reinvestment Act (CRA), coupled with new federal programs and the growing scale and sophistication of CDFIs, create new incentives and opportunities for partnership between conventional institutions and community development specialists.

This report describes the major types of CDFIs that have evolved over the past two decades; the benefits of collaboration between CDFIs and mainstream institutions; regulatory and legislative opportunities for building and strengthening partnerships; and the types of relationships available. Seven case studies show how partnerships between a variety of CDFIs and conventional lenders have emerged and evolved over the years.

It is hoped that this material will deepen mainstream lenders' awareness of the need and options for providing financial services to disinvested populations and encourage partnerships to direct development resources to where they are needed most.

The Range of CDFIs

Community development financial institutions include banks, credit unions, loan funds, microenterprise loan funds, and venture capital funds. Each of these distinct organizational forms take on particular areas of community development finance. Most community development credit unions, for example, lend primarily to lower-income individuals and small businesses. Many community development loan funds focus on community development projects and nonprofit organization borrowers. At the same time, a growing number of CDFIs encompass more than one of these types of lender under one umbrella. A loan fund, for example, may also operate a venture development fund; a community development bank is likely to include a nondepository lending or investing affiliate.

The CDFI field is rapidly expanding, both in number of institutions, their size, and the breadth of programs and products they offer. In general, community development financial institutions include:

Community Development Banks

In the United States, a growing number of federally insured and regulated depository institutions provide capital specifically to rebuild lower-income communities. These include: South Shore Bank in Chicago, Elk Horn Bank and Trust in Arkansas, and Community Capital Bank in Brooklyn. South Shore and Elk Horn are subsidiaries of larger bank or nonprofit holding companies that include non-depository credit and support mechanisms such as venture capital funds, development loan funds, and technical assistance agencies. Community development banks have opened recently in Oakland, Cleveland, Detroit, Portland, San Diego, Louisville, and other cities. Collectively, U.S. community development banks have lent more than $500 million since their inception, with loan loss rates that compare favorably to those of conventional financial institutions.

Community Development Credit Unions (CDCUs)

Owned and controlled by their membership, nonprofit community development credit unions differ from mainstream credit unions in that CDCUs target low- to moderate-income people and communities with limited access to traditional sources of financial services and credit. CDCUs have a dual mission: (1) to meet members' needs for financial services; and (2) to make loans that promote local development. CDCU loans are often the only source of money available to members for key individual needs. Loans may be used to start or expand small businesses; to pay for college tuition, car repair, and other expenses needed to get and keep jobs; or to finance home maintenance and improvement projects. Given sufficient scale, this individual lending can have significant impact on a community. In 1996, the 130 members of the National Federation of Community Development Credit Unions had $330 million in assets, with 167,000 members and $194 million in current loans. More than 3 million people live in communities or belong to organizations served by CDCUs.

Community Development Loan Funds (CDLFs)

These nonprofit, non-regulated intermediaries utilize social investment capital from individuals and institutions to make loans to otherwise unbankable projects, thus filling a credit gap that often stands in the way of community development. For the most part, CDLFs finance the housing and economic development initiatives of community development corporations and other community-based organizations. Many also finance small-business startups, expansions, or acquisitions. Loans from CDLFs often leverage larger loans from traditional financial institutions. For example, a loan fund might finance a second mortgage for a housing development project, allowing the project to utilize a first mortgage from a local bank. In this way, CDLFs maximize their development impact. In the United States, the 47 CDLF members of the National Association of Community Development Loan Funds have lent more than $300 million in the last decade with a loss rate of less than 1 percent.

Microenterprise Loan Funds

Loans to microenterprises generally range between $250 and $10,000 to start or expand self-employment or micro-businesses employing several people, often family members. Ventures include day care, tailoring and fashion design, catering and food service, hair and nail care, car repair, trucking, and retail and merchandising. Borrowers are predominantly women, often people of color, and almost all low-income welfare recipients, unemployed, or the working poor. Most micro-loan funds are components of microenterprise development programs that integrate economic and human development strategies. Many such programs also offer additional financial services through partnerships with local banks or credit unions, as well as training to develop personal, business, and technical skills. Approximately 190 microenterprise lending programs surveyed by the Aspen Institute in 1996 have made more than $125 million in loans since their inception to borrowers considered extremely risky by banking standards.

Community Development Venture Capital Funds

One of the newest community development financing structures is the community development venture capital fund. Because debt alone cannot address the financial needs of many of the companies at the base of sound local economies, a growing number of institutions now provide equity investments in early-stage companies. The companies targeted by community development venture capital funds fall below the radar screen of traditional venture capital funds, because of their size, their type of business, their location, and other factors. Though they differ significantly in focus and activities, the goals of community development venture capital funds include creating jobs and wealth among economically disadvantaged populations and regions, and assisting entrepreneurs in solving social and environmental problems. Community development venture capital funds are either free-standing organizations or affiliates of CDFIs or community development corporations.

What do CDFIs have in Common?

CDFIs differ in their structure and lending programs, but they share the same mission: to support the long-term development of economically distressed communities and individuals. They have other characteristics in common, as well. CDFIs:

- **Create new economic opportunity** for institutions, businesses, and individuals that do not have access to the mainstream economy for reasons of financial status, discrimination, lack of financial experience or the cost or availability of mainstream services.

- **Offer training and other services** that enable people and communities to *utilize* credit and capital effectively.

- **Make an impact on a targeted geographic area** by financing borrowers and projects that enhance the physical environment, create jobs and homes, and otherwise help to develop their communities.*

- **Channel private capital into low-income communities** by serving as a vehicle for direct private investments and deposits.

- **Are successful lenders, with considerable expertise and strong track records** in market niches that are difficult, and sometimes impossible, for mainstream institutions to serve.

Benefits of Partnership

Conventional institutions can and do stretch to meet some of the needs of disinvested communities—whether by adjusting underwriting standards, or by providing capital on more favorable terms than they might offer their standard customer base. Still, they do not address all the credit needs of disenfranchised borrowers. CDFIs, on the other hand, are in business to do precisely that. Partnerships between CDFIs and conventional financial institutions can benefit both sides.

Good Business for Banks

Partnerships with CDFIs help mainstream institutions serve the full range of credit needs found in their communities. Partnerships with CDFIs also help banks to fulfill their obligations under the Community Reinvestment Act (CRA) by meeting community lending and investment criteria revised in 1995. CDFIs are experts in addressing a wide range of low-income markets. They provide a bridge between conventional lenders and unconventional borrowers. CDFIs can be a reliable mechanism for involving mainstream lenders in deals they might otherwise not even know about, and expand their access to markets and customers in low-income areas.

* While most CDFIs target a particular area or areas for lending, some do not, focusing instead on particular types of lending or borrowers, regardless of location.

Participating with a CDFI in the earlier, riskier stages of community development financing can give a bank an advantage in capturing this market. In some cases, collaboration with a CDFI is the *only* way a mainstream institution can penetrate a depressed market.

Coastal Enterprises, Inc., Maine's first community development corporation, has evolved a number of targeted financing vehicles to help revive the sagging economy of the state's rural coastal region, a goal that is wholeheartedly supported by conventional financial partners. Over the long term, the healthier the local economy, the bigger the market for commercial loans. As one Maine banker observed, "This is a way for us to make a real difference in the local economy. In an undercapitalized region like ours, you will miss expansion opportunities for your own loan portfolio if you do not find a way to participate in community development financing."

CDFIs offer a way for banks to address some of the problems that community development deals pose for conventional lenders. CDFIs enable more **diversification** of community development portfolios than many mainstream institutions could afford on their own. CDFIs offer **credit enhancement** by providing subordinated debt. Their in-depth market knowledge and first-hand experience with borrowers can be invaluable in **underwriting** certain kinds of deals. In addition, CDFIs offer **technical assistance** and loan **monitoring** that would be prohibitively expensive and time-consuming for mainstream banks. Large banks are often attracted to CDFIs because the latter enable smaller deals than these banks would otherwise take on. For small banks, on the other hand, CDFI partnerships expand their capacity by bringing in expertise that the bank does not possess in-house.

Banks learn more about local markets from collaboration with CDFIs and are able to apply that knowledge to grow and improve their core business. In Camden, NJ, CoreStates Bank has benefited from business developed through work with the Cooperative Business Assistance Corporation (CBAC), a local CDFI.

In the long-term, CDFIs can also develop new customers. Says Janet Thompson, vice president and coordinator of Citibank's global community relations programs, "In 1980, I argued that the effort we were putting into microenterprise would pay off in the future when some of these borrowers became Citibank customers. Now we're beginning to see that happening."

CDFIs play an important market development role by testing the risks involved in modifying lending criteria. Banks can then apply the experience of CDFIs in developing their own programs. Summit Bank, a CBAC partner, adjusted its underwriting policies for businesses located in low- or moderate-income census tracts after working with CBAC. Says Bill Whelan, a Summit vice president who serves on CBAC's board: "It's not possible to correct the economic and business situation in Camden and places like it without giving effort and thought to changing policies to succeed in these markets. We learned how to do business in older cities like Camden through involvement in organizations like CBAC."

Expanded Capacity for CDFIs

Many CDFI managers do not come from a traditional financial background and must learn a new language and way of operating to succeed as financiers. Banking alliances and partnerships enable community-based institutions to draw on a range of expertise, including financial management, portfolio management, and underwriting, to build capacity and strengthen their organizations. Mainstream professionals can provide training and management assistance for credit union and loan fund staff; assistance in business planning and long-range financial projections; computer conversions; and marketing and public relations assistance. In-kind donations from conventional lenders have ranged from used computer equipment to former bank buildings.

Financial assistance may take the form of startup, operational, or capital grants; below-market loans and deposits; new product development for expanding community investment. Banks are a major holder of capital; resources leveraged through partnerships or alliances can help CDFIs more effectively meet community credit and capital needs. Alliances with mainstream institutions can increase liquidity, reduce risk, and enable CDFIs to participate in deals that require more debt than their own lending policies permit. For some CDFIs, a key goal is to promote bank lending in low-income communities. CDFIs often form consortiums or pools to provide a dependable delivery mechanism for bank capital.

Because banks and CDFIs are essentially in the same business, banks can quickly develop an understanding of CDFI operations. Support from mainstream lenders helps to build credibility with non-banking partners of CDFIs, such as foundations and public-sector agencies. As CDFIs expand their capacity, their successes, in turn, create new opportunities for mainstream community development lenders.

Regulatory and Legislative Opportunities

Both the Community Reinvestment Act and the Bank Enterprise Awards program of the U.S. Treasury's CDFI Fund provide new incentives for mainstream institutions and CDFIs to join forces.

The Community Reinvestment Act

Under the 1977 Community Reinvestment Act, financial institutions have an affirmative obligation to meet the credit needs of their communities, including low- and moderate-income neighborhoods. Banks and other institutions can meet some of these obligations and earn CRA credit through relationships with CDFIs. The revised regulations, promulgated in April, 1995, explicitly recognize many opportunities for bank partnerships with CDFIs, and bank examiners and other regulators are now much more knowledgeable than they have been in the past about CDFIs and the spectrum of relationships that is possible and desirable for promoting community reinvestment. Banks must report data according to the new regulations as of January 1, 1997, and will be evaluated under the new regulations beginning July 1, 1997.

The new rules establish a performance-based system for evaluating CRA activity, emphasizing the volume of loans and investments made in lower-income areas and for community development purposes. CDFIs, with their direct lending activities and performance criteria, are now especially valuable partners for banks. Under the new regulations, relationships with CDFIs can help to satisfy one or more of three standard tests of a bank's community reinvestment efforts.

Lending Test: The lending test evaluates an institution's lending activities by considering the bank's purchase or origination of home mortgage, small business, small farm, community development, and, in some instances, consumer loans. Among the performance criteria are the number, dollar amount, and complexity of community development loans, their geographic distribution, borrower characteristics, and the use of innovative or flexible lending practices. Banks may choose to have regulators consider lending in their assessment area by a third party or consortium in which the bank invests. A bank that invests in a CDFI which, in turn, uses the investment to make community development loans may have its pro rata share of the CDFI's loans considered under this test.

Investment Test: The investment test evaluates an institution's number and amount of qualified investments, their complexity and responsiveness to credit and community development needs, and the degree to which the investments are not routinely provided by private investors. Qualified investments include lawful investments, deposits, membership shares, grants, or in-kind contributions that have community development as their primary purpose. Investments in "equity equivalent" long-term, subordinated debt issued by a nonprofit CDFI (see case study, p. 26) that uses the funds to promote community development also can be considered qualified investments.

Service Test: The service test evaluates retail banking services to low- and moderate- income areas and customers. In addition, "community development" services provided by mainstream institutions to CDFIs qualify for CRA credit under this test. These might include educational outreach efforts or management assistance—in short, services that promote credit availability or affordable housing or provide technical assistance to organizations focused on meeting the credit needs of low- to moderate-income people.

Small banks (with assets totaling less than $250 million) are excused from this three-pronged test and evaluated instead by a simpler process that considers the institution's loan-to-deposit ratio; loan originations for sale to secondary markets; qualified investments; community development lending; borrower characteristics and geographic distribution of loans; and record of responses to written complaints about CRA performance. If small banks choose, they may maintain and report data for evaluation under the three-pronged test.

Leveraging CRA Credit

The opportunities created by the 1995 CRA regulations prompted CDFIs and banks to develop new kinds of relationships. Subsequent rulings create a special opportunity for mainstream institutions to leverage equity or equity-equivalent investments in CDFIs for CRA credit which exceeds the dollar amount of the investment. This can be done either by applying the CRA lending test to the CDFI investment, or by splitting the investment between the lending and investment tests. The amount attributed to the lending test would equal the bank's pro rata share of community development loans originated by the CDFI during the period under review. The amount attributed to the investment test would equal the institution's investment in the CDFI multiplied by the percentage of the nonprofit's asset portfolio consisting of qualified investments.

Assume an institution invests $1 million in a CDFI with total capital of $10 million. The CDFI, in turn, holds total assets of $30 million, with $12 million, or 40 percent, in qualified investments and $18 million in community development loans.

If the bank applied the investment test *only*, the amount of the qualified investment would be $1 million, the total amount of the institution's investment. The investing institution may request consideration under *both* the investment *and* lending tests. In this case, the amount attributed to the *investment* test would equal

$400,000 (the product of the bank's $1 million investment and the percentage of the CDFI's asset portfolio consisting of qualified investments). The amount attributed to the *lending* test would equal the bank's pro rata share of community development loans originated by the CDFI during the period under review. Assuming the CDFI's $18 million in loans were made during the period under review, the bank's pro rata share would be $1.8 million, because the bank has supplied 10 percent of the CDFI's capital. Therefore the bank may receive consideration for $1.8 million in community development loans under the lending test in the first year, plus $400,000 under the investment test, for a total credit of $2.2 million. The $400,000 credit under the investment test applies only in the year the investment is made. While the equity investment is in effect, however, the institution may receive credit each year for its share of the CDFIs new lending.

This example applies both to equity investments in for-profit CDFIs such as banks and venture capital funds and to certain investments in nonprofit CDFIs, such as community development loan funds. While nonprofit organizations cannot legally issue equity stock, they may create "equity equivalent" long-term subordinated debt that functions like stock in key respects. The full amount of an equity equivalent investment may be utilized for leveraged credit under the lending test or divided between the lending and investment test as in the example above. The first equity-equivalent investment product, developed by Citibank and the National Association of Community Development Loan Funds, (see case study, p. 26), has been approved by regulatory agencies for this leveraged CRA credit.

The CDFI Fund and Bank Enterprise Awards

Like the Community Reinvestment Act, the U.S. Treasury's Community Development Financial Institutions Fund (CDFI Fund) is an important tool for helping mainstream lenders and CDFIs to expand their capacity for community development lending. Working together through this and related programs, CDFIs and conventional financial institutions can multiply their impact on distressed communities.

The CDFI Fund was established in 1995 to fill a critical gap: the lack of investment capital controlled by CDFIs. The Fund's purpose is to promote a national network of financial institutions dedicated to community development, thus catalyzing the industry's growth, and to provide incentives for traditional financial institutions to expand their community lending and investment activities. Through the CDFI Fund, public and private sectors now have a means of increasing capital formation, filling market gaps, and building self-sustaining community development financial institutions. To accomplish these objectives, the CDFI Fund supports both CDFIs and mainstream institutions.

CDFIs: The CDFI Fund **s**upports CDFIs through equity investments, grants, loans, and technical assistance. In most cases, CDFIs must match all monetary assistance from the Fund one-to-one with private-sector dollars. The first round of funding, announced in July, 1996, selected 32 organizations for support totaling more than $37.2 million. These CDFIs provide numerous financial services and products to distressed urban and rural communities and low-income populations, including loans for first-time home buyers, to rehabilitation rental housing, community facilities, consumer loans, and commercial loans and equity investments to start or expand small businesses.

In the near term (two to three years) this initial $37.2 million of CDFI funding is expected to leverage three to four times that amount in total capital raised. Over the long term, it is expected to support lending and investment of 10 to 20 times that amount. The second round of funding will be awarded in the Fall of 1997.

Mainstream Institutions: The CDFI Fund also provides funds directly to conventional lenders to reward their support of CDFIs. One-third of the fund's total capital is allocated to the Bank Enterprise Awards (BEA) program. The program encourages banks and thrifts to invest in CDFIs, and to expand conventional lenders' activities in low-income communities.

The BEA program provides grants to banks and thrifts based on a percentage of the dollar amount of their eligible community development activities. In the first round of CDFI Fund Bank Enterprise Awards, announced in October, 1996, the Treasury granted $13.1 million to 38 banks and thrifts. The program gives priority and makes the most generous awards to bank investments in CDFIs. A bank award may equal up to 15 percent of its CDFI investments, whereas most other activities receive only 5 percent credit. The application process for recognizing CDFI investments is also much simpler than for other activities. Two-thirds of the first 38 awards went to banks and thrifts that increased assistance to BEA-related CDFIs.

To date, the BEA program has assisted nearly $66 million in private-sector equity investment and other support from banks and thrifts to CDFIs. In addition, the program has recognized or catalyzed $60 million in total direct lending and services provided by these institutions to distressed communities. Because the greatest current need and most valuable form of assistance for most CDFIs is equity investments, the CDFI Fund and BEA program hold great promise for expanding the capacity of both CDFIs and mainstream institutions for community development financing.

Types of Relationships

CDFIs and mainstream institutions can interact in a number of ways—from informal, personal associations between staff members to institutionalized relationships of escalating complexity and duration. Often a partnership begins informally with a branch manager, contributions officer, or someone else in a bank who understands the vision and impact of community development financing and advocates for a CDFI elsewhere within the bank.

There is no better way to educate mainstream lenders about CDFIs than to give them a first-hand look. The Board of Directors of Golden Gate Bank in San Francisco got excited about working with the Low Income Housing Fund when they went out to visit a temporary housing facility for battered women and their children. Then-senior lending officer Tim Leveque notes, "The story is out there - seeing it first hand makes a big impact."

An enthusiastic middle manager or other bank officer may join the board of a CDFI or serve informally as a technical assistance resource. Through this association, the bank may become involved in one or more deals with the CDFI. As experience, understanding, and trust develop between the institutions, their collaboration may become more formal.

The difference between doing a deal and forming a partnership is that a partnership grows and develops over time. Partnerships work best when they are based on shared values and goals, as well as an understanding of the difference between the partners and an appreciation of the strengths each brings to the effort—in short, when they are truly collaborative.

Many banks and thrifts engage in a range of relationships with various local CDFIs, or have several types of relationships with one institution. The complexity and type of relationship a mainstream institution develops with a CDFI depends on each partner's capacity and size. A small microenterprise loan fund may need little

more than some loan capital and in-kind assistance, whereas a large, sophisticated, multipurpose CDFI may offer numerous opportunities for partnership.

Following are the major categories of assistance that mainstream institutions have been known to provide local CDFIs. More detailed descriptions of each of these types of relationships can be found in the case studies in Section II.

Funds for Lending

CDFIs often seek below-market funds from mainstream investors or depositors in order to serve their target market. This is the most straightforward investment relationship and requires the least ongoing participation from a bank. CDFIs generally find longer term funds more valuable for lending purposes, although the importance a nonprofit attaches to terms depends on the type of lending it does and the characteristics of its other funds under management. Of the case studies included in this report, the Community Trust Federal Credit Union, Delaware Valley Community Reinvestment Fund, ACCION, the Low-Income Housing Fund, and the National Association of Community Development Loan Funds all have below-market investments and deposits from banks or mainstream credit unions.

Capital

CDFIs maintain equity capital equal to anywhere from 5 to 30 percent or more of their total assets, depending on the type of lending they do, the size of the fund, and capital availability. As we have seen, banks can make investments or grants to build the equity capital of CDFIs, including community development venture capital funds. In fact, the CDFI Fund was designed specifically to encourage such investments. Of the case studies included in this report, Coastal Enterprises, Inc., the Low-Income Housing Fund, and Citibank's equity equivalent investment in the National Association of Community Development Loan Funds are examples of this kind of partnership.

Loan Participations

A bank can reduce its risk and lend for projects it would not otherwise approve by participating with a CDFI in lending to borrowers. This type of partnership also permits CDFIs to make larger loans than they would be able to make solely with their own funds. The CDFI loan might be at different rates and terms from the bank loan, or subordinated to the bank's loan. Of the case studies included in this report, the Low-Income Housing Fund, Coastal Enterprise, Inc., and Cooperative Business Assistance Corporation engage in this type of partnership with mainstream institutions.

Loan Pools

Several financial institutions can spread the risk of community development lending by investing funds in a pool, which then makes loans to borrowers. In this arrangement, the banks and CDFI agree on underwriting criteria for the types of loans the pool will fund. CDFIs work with borrowers, underwrite the deals, and present them for approval to a loan committee representing member banks. All the financial institutions participate in the loan in proportion to their investments in the pool; one bank functions as the lead lender, and this bank or the CDFI itself handles the paperwork. Of the case studies in this report, the Low-Income Housing Fund, Cooperative Business Assistance Corporation, and Delaware Valley Community Reinvestment Fund, manage loan pools.

A variation on the loan pool is the lending consortium. Financial institutions pool their funds as investments in the consortium itself. Decision-making is handled the same way as a loan pool, and the CDFI, as manager of the consortium, performs the lead lender role. Of the case studies in this report, the Delaware Valley Community Reinvestment Fund's Collaborative Lending Institute operates as this type of consortium.

Loan Packaging

Banks can reduce the time and cost of community development lending by turning to a CDFI for loan packaging. In this arrangement, the CDFI works with the borrower to develop an application package that meets the bank's specifications; the bank knows that it won't waste time and effort reviewing unbankable proposals. Of the case studies in this report, the Low-Income Housing Fund and Coastal Enterprises provide this service.

Fund Administration

Many microenterprise loan funds and other CDFIs use the services of banks for loan collection, monitoring and other administrative functions. This arrangement is particularly useful for small or startup funds that lack resources for in-house servicing and financial administration. Of the case studies in this report, ACCION NM receives some administrative assistance from a local bank. On the other hand, CDFIs can provide administrative services and loan servicing to conventional lenders. The Low-Income Housing Fund has developed this type of relationship with several lenders.

Technical Assistance and Advocacy

Banks and other conventional financial institutions can provide other kinds of valuable technical assistance to CDFIs. Mainstream help covers a wide range, including marketing assistance, strategic and financial planning, development of administrative systems, new products, and services. Conventional institutions have also proved to be effective advocates for CDFIs with funders, government, and regulatory agencies. Of the case studies in this report, the most dramatic example of this kind of partnership is the Community Trust Federal Credit Union. Without the help of larger credit unions, the credit union would have been forced to close.

Lessons Learned

The relationships described in this report hold several important lessons for other mainstream and community development financial institutions interested in working together:

Begin Where You're Comfortable

A CDFI-mainstream relationship has to work well on two levels: substantively and interpersonally. Substantively, both institutions need to gain from the relationship, whether it takes the form of a single loan participation, technical assistance, or a long-term contract. Many partnerships have evolved gradually, one deal at a time, from ad hoc beginnings into a more formal, institutionalized, long-term arrangement. An interpersonal connection can begin at any level of the organization, and with any type of arrangement that benefits both parties. Several partnerships cited in this report began with informal meetings between CDFI personnel and middle-level staff from a conventional lender, e.g., a branch manager or CRA officer, who then advocated for the CDFI at higher bank levels. While a relationship

does not have to start at the CEO level, top management support is necessary for a sustained, long-term partnership.

See the Work First-Hand

The benefits of community development financing are readily apparent when bankers visit a borrower's place of business. Seeing the work of community development first-hand is important to understanding the strong impact of targeted financial services.

Be Willing to Commit Some Time

Real community development requires a sustained, long-term effort; consequently, CDFIs need long-term partnerships. The most energy-intensive phase of relationship and program development is the beginning. It takes work for each institution to understand the other's perspective and constraints, and it can be time-consuming to design and set up operating procedures. Once these are in place, however, many partners have found that maintenance is fairly easy. Numerous institutions reported that both sides became more comfortable as partners gained experience working together.

Support Staff Participation

Job descriptions and performance standards may have to be adapted to support banking staff involvement with CDFIs. Service to community development should reflect positively on a banker's performance, enhance a banking career, and be recognized and supported at all levels of the organization.

Build on Available Expertise

Good relationships build on the expertise of both the bank and the CDFI and utilize the right talent at each institution to develop the partnership. CDFIs often benefit from working with mainstream personnel who have relevant lending experience. This is especially true in business lending, but it also applies to affordable housing and other community development efforts.

Lay the Groundwork Carefully for Loan Pools and Consortia

Pools and consortia pose special challenges. From the CDFI, such an enterprise requires a solid track record of successful community development financing and good working relationships with all participating banks. Even then, it takes time for the mainstream partners to come to an agreement on common underwriting criteria, lending documents, and other issues, so that one institution doesn't dominate decision-making. CDFIs must see to it that participating banks share a common understanding of the purpose and benefits of the proposed pool or consortium. Mainstream banks must be willing to grant decision-making authority to the person who represents them during negotiations. If banking representatives at the table must go back to their superiors for approval after every negotiating session, it becomes almost impossible to establish consensus.

Money Isn't Everything

Relationships do not have to involve a financial transaction to be productive for both parties. Advocacy by mainstream credit unions on behalf of Community Trust Federal Credit Union helped to rescue the CDFI from the brink of regulatory extinction, and expert management assistance provided a solid

foundation for rebuilding the organization (see case study, p. 29). Technical assistance, other services, and in-kind donations to CDFIs earn community reinvestment credit under current CRA regulations.

Seek Out Ways to Strengthen Each Organization

In a truly collaborative relationship, each partner should not only contribute, but benefit as well. CDFIs sometimes take their resource-rich partners for granted in this respect, assuming that CRA credit and the satisfaction of helping to develop communities are sufficient rewards for bank participation. It is helpful for CDFIs to remember that their partners are in business to earn a profit, and to look for ways to direct business to mainstream institutions. Similarly, banks and other conventional credit providers should listen closely to community development lenders and provide assistance the CDFI and its borrowers really need.

Share the Glory

Long-term partners need to share recognition and credit for successful development stories. Each partner should be careful to recognize the other's contribution in dealings with regulators, the industry, and the public at large. If one side or the other monopolizes publicity about the partnership's accomplishments, the relationship will suffer. CDFIs with multiple banking partners must be sensitive to rivalry between mainstream institutions and frame their public relations to reflect equally well on competing organizations.

Outreach Is Important

Given current CRA and other federal incentives, the mainstream financial community is a largely untapped resource pool for CDFIs. Many conventional lenders would be happy to put their core business competencies to work on behalf of community development—but they have never been asked, or have not been exposed to the work of CDFIs. CDFIs would be wise to seek out and create opportunities to educate bankers about their work and invite their participation.

Seek Corporate, Foundation, and Government Partners

Access to credit and capital is a necessary but not sufficient condition for revitalizing distressed communities. While support from the financial community is indispensable to the work of CDFIs, so are partnerships with other private-, public-, and nonprofit-sector organizations. Business, nonprofit, and government support is needed, not only to build equity and loan fund capital for CDFIs, but also to address problems beyond the scope of the financial community, such as health care, education, and other social needs.

Section II: Case Studies

The seven case studies that follow demonstrate an effective partnership or partnerships between community development financial institution and a conventional financial institution or institutions. The seven organizations selected encompass a range of types of community development financial institutions, and a range of types of banking partnerships.

Each case study focuses on the existing partnership from the point of view of both partners--the value, benefits, and challenges of the collaboration to both the conventional financial institution and the community development financial institution.

A number of the organizations profiled here have developed an array of community development finance programs and, in some cases, subsidiary operations. In the case of several of them--Coastal Enterprises, Inc., Delaware Valley Community Reinvestment Fund, and the National Association of Community Development Loan Funds, these case studies focus primarily on one particular finance program within the larger organization, and therefore do not necessarily cover the full range of their banking partnerships.

Contact information for these organizations, as well as other resources for information on CDFI/bank partnerships, can be found following the case studies.

Cooperative Business Assistance Corporation

By pooling their resources through the Cooperative Business Assistance Corporation (CBAC), banks in Camden, New Jersey, can lend to inner-city businesses that otherwise couldn't qualify for a loan. This innovative partnership blends public, bank, and foundation funds to reinvest in a community that has experienced massive erosion of its business base in the past few decades. Camden is a city of 90,000 people across the river from Philadelphia; its official jobless rate has hovered around 20 percent for years.

Origins

A grant from the Fund for New Jersey and investments by the city and participating financial institutions launched CBAC in 1987. Three banks matched Community Development Block Grant (CDBG) funding of $150,000 by 3:1, thus sparking the return to Camden of conventional financial institutions.

CBAC began by offering commercial loans of $20,000 - $60,000. CBAC made a subordinated loan for 50 percent of a project, or up to $30,000, and the three banks split the other half. Putting the banks in the first position reduced each bank's exposure; banks were more willing to take on higher credit risks if they knew they would be paid off first. A lead bank fronted the money, housed the documents, and serviced the two loans, then sold participations to the other banks. This structure has remained essentially unchanged, despite comings, goings, and mergers of various banking partners. Today there are five banks in the pool. The maximum loan amount is $100,000, typically for equipment, minor leasehold improvements, and working capital. CBAC's maximum participation is now 40 percent of the loan. The term is five years; the bank's portion is priced at prime plus 1.5 points, while CBAC charges prime.

Two more loan products joined the mix a few years later. The Fixed-Asset Loan Program, initially launched in 1989 with city CDBG money, finances real estate and equipment. The program began as a pilot, with 15-year loans between $100,000 - $750,000 to stimulate large-scale job creation. The program took hold in 1992, when CBAC acquired another economic development organization's assets and portfolio, including cash from the U.S. EDA Revolving Loan Fund and a repaid Urban Development Action Grant. Borrowers invest 10 percent of the project cost, and CBAC lends up to one-third. CBAC also helps package the application for the bank portion, thus leveraging additional private capital, a key goal.

In 1993, CBAC received the first EDA Title IX grant to capitalize a Micro Loan Fund. This third product offering lends $1,000 - $20,000 for startups and businesses with fewer than five employees. CBAC makes direct loans to minorities using federal dollars and borrows against a $150,000 line of credit from two participating banks for other loans.

Cultivating Banking Relationships

Staff were and are instrumental to strong banking relationships. From the very beginning, bankers were impressed with CBAC's underwriting; loan memos produced by CBAC were as good as anything from banking staff, and banks were happy to find competent collaborators to work with in a difficult market. While some of the banks started out with fairly stringent criteria for what they were willing to underwrite, over time they became much more comfortable working with CBAC. Today, bankers are confident that CBAC will not waste their time by sending over projects they can't approve.

CBAC, in turn, found bankers cooperative, dependable, and systematic. Small-business lenders brought valuable expertise to the table; CBAC found them more apt to be flexible and responsive with their funds than government and foundation partners. Over the years, bankers on the loan committee have turned down only a few projects each year recommended by CBAC staff.

When the Fixed-Asset Loan Program took off, CBAC's relationship with the banking community changed. The program brought new benefits to banking partners. CBAC could provide real assistance to some of the banks' customers—not just those below its radar screen—and referrals increased significantly.

Andrew MacNabb is a vice president and middle market commercial lending credit officer at CoreStates National Bank—not one of CBAC's original investors, but now the organization's lead banking partner. When the bank began working with CBAC, it did not have a Camden branch but felt the bank should be involved in the area. Since then, CoreStates has opened a Camden community development branch in conjunction with a local credit union. While involvement with CBAC hasn't changed the bank's underwriting, reports MacNabb, "It does make us work harder to find ways to do things in communities like Camden—it's heightened our awareness of the need."

"In a participation arrangement like this," MacNabb continues, "it's essential to give the people you send to the table the authority to make the decisions at the table. If everyone had to go back to the office for approval, nothing would ever get done. It's also important to get support from public sources. For us, this kind of effort is a low-risk way to revitalize the community. Now that the systems and relationships have been established, we can make a big impact with a low investment of time—monthly meetings at most."

Summit Bank, another CBAC partner, views the relationship as a long-term investment in building the local economy, which ultimately benefits the bank. Working with CBAC and other community-based lenders, says vice president Bill Whelan, has taught the bank how to do business in older cities. It has also changed the way Summit does business. About two years ago, the bank added a section to its small-business underwriting policy that sets different standards for businesses located in low-to-moderate-income census tracts, including more flexibility in key financial ratios, percentage owner occupied, and debt coverage ratios.

"The only way to revive a market is to understand market needs, and then adjust to meet them better," says Whelan. While delinquency and default rates are somewhat higher than in other bank

business, says Whelan, "when you think about the multiplier effect of these loans on the overall economy, the wins outweigh the losses." Summit's default rate on inner-city business loans is about 6 percent. The bank has a significant volume of these loans and does not view performance as a major problem.

Lending Activity

Since 1987, CBAC has made 101 loans, of which 66 are still outstanding, amounting to $3.2 million. This activity has saved 425 jobs and generated an additional 260 new jobs. In fiscal year 1996, the organization made 22 loans totaling $1.127 million. These included 13 minority loans, 11 microloans, 4 commercial loans, and 7 fixed asset loans. For commercial and fixed-asset loans, bank participation was 68 percent. Since its inception, the Micro Loan Fund has extended 32 loans totaling $423,000, of which 28 went to minority- or women-owned businesses.

Total capitalization is $13 million. CBAC has recently received additional foundation capital and money from the Urban Enterprise Zone Fund, a state program, which will be used as a match for additional federal EDA dollars. Loans for two companies have been approved out of those funds: one to a commercial laundry with 180 jobs; and another to help Camden's only supermarket expand. CBAC has also applied for $2 million through the Philadelphia/Camden Empowerment Zone program.

How CBAC Operates

The organization currently has four full-time staff, two of whom are loan officers. CBAC staff analyze loan applications, visit applicants, prepare credit memos, and bring recommendations to a bank committee. The lead bank prepares the loan documents and participation paperwork for all the banks.

A 14-person board of directors includes representatives from the city, participating banks, business, and the community. This diversity keeps members apprised of what is going on at the neighborhood level, city plans, and community and business needs—information that is invaluable in making sound lending decisions.

A subcommittee of the board of directors reviews requests for commercial and fixed-asset loans. Another committee reviews requests for $20,000 or less. These committees must approve all loans recommended by the staff except those to a repeat borrower for less than $10,000.

Challenges

The biggest challenge to many bankers is the need to go outside their normal box--that is, to stretch their standard lending criteria. Their purpose in partnering with CBAC is to enable riskier loans. But the tools they use to evaluate and underwrite community development loans are the same as for mainstream loans, and those tools were designed to minimize risk to the bank. CBAC's structure helps to address this problem, at least for commercial loans. Each bank pledges a certain amount for a five-year period; pooled loans require only relatively small investments from each participating institution for each project, and the low dollar amounts enable banks to take more risks. While real estate loans are not pooled, CBAC's subordinated one-third position helps to relieve banking concerns.

"These loans make no economic sense for the bank in and of themselves," says Bill Whelan. "They are too small and labor intensive, and they carry greater risk. For us, efficiency is the single biggest issue--how can we get them done right, but efficiently." Summit Bank, with assets of $22 billion, works with several other community development organizations, including the Trenton Business Assistance Corporation and the Greater Newark Business Development Consortium, and is trying to replicate the CBAC model in Cumberland County. For the latter project, Whelan has found that the biggest hurdle is finding a lead bank willing to service the loans; raising loan and operating money is less of a problem.

For CBAC, the biggest ongoing challenge is how to distinguish bankable loans from those that might work with participation and loans that are simply too far over the line. When the loan committee thinks a deal might be bankable, it sends the loan to a participating bank; if the bank approves it, then it's bankable. In 1996, three deals were passed on to mainstream institutions in this way.

Next Steps

CBAC has set an ambitious agenda for 1997. Its foremost goal is secure public source funding through the U.S. Economic Development Administration, Urban Enterprise Zone, and Empower-ment Zone, plus additional philanthropic funding to increase lending by $4 million, adding 25 loans to the portfolio. Four million dollars in CBAC capital creates an additional $8 million potential new bank lending. At that scale, CBAC will be able to support itself. Grant support would help build the capability to provide systematic technical assistance to borrowers; CBAC would also like to add a staff person to offer bookkeeping services to microloan customers, add an additional loan officer, increase its member banks to six, and implement new loan accounting and cash management systems.

Coastal Enterprises, Inc., and CEI Ventures

Coastal Enterprises, Inc. (CEI), began as Maine's first nonprofit community development corporation, then quickly spun-off a number of financing vehicles. Formed in 1977, CEI directs economic and human resources to help low-income people and rural communities. Through partnerships with banks, public and private agencies, and community organizations, CEI develops and expands industries, small businesses, social services, and affordable housing. CEI also helps low-income people directly, including welfare recipients, persons with disabilities, and women with limited resources, by developing training, education, employment, and ownership opportunities. Research and public policy development support this community-based work. CEI has a staff of 40 and offices in Wiscasset, Augusta, and Portland, Maine.

Targeted Financing

Since 1979, CEI has directly invested a total of $42 million in 800 economic and housing development projects in Maine and leveraged an additional $120 million in financing. CEI raises capital from a variety of public and private sources. Targeted businesses include natural resource-based companies, job-generating manufacturers, emerging technology firms, small and women-owned businesses, child care facilities, and microenterprises. Public-sector partners include both federal agencies, such as the Small Business Administration, U.S. Department of Agriculture, and the Department of Health and Human Services; and state agencies, such as the Small Business Administration and Finance Authority of Maine (FAME). Thirty to forty percent of CEI's capital comes from private investments, including local and national foundations, banks, and other corporations. CEI provides financing through several targeted funds:

- ***Development Fund***
  Targets small job-generating manufacturers, natural resource-based companies, and other Maine employers for real estate and equipment loans and working capital. Loans range from $50,000 - $300,000 and average $124,000, provided by a combination of bank and CEI loans. The Fund aims to create one job per $15,000 of CEI capital.

- ***Enterprise Fund***
  Lends $500 - $50,000 for equipment, working and start-up capital to small, women- and minority-owned businesses, small manufacturers, low-income and self-employed borrowers. Average loan size is $12,000.

- ***Venture Capital Fund (a Coastal Ventures LP)***
  Makes equity investments up to $125,000 in high-growth, socially responsible companies to develop products and services such as natural pharmaceuticals and environmentally sensitive packaging.

- ***Housing Fund***
  Provides predevelopment and construction financing to nonprofits, affordable housing corporations, and quasi-municipal agencies for rehabilitation and new construction projects serving low-income Maine residents, including the elderly, single parent families, tenant groups, and people with special needs. Loans range from $50,000 - $150,000.

Additional funds provide targeted support for the fishing industry (including loans and investments to harvesting, processing, and marketing enterprises), defense conversion, child care centers and homes, assisted living facilities, small farming, and "green" companies. Finance criteria vary. Loan terms may be up to 15 years, depending upon use, generally at fixed, market rates. Security includes business assets, personal assets, and personal guarantees.

Banking Involvement

CEI's bank relationships are numerous, varied, and still evolving. They include participation in financing, loan guarantees, funding relationships, referrals, client and staff mentoring, organizational development and marketing assistance, board participation, advocacy; and more.

Over the years, some 34 banks have helped to finance the organization's projects. Typical participation in small-business lending involves a subordinated loan from CEI for $60,000 - $90,000, with a bank loan for typically two to three times that level. Some loans, however, may be as small as $20,000. CEI makes about 100 such loans per year. CEI can also use its funds to guarantee up to 50 percent of a bank loan.

Relationship-Building

CEI began as a community development corporation concerned with creating effective programs to build up Maine's economy. Though CEI viewed access to capital for local enterprises as critical to its goals, the organization did not have the in-house banking expertise, nor could it amass sufficient capital on its own, to meet all the needs it saw. Bank partnerships could supply needed financial expertise, helping to ensure that CEI's loans--and the organization itself--would perform over time. CEI reached out early and aggressively to the financial community, calling on loan officers, exhibiting at trade shows, inviting bankers to sit on its board and otherwise seeking their counsel.

Many in the banking community initially viewed community development corporations as organizations which were well intentioned but well outside the financial mainstream and not necessarily equipped to make sound credit judgments. Once CEI established a track record, banks became more involved and responsive. Good publicity and the requirements of the Community Reinvestment Act helped. As banking relationships deepened, bank officers gained a better understanding of what community development lending is all about. They began to refer borrowers

who didn't quite meet mainstream standards or who needed more technical assistance than banks could provide.

Today CEI is recognized as a strong partner in subordinated debt and financing relationships. Representatives of both local and regional/national banks sit on CEI's board. Community development lending is considered a profitable line of banking business, not just a means of satisfying CRA requirements. In Maine's depressed business climate, banks have a lot of cash to lend, and CEI clients are potential

customers. Some micro-borrowers have, in fact, graduated to become mainstream bank borrowers; at a minimum, they represent potential accounts. Some banks are developing “CEI-friendly” products, such as streamlined loan applications and small-business checking accounts. CEI, in turn, has learned to appreciate the regulatory and other constraints on mainstream banks.

Support Takes Many Forms

Bankers’ growing enthusiasm for community development lending has been expressed in both financial and nonfinancial support. For example, Key Bank, a major investment partner providing loan funds and co-lending with CEI, recently made a three-year, $90,000 commitment for matching funds for an SBA microloan program, plus a $30,000 pledge of in-kind support. The bank advocated effectively with the SBA on CEI’s behalf. Its marketing department produced a brochure and organized a press event to announce the new program. An officer sits on an advisory board for a small group of women business owners that meets quarterly, and bank staff serve as volunteer mentors. Mainstream bankers have also participated in a one-day regional forum on microenterprise and helped to organize a statewide association of microenterprise organizations.

Coastal Ventures, Inc.

Coastal Ventures, Inc., represents another step forward in CEI’s relationship with Maine’s financial community. A central problem in the state is the lack of small-scale equity for local businesses. Banks can go only so far in making loans if businesses lack a source of equity for expansion. CEI and its banking partners saw a need and opportunity to create more business loan customers by improving targeted companies’ balance sheets.

CEI Ventures, Inc., a for-profit, wholly owned subsidiary of CEI, was formed to raise, manage, and invest socially responsible venture capital funds. Coastal Ventures Limited Partnership is the first such fund, initially capitalized in 1996 at $3.35 million with investments from eight Maine banks, plus several national foundations and social investors. The fund seeks to co-invest where appropriate, making equity investments between $50,000 - $350,000 in companies with potential to generate above-average returns over 5 - 7 years. CEI Ventures, Inc., is the only venture capital firm in Maine, and its target companies fall below the radar scope of national venture capital firms. Its board of nine directors includes two bank members; bankers also sit on the firm’s advisory board.

The fund’s social goals are to create jobs and ownership opportunities for low-income people; to support the development of socially beneficial products and services; and to support progressive management practices ranging from employee ownership to innovative environmental engineering. Portfolio companies must commit to hire low-income people as a result of growth financed by the fund. Companies must also demonstrate growth, strong management, potential for an attractive return, and a proprietary position in a technology, operating method, or other factor that affords a competitive advantage.

For firms that meet these criteria, the fund provides human as well as financial resources. Coastal Ventures assumes a seat on the company's board of directors to assist with strategic planning, financing, and other management functions.

Marketing CEI Ventures

Prior to forming CEI Ventures, CEI had, over a number of years, made $1.5 million in equity investments in 16 firms. CEI was fortunate to have recruited a staff person with venture capital experience, who was able to develop the expanded investment program. CEI's track record, the financial community's confidence in the fund's managers, and the obvious need lent credibility to CEI's proposal to form a venture capital subsidiary, at least within the banking community.

According to Nat Henshaw, president of CEI Ventures, banks were attracted to the new enterprise for three reasons: the opportunity for return on their investment; the project's potential for growing the state's economy, and thus expanding the long-term market for loans; and the opportunity to earn CRA credit. CEI Ventures was successful in attracting as initial investors both community and independent banks, such as Atlantic Bank, Androscoggin Savings Bank, and Bath Savings, as well as larger regional banks, such as Fleet Bank and Key Bank. Large regional banks, with Maine-based assets of $2.5 - $3 billion, committed between $250,000 - $300,000 as a rule. Smaller banks, with assets in the $200 million range, typically invested around $50,000.

"Banks were more receptive than others at the outset because they understood the need for this kind of capital," says Henshaw. "They were in agreement with our overall strategy, and they know if we succeed, their core business will grow." With banks as a strong base, along with several foundations, CEI Ventures can now focus on broader institutional and individual markets for expansion.

Initial Investments

CEI Ventures has approved two investments to date: a startup business that composts salmon waste and blueberry leaves in Washington County, the county with the highest unemployment rate in Maine; and New England Audio Resource, in Lewiston, an old mill town. New England Audio makes high-end speakers and has annual sales of $1.4 million. Its 17 employees include a number of former AFDC recipients who are graduates of CEI's job training program.

CEI is investing $100,000 in the composting enterprise, worth 30 percent of the company. The owners have $100,000 equity, and the company will get a working capital loan of $150,000 from People's Heritage Savings Bank. New England Audio will get a $100,000 equity investment from the fund, worth 20 percent of the company, plus a $190,000 working capital loan from Key Bank.

CEI's investments are convertible preferred stock. Notes earn a 3 percent annual interest, and CEI expects to sell them down the road at a profit. After the investment's fifth year, CEI can sell its stake for six times net income and can require a company to buy out its shares between years five and seven. With the banks, CEI has a ten year investment which can be extended for two years at CEI's option. Thus, CEI will not be forced to sell its stake in the company at an inopportune time to pay back the bank's investment.

As for return to investors, says Nat Henshaw, “We have told the banks that we hope to earn about the same as very long term stock market investments—around 10 to 11 percent.” Banks recognize that their actual return could fall within a wide range.

Win-Win Relationships

Bank participation has played a key role in CEI’s success from its earliest days. “There’s a great deal of reciprocity in the relationship,” says Michael Finnegan, vice president of Key Bank.

“Most of what you do in your banking career is about making individual loans and improving the performance of your institution,” says Finnegan. “Ultimately, that needs to be coupled with the broader mission of creating a climate where your institution can succeed, and that means building the local economy. This is a state where capital formation is very weak. Working with community development corporations spreads the risk, so that riskier loans can get made. We need growth in microenterprises and small businesses in this climate. Without it, the bank is not going to grow.”

The relationship with CEI has enhanced both the size and the quality of Key Bank’s commercial lending portfolio and helped to expand the market. “Working with CEI has widened my understanding of what we should be doing as stewards of capital,” says Finnegan, “and strengthened our ties to the market.” CEI is uniquely equipped to study large economic issues for the region and examine particular sectors, such as the fishing industry, in depth. This analysis is of great value to bankers in determining how to make a real difference in the local economy, as well as what political and other nonfinancial support is needed.

CEI hopes that as its relationships with the mainstream financial community evolve, banks will become increasingly active in development efforts. Raising federal matching funds is a particularly difficult challenge for a small organization in a rural area. CEI views the banking community as its most important resource for meeting this challenge.

Since the early 1970s, Citibank has implemented numerous programs to stabilize and build the capacity of community development loan funds, community development credit unions, and microenterprise lenders. One innovative new product, developed in collaboration with the National Association of Community Development Loan Funds, enables Citibank to 1) make “equity equivalent” community investments for its portfolio, not from its grant budget, and 2) is designed to be replicated by other banks. This newest type of relationship with mainstream institutions opens up a significant new source of funds for community developers and provides very favorable CRA treatment for banks.

About NACDLF

Founded in 1986, NACDLF is a national community development financial intermediary whose 47 member CDFIs provide development capital for urban and rural communities throughout the U.S. At year-end 1995, its members managed more than $200 million in capital from individual and institutional investors and have lent more than $300 million. NACDLF members’ loans have leveraged $2.7 billion in public and private capital to finance 56,423 housing units and create 11,313 jobs for poor Americans. NACDLF members’ collective loss rate on cumulative loans made is less than 1 percent, which is comparable to most conventional financial institutions.

NACDLF’s mission is to strengthen the performance and increase the capital base of its members, and to build political and economic support for the CDFI industry. The organization provides evaluation, training, financial service, and public education programs, including assessments, technical assistance, Central Fund loans, and industry promotion and policy development.

From its Central Fund, NACDLF makes performance-based, unsecured term loans to assist members’ efforts to raise capital and to finance local development projects. The Central Fund is currently capitalized at more than $10 million with below-market rate institutional investments. NACDLF has made more than $8 million in loans and commitments to member funds since 1990. In 1995, Citibank contributed $1.1 million to launch a $25 million Equity Grants Program to enable member funds to achieve increased net-worth and loan loss reserve levels.

Evolution of the Equity Equivalents Product

Nonprofit CDFIs cannot legally sell stock. For them the “equity” needed to support their lending has historically come in the form of capital grants. These capital grants provided what is sometimes referred to as “permanent capital.” As the CDFI grew, NACDLF members needed increasing amounts of permanent capital to increase their lending flexibility and risk tolerance, to leverage additional debt, and to reduce the cost of capital. By 1994, NACDLF recognized that the kind of growth in permanent capital needed by member loan funds, and its own Central Fund, could not come from grants alone. To grow substantially, the industry had to develop ways to bring in new

types of equity. NACDLF believed that financial institutions could be an important source of new equity.

With an initial planning grant from the Ford Foundation, NACDLF set out to develop an investment product that would have the features of equity for nonprofit CDFIs--a product that could be an investment, not a grant, from mainstream institutions and would qualify as such for CRA purposes. Putting this product together required new thinking about and understanding of capital markets. NACDLF needed a partner committed to innovation and willing to work through the details of product development and committed to overcoming regulatory hurdles. With its long history of support for community development financing and strong relationships with CDFIs, Citibank was an obvious choice.

"Our relationship with CDFIs gradually evolved over a 20-year period from grants to investments to new product creation," says Janet Thompson, vice president and coordinator of Citibank's global community relations programs. "CDFIs reach a market that we don't. Development lending is time-consuming and requires subsidy, which makes some types of projects inappropriate for us. We do make an effort to serve underserved communities when we can. But working with CDFIs is a terrific way to make sure that financial services are available to a wider range of communities than we can reach directly."

To determine how to put the deal together, Citibank brought in its structured finance, investment banking, legal, and accounting departments to design a new type of investment instrument and conduct a detailed, due-diligence review of NACDLF's financials, operations, and track record. Citibank also consulted the Office of the Comptroller of the Currency (OCC) to determine regulatory issues, especially regarding CRA treatment of the investment.

What is an Equity Equivalent Investment?

NACDLF and Citibank's equity equivalent product is a substitute for equity capital in several key respects. Citibank accounts for the equity equivalents as investments, following generally accepted accounting principles. The investment is a general obligation of NACDLF that is not secured by any NACDLF assets, is fully subordinated to the right of repayment of all other creditors of NACDLF, and generally does not permit Citibank to demand accelerated payment of the investment. The investment carries an interest rate that is not tied to any income received by NACDLF and the investment term is indeterminate, i.e., it can be rolled over.

Citibank agreed to make a $1 million investment in NACDLF's Central Loan Fund and committed to a subsequent investment of an additional $1 million once NACDLF has fully drawn the first $1 million and complied with certain performance covenants.

The investment has a rolling term of ten years. During each of the investment's first five years, if NACDLF satisfies the performance covenants, Citibank will be obligated to extend the investment for an additional year, effectively extending its term to a minimum of 15 years. Because the Citibank investment has many of the features of true equity, it increases NACDLF's debt capacity.

The Office of the Comptroller of the Currency ruled (in a letter dated June 27, 1996, and endorsed by all four regulatory agencies) that the new product essentially gave Citibank pro rata ownership of NACDLF's Central Fund and could be considered under either the "investment" or the "lending" tests for CRA activity or a combination of the two tests. Thus Citibank could claim a pro rata share of NACDLF's total new lending over the period of its investment for loans made in Citibank markets (see p. 6). Using conservative assumptions, over 15 years the bank's CRA credit will amount to six times its investment.

Performance Covenants

Citibank's projections require some confidence in NACDLF's ability to make good loans and to leverage its capital effectively, especially over the long term. For this reason, Citibank and NACDLF negotiated performance covenants, creating a "performance-based equity equivalent." In negotiating these standards, both Citibank and NACDLF were concerned with balancing the competing goals of safety and loan productivity.

The partners' performance covenants include social criteria for the types of loans NACDLF will make with Citibank's money, and criteria governing NACDLF's management staffing and skill levels. Financial performance standards are as follows:

NACDLF will maintain the ratio of equity (defined as permanent capital plus the equity equivalent investments) to total capital under management (defined as equity plus notes payable to third parties, the proceeds of which are used to finance lending activities) at no less than 15 percent, measured annually as an average ratio. Equity equivalent investments may not comprise more than 50 percent of NACDLF's equity. NACDLF will maintain a minimum 3:1 ratio of senior debt to equity, and funded loan loss reserves at no less than 2.5 percent of loans outstanding—higher if the risk of loans warrants it.

Capital Structure

- ***Loan Productivity***
  Annually, NACDLF will achieve a minimum ratio of loans outstanding and committed to average total capital under management of 75 percent. At NACDLF's request, Citibank may make exceptions based on NACDLF's financing cash flows.

- ***Risk Management***
  NACDLF will not, without Citibank's consent, make changes to its underwriting procedures for extending loans to member CDFIs that materially increase the risk of default in its loan portfolio.

- ***Citibank Investment Limits***
  Citibank's equity equivalent investment is limited to 40 percent or less of all equity.

- ***Interest Rate***
  The initial interest rate is 250 basis points below the ten-year Treasury Bond rate. This rate is fixed for ten years, after which it will be reset. Extensions will be priced at 200 basis points under the appropriate Treasuries. Interest is payable quarterly and there is no penalty for early principal payment.

Accounting for Equity Equivalent Investments

Citibank treats its investment as an "other asset," per an OCC regulation that permits a community development loan that isn't bankable to be classified this way. Each year, Citibank can expense its loss on the loan due to the lower than market interest rate, while carrying the loan on the books at its full principal value.

On NACDLF's books, the investment is treated as an "other liability." NACDLF is required by its senior lenders to have a certain percentage of net worth in its Central Fund, and NACDLF expects to be able to include the Citibank funds in calculating its net worth. The rationale is that as long as Citibank's funds are subordinate to senior lenders' funds, and are guaranteed to stay in the Central Fund for longer than the senior lenders' funds, the Citibank investment functions like equity from the point of view of senior lenders, and should be viewed as equity for purposes of evaluating NACDLF debt capacity.

Replicating the Product

NACDLF and Citibank have designed a product that they hope will be replicated by other banks, and which can also be used by banks for investments in individual CDFIs. Some of the provisions negotiated in this investment are due to the NACDLF's unique intermediary role; investments directly in individual CDFIs may differ in their specific provisions, or the need for performance covenants.

Community Trust Federal Credit Union

The Community Trust Federal Credit Union in Apopka (CTFCU), Florida, provides the only access to financial services for the area's migrant farm workers. The credit union ran into serious management problems a few years back; if not for the support of a number of mainstream financial institutions, CTFCU would have shut down.

Products and Services

CTFCU provides savings accounts, certificates of deposits, and loans ranging from four-month, $250 "starter loans" to auto loans with a $30,000 ceiling. While the credit union does no mortgage lending, it has been able to assist a few members in obtaining mortgages from CUNA Mortgage, operated by the Credit Union National Association. With $2.4 million in total assets and $1.8 million in 610 loans, CTFCU currently has about 1,700 members. Non-member deposits total about $560,000.

In 1991, Community Trust began to develop serious problems with record-keeping and delinquency. In September, the National Credit Union Administration, the federal regulatory agency, issued a letter of agreement that put the credit union on a track to be liquidated or merged, and which also prohibited CTFCU from making more loans. The credit union's problems stemmed from lack of management and oversight capacity. CTFCU had experienced very rapid growth in deposits and loans; with a volunteer CPA as manager and an insufficiently trained community-based board, the organization was not equipped for growth.

The regulators' first tactic was to seek merger partners. They went to the region's large mainstream credit unions, which felt they lacked the resources and expertise to take in a membership so different from their own. Ed Baranowski, president of Fairwinds Federal Credit Union in Orlando (formerly Navy FCU) proposed an alternative: to set up an advisory group of managers from larger credit unions to provide technical and financial assistance to get CTFCU back on its feet. Fairwinds, a $435 million institution, has 85,000 members.

"In this country, 40 million people use check cashers because they don't have access to financial institutions," says Baranowski. "A whole chunk of the population is disenfranchised, and we didn't want to see this group go down the tubes—that's what the credit union movement is all about. We knew that money alone wouldn't do it, but we felt Community Trust could work if we were there to provide hands-on help."

Under New Management

At the behest of Sister Anne Kendrick, a founder of the credit union and member of the credit union's sponsoring organization, Kelly Schermerhorn joined CTFCU as manager in July, 1992. He left a well-paid job in mainstream banking for low pay, no job security, and the chance to do something he really believed in. Kelly's background was in lending and collections, but he had no experience in management, operations, and regulatory policies governing credit unions. Through the local chapter of the Florida Credit Union League, he asked for help in these particular areas from managers of larger credit unions.

Advisory Board

CTFCU formed a nine-member advisory board of conventional credit union managers, including some retired managers from the largest credit unions in the Orlando area. The advisory board sends a member to every Community Trust board meeting and in this way provides ongoing advice and capacity building. The advisory committee structure has worked out well for CTFCU. Community-based board directors know the culture and needs of members, while the mainstream credit union representatives keep Community Trust focused on it primary purpose: helping members meet financial goals. For example, the advisors recommended against using scarce resources to survey members regarding the impact of pesticides; while the project was worthwhile, it was beyond the credit union's scope.

The advisory board's original purpose was to see the credit union through the process of cancelling the NCUA's letter of agreement. Once this was accomplished, the advisors decided to stay on through 1996—

both because they felt that CTFCU could still benefit from their help, and because they had become very committed and were getting a lot out of the relationship themselves. Over time, the president and entire management team of Fairwinds FCU have worked directly with Community Trust; most department heads have volunteered staff from their departments to assist the smaller credit union. Due to the credit union's success and board development, the formal advisory board was terminated at the end of 1996, though the informal relationships and assistance continue.

Working with CTFCU is very different from the managers' day-to-day experience in their larger organizations. "Without contact with small credit unions, large ones can lose perspective on the fundamentals and grassroots," says Schermerhorn.

Interaction with CTFCU has raised larger credit unions' awareness of unmet credit and financial services needs. Orlando's mainstream credit unions now actively seek new ways to expand their outreach. Baranowski observes: "Our credit union is doing a needs assessment in a small town that doesn't have a bank. I've been in this area for many years, but I hadn't been aware until now that these people had no banking services. They have nowhere to go for minority business loans."

Other Types of Assistance

The regulators' position was that Community Trust could become viable if it had good policies in place and followed them. Two large credit unions lent staff to design and write policies and operations

manuals—one for investments and one for collections. The NCUA examiner hasn't said a word in the past three years about CTFCU's policies—a testament to the quality and importance of the work done by volunteer technical advisors.

From the beginning of the relationship, Fairwinds FCU emphasized the importance of educating community-based leadership to serve effectively on boards and committees. Fairwinds initially came through with a $10,000 grant for education and training. Later, when NCUA permitted CTFCU to accept operations grants, Fairwinds provided another grant to increase Community Trust's reserves.

Recent assistance from larger credit unions has included: a donated security system and computer equipment, scholarships for training; technical assistance on choosing and managing technology, a $5,000 grant to purchase computer equipment and software, and teller training.

Kelly Schermerhorn believes that larger credit unions represent a substantial, often underutilized, resource for community development credit unions, especially because large organizations share the same regulatory system. "I now can call on at least 15 CEOs from credit unions of more than $50 million, who will respond to any reasonable request," says Schermerhorn.

Schermerhorn's approach to soliciting nonmember deposits is a case in point. CTFCU was limited to 20 percent nonmember deposits until regulations changed to permit up to $1.5 million. At that point, Schermerhorn obtained a data base from the Florida Credit Union League listing all credit unions of $100 million and up, then solicited them for below-market deposits for a minimum term of two years. The mailing boosted nonmember deposits by $275,000 in 40 days, with very little effort on CTFCU's part. One credit union wired in its money even before filling out a deposit card. Another called the NCUA examiner for verification, then sent $75,000.

"The key to developing relationships with larger institutions is to show them how they can be useful," says Schermerhorn. "Other credit unions do care about our mission. What we do gets back to the roots of the credit union movement. You just have to give people a way to plug in."

Changes in the Environment

Federal regulators have been encouraging large credit unions such as Fairwinds to expand into low-income areas. However, recent court rulings restricting credit union expansions mean that partnering with community development credit unions is one of the only ways for mainstream credit unions to assist low-income communities outside their field of membership.

Community Lending Institute, Delaware Valley Community Reinvestment Fund

Since 1986, the Delaware Valley Community Reinvestment Fund (DVCRF) has grown from a $10,000 loan fund to a multifaceted community development financial institution that manages tens of millions of dollars. Today it lends as much in one month as it did during its first three years. More than 750 investors, including dozens of banks, hundreds of nonprofits and foundations, and more than 450 individuals, have provided almost $23 million at below-market rates to benefit low-income neighborhoods in the nine-county Philadelphia region. Equity investments in the permanent capital fund now total $5 million.

Historically, DVCRF's main focus has been on pre-development, rehabilitation and construction financing for affordable housing and community facilities built by nonprofit developers. It formed a business lending subsidiary in 1996, and also collaborates with various partners on nine special initiatives, ranging from a nonprofit energy conservation fund to the Philadelphia Jobs Initiative, which links workers to regional employment opportunities.

Lending Record

More than 350 loans totaling in excess of $34 million have leveraged an additional $135 million in private- and public-sector financing in DVCRF's first decade. The Fund has helped to finance more than 1,800 housing units, create more than 4,000 jobs, and revitalize some 950,000 square feet of commercial and community facility space. The greatest concentration of DVCRF's loans has been in Philadelphia and Camden, New Jersey. Customers range from residential and commercial developers to community art centers, schools, small businesses, settlement houses, and social service agencies. Beneficiaries are overwhelmingly low- and moderate-income people, and most end users are minority residents, about 55 percent African-American and 32 percent Latino. In 1996 alone, the Fund lent to more than 40 borrowers.

Banker's Role

Over the years, DVCRF has established relationships with most of the banks in its service area. They are investors, grantors, and providers of take-out financing for short-term mortgage and construction loans. They have purchased participations and bought seasoned loans. Bankers also serve on various boards and committees and have proved invaluable sources of information and ideas as the fund has grown.

In its first few years, DCVRF's primary relationship with banks was through investments in the loan fund. These below-market-rate loans, usually low five-figure amounts, accounted for about 10 percent of total assets. Banks were reluctant to commit to higher amounts; they weren't sure how to book very low-interest investments that were not outright grants.

DVCRF's first attempt to expand its banking relationships was by selling participations in larger loans. This initiative coincided with a wave of bank mergers in the area, and DVCRF found banks

receptive and even eager to buy in. The problem was that each deal was unique, and therefore labor-intensive to package and service. Mergers precipitated many changes of banking staff, and each institution required its own type of tracking. As institutional priorities changed, banks' interest in participation vacillated.

Nonetheless, DVCRF continued to grow. DVCRF doubled its lending activity in one year, exceeding $1 million in loans in 1989. By 1990, the Fund was doing deals in the $300,000 - $400,000 range. In 1991, DVCRF launched its first subsidiary and technical assistance arm, the Community Development Institute, to build local organizational and business capacity and strengthen borrowers' ability to plan, finance, construct, and manage community development projects.

Making Million-Dollar Loans

Relationships with bankers were evolving to the point where a bank sometimes sought participation as it underwrote or originated a loan; in this situation, DVCRF could enable million-dollar loans, taking only part of the deal at the outset. In short, DVCRF was becoming a broker.

The upper limit on DVCRF loans was $250,000, yet some of its customers needed far more. To increase the flow of bank financing for affordable housing construction through the sale of loans, direct and indirect participation, technical assistance and credit enhancements, DVCRF created its second nonprofit subsidiary, the Collaborative Lending Initiative, in 1994. Fifteen member banks provide lines of credit to fund housing construction loans that are too large for the regular DVCRF loan pool—up to $1 million. To provide a credit enhancement for the banks, DVCRF purchases a subordinate position in the portfolio equal to one DVCRF dollar for every three dollars of bank financing.

Benefit to Banks

Over the years, DVCRF had established enough credibility to interest the financial community in pooling resources for the initiative. Financial institutions were working to make more community reinvestment loans, and DVCRF had a history of working with smaller groups. While individual banks would be hard pressed to lend to this community, by participating as a group they could diversify their portfolios and reduce their exposure. Bankers were comfortable with the proposed customer base: borrowers who had already paid back earlier housing construction loans and demonstrated a high degree of competence.

The collaborators would not be lending to risky startups but rather enabling successful borrowers to expand. By financing an intermediary, the banks could access DVCRF's construction lending expertise, market knowledge, and extensive customer base; meet their CRA obligations; and avoid the time and transaction costs for low-income housing projects.

Structuring the Consortium

It took considerable effort to develop a structure to make the lending process efficient and workable. DVCRF experimented with two models. The first was a master participation pool, modeled after the Low-Income Housing Fund (see case study, p. 41) and the Greater New Haven Community Loan Fund. This pool was supported by the six largest banks in the region. Each institution took on a task, from developing documents to performing due diligence. Participants worked the whole model through, even producing common underwriting criteria. But the effort collapsed under the weight of FIRREA requirements established in the wake of the savings and loan debacle. DVCRF could not act as lead lender, and neither could any of the banks—each participating institution had to keep a full file on each loan, order appraisals, etc.

For this reason, DVCRF and its banking collaborators turned to a second model: the Community Preservation Corporation, a low-income housing consortium of bank lenders organized by Citibank and other large banks in New York. The partners decided to incorporate Community Lending Institute (CLI) as a separate entity, to which financial institutions would then lend money. Senior lenders would commit to purchase CLI's promissory notes in increments of $25,000 as needed. Commitments would have at least a 12-month term. Under this arrangement, banks would have a business loan on the books, not a real estate loan, and FIRREA requirements would not apply.

What would it take to enable the bankers to make loans to this proposed new entity with no net worth? The partners decided that a minimum 25 percent subordinated debt from DVCRF was sufficient credit enhancement, but they also limited the operation's total debt to $6 million. This arrangement creates a bank loan to the borrower that is 65 - 75 percent loan-to-value. The remainder of the loan is DVCRF's investment, and the banking risk is shared equally by all the partners in the pool.

CLI pays the prime rate to banks. The markup on loans is small—generally about 75 basis points. Origination fees of 1 - 1 ½ percent and fees from selling loans provide CLI's income. While banks don't get the spreads they would normally receive for conventional lending, they don't have the work, either. Collateral was an issue. It would be far too cumbersome to list 15 banks on a mortgage, but there had to be a way for all the banks to share proportionately in the collateral for each loan. The solution was to have CLI issue a mortgage; a custodial agreement indicates that the banks share the collateral, but one bank keeps all the documents.

Small- Versus Large-Scale Bank Relationships

To diversify its investor base, CLI wants to involve both large and smaller institutions. Large-scale banks, with assets over $1 billion, can provide major infusions of capital, while smaller banks provide diversity. Currently CLI has 17 participants, with no one bank representing more than 10 percent of available assets.

Large and small institutions bring different motivations to partnership with CLI. Large banks cannot easily write loans for less than $1 million—while they have the in-house capacity to evaluate construction lending risks and the interest in making smaller loans, these deals are simply too labor-intensive. Partnership with CLI improves large banks' efficiency and cost-effectiveness in community development lending.

Smaller banks, on the other hand, lack experience in construction lending. Their primary motive is to expand their capacity; without technical assistance from CLI they couldn't consider such loans. Smaller lenders turn for help in underwriting CLI loans to larger local institutions and the Federal Reserve Bank, which has

strongly supported CLI and in fact convened some of the early meetings on how to structure the organization.

Board of Directors

CLI's board of directors makes all loan approvals. The board includes five banking members and four community representatives—staff from local community development corporations and one consultant. "It's important to get the community involved," says Arthur Birenbaum, vice president for commercial lending of Jefferson Bank. "The community groups make sure we hear from both sides, and that we conservative bankers don't do what we sometimes do best—find ways not to do a deal." Birenbaum observes, however, that community representatives are sometimes tougher evaluators than bankers.

Bank representatives on the board are almost entirely from large institutions. The fact that bank members are required to have relevant lending experience eliminates most of the smaller banks, which are involved with CLI precisely because they lack internal capacity for this type of lending. Bankers on the board come from both CRA lending departments and commercial loan divisions, and range from a senior vice-president to an assistant vice president who has in-depth knowledge of the region's nonprofits.

One Banker's Story

Martha Van Cleve was working in the real estate department at Midlantic Bank when a fellow banker invited her to join the loan review committee at DVCRF. This required only six hours per month, a commitment of personal time which Van Cleve was willing to make. "I wanted to get involved in community development, and I thought this was a good way to use my professional talents in volunteering my time, rather than licking envelopes somewhere," she recalls.

Midlantic had made investments in the fund, and over time became increasingly supportive of Van Cleve's work with DVCRF. When the organization started CLI, Van Cleve became Midlantic's representative to the CLI board, and her involvement extended into working hours. "If the commitment was just from me, it wouldn't work," observes Van Cleve. "It's important that the bank allocate time for its people to work with a CDFI. For example, it was noted in my performance evaluation that I was doing this work—this is part of my job, and I am not penalized because time spent working with CLI detracts from my total loans made."

Van Cleve became vice president of the real estate department when PNC Bank purchased Midlantic. "PNC is not set up to be efficient at real estate loans of less than $1 million," says Van Cleve. "To the extent that we can provide loan dollars and the CDFI has the time and expertise to find, underwrite, and approve the loans, I think both sides come out ahead."

Van Cleve's involvement with local CDFIs has led to new ways to do deals. For example, she recently received a request for a $1.2 million loan, which is small for the bank. It was a good deal, but it would have taken too much time and effort to be cost effective for PNC. Van Cleve called DVCRF to partner with the bank; DVCRF took the lead lender role and lent $200,000, while the bank took $1 million.

Building a Track Record

CLI made its first loan in August, 1994, and has since created more than 500 units of housing in the region. To date, it has lent more than $11 million and generated in excess of $10 million in additional financing that otherwise would not be available. The current loan pool is $8 million. In 1996, the board raised CLI's debt ceiling to $12 million, although DVCRF cannot invest more than 10 percent of its assets in CLI.

CLI and DVCRF

Scale is the primary difference between underwriting CLI loans and DVCRF loans. Also, whereas DVCRF may lend for predevelopment or mortgages, CLI loans are all for construction, and its borrowers are more experienced.

The banking community's participation in CLI has not detracted from its support for DVCRF's revolving loan fund; lenders have been steadily increasing their individual and aggregate investments,
and banks now account for 17 percent of DVCRF assets. CoreStates and PNC banks together have committed a total of $1.1 million. These and other banks continue to make grants to DVCRF as well. DVCRF expects that the financial community will reach the limit of direct investment in DVCRF before long, but this would happen eventually with or without CLI.

Next Steps for DVCRF

Over the next five years, DVCRF plans to grow its loan funds substantially, and provide more than $75 million of new credit over the five-year period.

A third subsidiary will begin operations in FY 1997. DVCRF Ventures will concentrate on job creation strategies by providing debt and equity to rapidly growing small businesses. This business financing program, organized as a limited partnership, with DVCRF Ventures acting as general partner, already has commitments of $3 million, with projected capitalization between $6 - 8 million by the end of 1997. DVCRF Ventures will link its financing with DVCRF's work force initiatives to assure a qualified low-income labor pool to fill job openings created by its financing activity.

DVCRF has always targeted commercial and residential real estate development to specific neighborhoods to build the critical mass of investment needed to turn communities around. While this commitment remains strong, the fund will also look for ways to connect neighborhood initiatives with the regional economy, expanding into project and policy areas ranging from transportation planning to work force development. An example of this connection-building is DVCRF's role in the Philadelphia Jobs Initiative. This initiative,

sponsored in part by a grant from the Annie E. Casey Foundation, will promote strategies related to training, job placement, and support of residents in low-income communities. The long-range goal is to build a seamless community development finance system.

Low-Income Housing Fund

The Low-Income Housing Fund (LIHF) was established in 1984 to increase capital for permanently affordable housing for low-income communities. Although LIHF began with a primary focus on financing affordable housing at affordable rates and terms, with time, the Fund has come to take a broader, more holistic view of community development. Today LIHF is among the nation's largest community development loan funds and a pioneer in building a comprehensive range of relationships with conventional lending institutions.

LIHF serves as a critical link between traditional lenders and the nonprofit community, combining sound financial investment opportunities with public benefit. The Fund is constantly "pushing the envelope" in response to changes in the business environment. In recent years, as cutbacks in public assistance programs have complicated the Fund's work, LIHF and its banking partners have stepped up their efforts to create innovative approaches to financing. The Fund assembles capital from as many sources as possible and develops multiple vehicles to move that capital. Each vehicle is carefully crafted to meet both borrowers' and lenders' needs.

LIHF maintains offices in San Francisco, Los Angeles, and New York and has made or committed loans in more than 22 states. The Fund has been involved in financing approximately 14,000 units, most of which house very low-income people. In certain areas, LIHF can now provide a full range of financing assistance with very reasonable terms: from smaller, short-term, low- and high-risk gap loans to permanent financing.

Programs and Banking Partnerships

LIHF makes direct loans through its Revolving Loan Fund (RLF), now capitalized with about $33 million in grants and loans from foundations, religious institutions, and numerous banks. It also serves as a financial intermediary to arrange permanent and interim financing, mostly from conventional lenders, through allocations, participations, and pools. LIHF administers a small mortgage guarantee program and a small investor program that generates interest subsidies; provides technical assistance to low-income housing developers and to service providers for special needs populations (for example, shelters for battered women and their children); and helps foundations and public agencies to develop and operate new programs for channeling capital into low-income communities. LIHF's Revolving Loan Fund has made a total of $50 million in loans since its inception.

From the beginning, LIHF has taken a comprehensive approach to financing community development, working to involve different types of lenders and a range of financing vehicles and has built formal relationships with federal and local government agencies, and secondary market agencies. Over the years, LIHF has built several types of relationships with conventional institutions, including innovative responses to community needs crafted by banking partners themselves. Some types of banking relationships work best with large institutions, while others are better suited to smaller banks. Some have proved so successful that they are beginning to outlive their usefulness, while others show potential for significant expansion.

Direct Investments

Investments in LIHF's Revolving Loan Fund provide the foundation of its lending program. LIHF's Revolving Loan Fund capital comes from grants and loans from banks, foundations, insurance companies, corporations, religious institutions, and individuals. Investments in the loan fund provide a simple mechanism

for bank participation. They also give LIHF the greatest flexibility in addressing its borrowers' needs. Returns to the bank are lower than other lending mechanisms, but transaction costs are also lower.

Many banks begin their relationship with LIHF through the Revolving Loan Fund; others expand their participation to the RLF after gaining experience with a lending pool.

Packaging

In these banking partnerships, LIHF play a packaging role for its borrowers. LIHF gathers information, structures a loan, underwrites, and presents a deal for approval to one or a group of financial institutions. LIHF may also assist in loan closings and loan servicing. LIHF has facilitated $83 million in cumulative lending in this way, and currently works with bank pools and commitments totalling $50 million.

LIFH's packaging relationships are structured in several different ways. These include:

- ***Lender/Borrower Matches***
  With large and small banking partners in several cities, LIHF can match a wide range of qualified borrowers with an appropriate lender on a case-by-case basis. Such matches tend to be for long-term loans.

- ***Allocations***
  In this type of relationship, a bank or other institution allocates a specific amount to be set aside for LIHF-referred loans. These may be short- or long-term loans, depending on the institutional partner, although the majority to date have been long-term deals. LIHF and the institution negotiate the terms in advance, and the lender sets aside a specific amount of loan funds. Then LIHF packages and submits loans that conform to the agreed-upon criteria. LIHF's partners in this type of arrangement include Bank of America, Citibank, United Methodist Church Board of Pensions, and Metlife.

- ***Pools***
  LIHF has organized a number of lending pools, each serving a particular community or region, and each with a different set of participating banks. LIHF and participating banks negotiate mutually agreeable underwriting criteria. Conventional lenders and other institutions commit a set amount to a pool, which then funds loans on a prorated participation basis. The minimum preferred level is $250,000, although several smaller lenders have allocated less than this amount to LIHF pools. Current participants have committed anywhere from $100,000 to $1.5 million.

  A loan committee comprised of representatives of three or more lenders reviews loan requests and can require additional terms, if necessary. Loans are priced at the weighted average of the applicable term, wholesale certificate of deposit rate plus 100-125 basis points on average.

  Pools fund shorter term lending--generally 6 months to 3 years, with a maximum term of 5 years. Loans may be used for purchase of improvements and land, construction, rehabilitation, refinancing, and predevelopment costs for multifamily rental properties, residential hotels, transitional facilities, group homes, cooperatives, single-family homes, condominiums, and increasingly, mixed-use property. Loans are secured primarily by first mortgages, and occasionally by second mortgages where the aggregate loan-to-value ratio does not exceed 75 percent.

As with allocation, terms and pricing are agreed to by the participating banks up front. LIHF finds and packages the loans; documents and closes loans, services loans, and participates in funding the loans. The lead lender (a participating bank) holds the note and all other loan documents on behalf of all

This arrangement has several benefits to the lenders. Lenders can share the risk of loans which may be too labor-intensive or costly for conventional institutions to make alone. Investments offer reasonable returns, and administrative costs are very low. By partnering with LIHF, an experienced nonprofit with in-depth market knowledge, lenders gain access to markets they otherwise could not serve, as well as experience with new types of lending, at least in the case of smaller banks.

“Setting up the pools created a learning device for financial institutions,” says Phyllis Klein, Regional Vice President for Community Lending at Wells Fargo Bank, who has served for three years on LIHF’s board of directors. “At the time the pools were created, there wasn’t an active market for these types of loans. While larger banks were familiar with construction lending and minipermanent loans, some of the smaller banks had no exposure. Many of the deals pursued by the fund had enough hair on them--such as borrowers’ capacity issues or loan-to-value ratio, so that banks needed to share the risk in order to take them on. LIHF’s expertise and involvement could make these deals work.”

Sitting down at a table together for one meeting per quarter, raised banks’ understanding of the market, Klein observes. In addition, the marketplace grew more competitive. Thanks to these two factors, today some of LIHF’s pools are actually underutilized. In an increasingly competitive market, big banks in particular became more aggressive about community lending and took on riskier loans that formerly would have been shared by the pool. In certain markets, loan pools are still relevant as vehicles for helping smaller banks get money out into the community. There is also an important niche for pools which involve riskier loans on the margins of what is considered bankable or develop new funding mechanisms. For example, LIHF is developing a new pool to make smaller loans ($100,000 - $750,000), then combine them for take-out with tax-exempt financing, enabling much smaller projects to utilize the cost savings of tax-exempt financing.

- ***Participations and Purchases***
  These particularly good for small banks that do not have the in-house expertise to make community development loans themselves. These arrangements also help larger banks do deals that are either too small or located in an area that is difficult for the bank to serve. Participations and purchases benefit LIHF in that they increase the Revolving Loan Fund liquidity and permit the Fund to make loans without absorbing all the costs. LIHF views participations and purchases as a way to develop its own secondary market for loans. While these products are relatively new to LIHF's portfolio, president Dan Leibsohn thinks they have significant expansion potential.

  In a participation, LIHF acts as lead lender, with banks taking on a portion of the loan. LIHF also has sold participations in its existing loans. Once the loan has established a repayment record, LIHF regains liquidity by selling a participation to a conventional bank. In most of these deals, the bank purchases 50 to 90 percent of the loan at par. In case of delinquency, LIHF manages the delinquency process. LIHF can also buy back the loan at a later date if it wishes to do so.

  These products grew out of a relationship between LIHF and Golden Gate Bank, where Tim Leveque was then Chief Lending Officer. (Today he is senior vice president for Credit at Pacific Coast Banker's Bank.) At that time, Golden Gate needed to improve its CRA rating, but it lacked the product knowledge and expertise to do community development lending on its own. Recalls Leveque: "We were looking for someone who was dealing with nonprofits in affordable housing. For profit operations come and go, but LIHF has a vested interest in staying with the market, and can attract public and philanthropic dollars as well. LIHF could bring together all the actors--could do the acquisition, development, and the takeout--but needed a funding source. Together we developed the participation concept, which I then took to our board."

  Once the bank's directors were on board, the rest flowed easily. Each deal was in the $400,000 - $500,000 range; the bank took a maximum of $250,000. Regulators were very receptive to the bank's efforts; the San Francisco Federal Reserve wrote an article about the projects and the partnership with LIHF definitely changed the bank's perception of community development lending.

Says Leveque: "The participation mechanism is an inexpensive way to get into a new product--in Golden Gate's case, low-income housing. The program could be developed without a major commitment of new staff time from the bank. If Golden Gate had launched its own direct lending program, it would have had to hire new staff."

Building Long-term Relationships

Tim Leveque has this advice for banks considering a partnership with a CDFI: "The bank has to make a commitment they are going to do it, that this is an important market to them. If that commitment is in place, partnership with a CDFI is a great way to act on it. But if a bank does not have the commitment, the relationship won't work for either partner."

In order to develop that commitment, Dan Leibsohn notes, a certain amount of banker education is required. This is complicated by the fact that the banking industry as a whole is characterized by rapid turnover of personnel. "We work closely with lenders to explain the unusual qualities and aspects of

community development lending," Leibsohn says. As in the case of Golden Gate, bankers often come to be more comfortable with the risks of community development lending with increasing exposure to actual projects.

The desire to do good is compelling but insufficient motivation for bankers. Equally important is the desire to do well. LIHF is very conventional in its management, systems, and reporting--important in building bankers' comfort. Says Wells Fargo's Phyllis Klein: "LIHF staff are very high caliber. They bring a great deal of credibility to what they do. They don't necessarily talk like bankers, but they have strong financial skills."

"It's important to know when we have to act like a business, and when like a nonprofit," says Dan Leibsohn. "We're as rigorous in assessing and trying to mitigate the risks of our loans as any conventional business. But then, as a development lender, it's our job to take on some of those risks, and to expand private-sector community development lending."

Conventional institutions find that LIHF is a valuable resource. They often turn to LIHF for advice on a particular market, area, or project. Says Phyllis Klein, "People in the bank are always looking at developing new products, but they tend to look at how these fit within conventional parameters. LIHF has helped spark some more creative thinking." She believes LIHF has a clearer market perspective than conventional lenders, because nonprofits tend to be more straightforward with another nonprofit. Also, LIHF has relationships with numerous foundations. Banks don't always appreciate the role that foundation support may play in a deal.

An important long-term success factor in working with LIHF has been the bank's willingness to keep an open mind when assessing potential deals. "At first glance," says Klein, "everything looks funky. You have to be willing to see how LIHF is structuring the deal, how they've built in enough comfort so it can be done."

LIHF and its banking partners work hard to overcome the obstacles to maintaining their relationship. Deals take a long time to put together. The borrowing nonprofit has to locate and put together whatever subsidies might be available, and it is labor-intensive for LIHF to package and service loans. LIHF and its partners must also overcome the tension that arises from sometimes conflicting goals of private and nonprofit organizations; LIHF is always pushing banks to be more aggressive, and conventional lenders to avoid risk.

Challenges

LIHF is moving beyond affordable housing into full-spectrum lending for the entire range of activities that constitute community development. Says Dan Leibsohn: "It's clear that in many neighborhoods, housing alone isn't solving the problem." Consequently, LIHF has dramatically increased loans to facilities and is taking a more holistic approach to development lending in each community it serves. One related challenge is to assist banks to move in this direction also: mainstream partners in pools and allocations tend to resist mixed-use projects and unusual types of buildings. LIHF found it difficult, for example, to finance a Head Start facility because the project did not conform to standard lending guidelines.

Some banks do understand and try to do full-spectrum lending, but loans may be housed in different departments and viewed as individual deals, not as CRA lending. For example, LIHF negotiated an agreement between a community group and a bank for an affordable housing project. When the same group later applied for a loan to buy an office building, the application was reviewed by bank staff from a different department, with whom relationship-building had to start again from scratch.

While pools, participations, and purchases have expanded LIHF's lending capacity, LIHF also needs to grow its own Revolving Loan Fund, the core of the organization's lending. Today the Revolving Loan Fund's

With welfare reform in full swing, LIHF's believes its capacity to do special needs housing projects may be seriously curtailed. In the past, AFDC and SSI were major sources of income for the residents of this housing. The loss of transfer payments will have an adverse impact on the cash flow of special needs housing projects, yet the need will increase substantially.

Pushing the Envelope

In the future, says Dan Leibsohn, banks will have to develop imaginative new mechanisms to meet the new challenges of financing community development, such as Bank of America's tax-exempt lending in Texas. LIHF brought a loan to Bank of America as part of an allocation agreement, and the bank came up with the concept of structuring the project as a tax-exempt bond deal.

With this mechanism, the interest rate on the bank's portion dropped from above 9 percent to 6.75 percent. With the lower interest rate, the bank could lend more to the project. Further, the project needed less equity, and cash flows were better. The bank lent $1.75 million, while LIHF made a second-position taxable loan of $200,000, which would have been $330,000 without the tax-exempt financing. The mechanism permitted LIHF to pay back its loan much sooner and strengthened the overall project as well.

LIHF continues to push the envelope. For example, in New York City, a lot of affordable housing owned and operated by nonprofits or single-purpose corporations called Housing Development Finance Corporations are suffering from deferred maintenance, poor management, and other problems. The Fund has set up a loan pool to help rescue these properties by consolidating debt and financing needed repairs. The new pool, funded at $3 million, currently has six participating banks and has three projects in the pipeline, totalling $1 million. Because banks are unwilling to lend directly to these properties, the banks lend to LIHF, with recourse to LIHF. The Fund, in turn, lends to the property--under stringent conditions governing escrowed reserves, outside management, board composition, and operating procedures. This pool will also target special needs housing and non-subsidized single-room-occupancy buildings.

ACCION Texas and ACCION New Mexico

ACCION International is a private, nonprofit organization formed more than 30 years ago to work with underserved populations in Latin America and the Caribbean. Today it coordinates a network of microlending programs some more than 20 years old in 14 countries. Over the last five years ACCION has disbursed more than $1.3 billion in commercial loans worldwide.

After participating in two experimental projects in the United States in the 1980s, ACCION initiated its first microlending program in New York in 1991; it has since established additional operations in New Mexico, San Antonio, El Paso, Chicago, and San Diego. U.S. associates offer business training and loans that start as low as $200 to microentrepreneurs who cannot obtain conventional credit. Each office operates independently and is separately incorporated. Associates receive ongoing support from ACCION International and share experience and knowledge with other members of the U.S. network as well as with their Latin American counterparts. The idea is to experiment and devise a working model for U.S. microlending that is sustainable over the long term.

From the program's inception through August 31, 1996, ACCION's U.S. network has lent a total of almost $7 million. The U.S. initiative has three central goals:

- ***Scale***
  ACCION's intent is to achieve a sufficient scale of operations so that over time, associates will reach a significant number of microentrepreneurs in need of assistance in each city, building stable businesses that strengthen communities.

- ***Self Sufficiency***
  ACCION focuses on obtaining enough direct revenue from program services to eventually cover 100 percent of each associate's operating costs.

- ***Quality***
  It is critical to maintain loan portfolios of high asset quality in order to demonstrate that micro entrepreneurs can and will pay back their loans.

Banking Intermediaries

ACCION associates borrow from banks in amounts similar to conventional corporate customers, then lend the funds in far smaller increments to qualified micro entrepreneurs. In this way ACCION bridges the gap between the banking sector and low-income, otherwise "unbankable" borrowers. Bank support for ACCION takes the form of lines of credit, grants, and in-kind contributions.

Both partners benefit from these relationships. ACCION avoids the restrictions of state and federal funding and maintains the flexibility needed to make its own decisions about underwriting criteria, amounts, and terms of loans. Transaction costs and risks to bank partners are minimized--the

ACCION associate organization manages the micro loans, and ACCION, not its entrepreneurs, is responsible for repaying the banks. Risk is generally spread among several banks participating in the capitalization of the loan fund. Banks reach a market they could not effectively serve on their own, not only meeting their CRA obligations cost-effectively, but also developing potential future customers for retail and consumer banking services, or perhaps commercial loans.

ACCION Texas

In 1993, with funding from the Levi-Strauss Foundation, ACCION International of San Antonio surveyed 120 micro and small businesses on the city's west side. Only 2 percent of respondents to the San Antonio survey had ever used a bank loan to finance their business. Eighty percent said their businesses were not operating to full potential, and 77 percent cited lack of capital as their biggest constraint. Unable to obtain bank loans, these people turned to pawn shops, finance companies, and informal moneylenders for credit costing anywhere from 36 - 50 percent per month, with very short terms.

ACCION Texas began lending in June, 1994, to entrepreneurs scattered throughout the city of San Antonio. Through February, 1997, the program made 615 loans worth approximately $1.72 million to 259 microentrepreneurs, including storefront business owners, taxicab drivers, home-based businesses, and street vendors. The average loan size is $2,799. ACCION's loss rates are minimal, demonstrating that given the opportunity, enterprising men and women who may need only a few hundred or a few thousand dollars for their businesses are good credit risks. The majority of borrowers are Hispanic (64 percent); 76 percent are minority; borrowers' median annual household income is $28,800 for an average household of 3, well below the national median income for a household of 3 of $41,043.

Products and Services

ACCION Texas targets the marginalized self-employed—microenterprises owned by disen-franchised, low-income and minority individuals and families who are struggling to meet basic needs through small, often home-based, initiatives. Borrowers may receive some form of public assistance or other help, but self-employment is an important source of monthly income.

ACCION Texas does not directly provide much technical assistance to borrowers, which helps the organization control its operating costs. But it does refer borrowers to local colleges and small business centers for help preparing business plans, and for other assistance.

The organization offers four financial products:

- ***Borrowing Groups***
  ACCION Texas makes initial loans of $500 per member to borrowing groups of four or more individuals who prefer a group guarantee mechanism or who do not have collateral or a co-signer to guarantee their loans. In this arrangement, all members of the group co-sign or guarantee each loan. Once an initial $500 loan has been repaid, borrowers become eligible for larger loans. There are currently nine such borrowing groups, most of which are taxi drivers. ACCION Texas has found that borrowers are reluctant to co-sign for loans to people they don't know personally.

- ***Initial Loans of $1,000***
  First-time borrowers may borrow up to $1,000. Subsequent loans increase to a maximum of $3,000, based on a collateral guarantee. ACCION is very flexible on collateral: it might be furniture, or a freezer, or inventory.

- ***Initial Loans of $3,000***
  Borrowers who can present both collateral and a qualified co-signer may take out an initial loan of $3,000, increasing to $25,000 or more with successful repayment.

- ***Initial Loans of $10,000***
  The Fund's newest product allows first-time applicants to borrow $10,000. The borrower must have been in business for four years, have financial statements, collateral, and a co-signer.

San Antonio Partnerships

San Antonio's strong, active banking community has been involved and supportive from the program's earliest days. Al Martinez-Fonts, Jr., president of Texas Commerce Bank, became the first president of ACCION's board of directors. His bank helped to raise startup money, hosting luncheons for other local bankers to enlist their support. Texas Commerce also provided temporary office space to house the program initially. Regulators cited the bank's support of ACCION in awarding an "Outstanding" rating on its most recent CRA exam. (Texas Commerce also has made a $200,000 equity investment in the San Antonio Business Development Fund, a multi-bank community development corporation.)

As ACCION continues to build a track record in San Antonio, bank partners have become more committed to the organization. One bank that turned the organization down two years ago has now offered operating funds and a line of credit. Today ACCION Texas enjoys financial support from eight local banks, including interest-free lines of credit from five of them. In all, current lines of credit total $475,000, of which $225,000 is interest-free. Other support includes a program-related investment of $100,000 from the Meadows Foundation and a $150,000 loan from Partners for the Common Good Loan Fund 2000, a consortium of religious congregations. Wells Fargo Bank made an in-kind donation of office space, utilities and furniture and is now the organization's permanent home. ACCION Texas's marketing materials and publicity identify all participating institutions, a strategy that pays excellent public relations benefits even in communities where banks may not have branches.

Two bankers, along with two ACCION employees, review loans over $8,000, and four banks are represented on the 16-member board. Banks refer customers and participate actively in fundraising and outreach. ACCION Texas raised $500,000 equity from the local community for its loan portfolio through a capital campaign. The program also received a $500,000 matching capital grant from the Federal CDFI Fund

ACCION New Mexico

ACCION NM also has benefited considerably from local banking community support. The organization was formed as the result of a feasibility study by ACCION International in response to a proposal by

Albuquerque Economic Development (AED), a nonprofit organization. The feasibility study surveyed more than 200 entrepreneurs and interviewed more than 40 community organizations and institutions. Following the study, ACCION International organized a steering committee of bankers and other local business leaders which ultimately became ACCION NM's board of directors.

The first two banks to take a risk were First State Bank and United New Mexico Bank (now Norwest). Each provided a $100,000 line of credit, on which ACCION NM pays interest. Initially, First State also made a $5,000 contribution, and United an in-kind donation of rental space and office furniture. Since then, both banks have increased their operating support. The lines of credit are governed by formal contracts, whereby ACCION NM agrees to establish and maintain a 15 percent loan loss reserve fund raised from outside sources. ACCION NM provides the banks with financial statements. Both banks are represented on ACCION NM's board of directors.

To minimize banking risk and to promote partnerships with local lending institutions, ACCION International established the U.S. Bridge Fund, which provides a stand-by letter of credit guarantee issued by Citibank. The letter of credit provides a 50 percent guarantee to local banks lending to ACCION NM. The Bridge Fund is capitalized with loans and investments from individuals, foundations, mutual funds, and other banks. ACCION NM pays a commission to the Bridge Fund for use of the guarantee.

First State Bank has assisted ACCION NM in training its loan officers and provides guidance in collections, hiring, and recruiting. In cooperation with ACCION NM, First State Bank established a system enabling ACCION NM clients to make their payments at bank branches. The bank receives client payments and faxes ACCION NM a daily list of client payments received.

"First State and Norwest did not simply make an investment in us, they became partners," says Anne Haines Yatskovitz, ACCION NM's executive director. "Not only did they come on board before we had a track record, but they've been invaluable sources of moral support."

"Initially we saw the relationship as a one-way street," recalls Pat Dee, First State's executive vice president, who sits on ACCION's board. "But ACCION's clients come into our lobby to make loan payments, and we like having more people in our lobby. Some clients have become bankable, and we and other banks have taken on those customers. Of course, the regulators like our work with ACCION, too. This is an easy way to have a significant impact on a community. And that, ultimately, is good for the bank."
Loans start as small as $200; the average is $1,000. ACCION NM serves a diverse client base, with loans in retail, services, wholesale and manufacturing. To qualify, a business must have a three- to six-month history of generating sales and be located within 20 miles of Albuquerque. About two-thirds of borrowers are minority: approximately 41 percent are Hispanic, 39 percent white, 7 percent Native American, 9 percent African-American, and about 49 percent women. ACCION NM now has made more than 500 loans, and its staff has grown from one to five. A preliminary analysis of program impact shows that clients who complete two loan cycles increase their average take-home income by more than 87 percent, and their household income by more than 20 percent.

Borrowers have organized themselves into a small-business network that meets monthly to hear speakers ranging from advertising specialists to accountants, insurance providers, and the mayor of Albuquerque. They promote the program through house parties and speaking engagements throughout the city. ACCION NM was a founding partner of a Business Resource Center, a one-stop capital and technical assistance shop, and will soon be starting a mentoring program.

As ACCION NM has built credibility, more and more banks are getting involved, not only by providing lines of credit, but also by helping to guide the organization. Bankers have been instrumental in helping ACCION NM to formulate long-term goals.

Challenges

Managing growth is a continuing issue. ACCION Texas plans to increase active clients to more than 300 by the end of 1997. It projects to have more than 800 active clients and an outstanding portfolio of approximately $3 million by the year 2000. In the short term, ACCION Texas depends on donations to cover most of its operating costs, although in its first full year it was able to cover 29 percent of total expenses with income from interest and fee revenue (rising to 40 percent in 1996). Similarly, while ACCION NM's long-term goal is self sufficiency, operating support is currently coming from foundations, corporations, banks, small and medium-sized businesses, and individuals.

For the New Mexico program as well as most microenterprise loan programs, another major financial challenge is how to raise equity. To grow stronger and larger institutions, ACCION groups must attract equity or grant investments in their portfolios in addition to loan capital. ACCION hopes to attract increased public- as well as private-sector support to meet this challenge. ACCION Texas provides an example of a successful equity raising campaign. In both Texas and New Mexico, strong boards of directors and good banking relationships have been and will continue to be instrumental in ACCION's success.

Appendix: Resources

Ms. Ann Yatskovitz

ACCION New Mexico
219 Central Ave., NW, Suite 620
Albuquerque, NM 87102
(505) 243-8844 Fax (505) 243-1551

Ms. Janie Barrera
ACCION Texas
109 N. Sansaba
San Antonio, TX 78207
(210) 226-3664 Fax (210) 226-2258

Ms. Ellen Golden
Coastal Enterprises
P.O. Box 268, Middle Street
Wiscasset, ME 04578
(207) 882-7552 Fax (207) 882-7308

Mr. Kelly Schermerhorn
Community Trust Federal Credit Union
P.O. Box 1023
Apopka, FL 32704
(407) 880-4300 Fax (407) 880-4384

Mr. Nat Henshaw
CEI Ventures
2 Portland Fish Pier, Suite 302
Portland, ME 04101
(207) 772-5356 Fax (207) 772-5503

Mr. Mike Diemer
Cooperative Business Assistance Corporation
800 Hudson Square, Suite 325
Camden, NJ 08102
(609) 966-8181 Fax (609) 966-0036

Mr. Donald Hinkle, Jr.
Delaware Valley Community Reinvestment Fund
924 Cherry Street
Philadelphia, PA 19107-2405
(215) 925-1130 Fax (215) 923-4764

Ms. Adina Abramowitz
National Association of Community Development Loan Funds
924 Cherry Street, 3rd Floor
Philadelphia, PA 19107-2411
(215) 923-5363 Fax (215) 923-4755

Low Income Housing Fund

74 New Montgomery Street, 2nd Floor
San Francisco, CA 94105
(415) 777-9804   Fax (415) 777-9195

Other Resources on CDFIs and Bank Partnerships

Association for Enterprise Opportunity
70 E. Lake Street, Suite 620
Chicago, IL 60601
(312) 357-0177   Fax (312) 357-0180

CDFI Coalition
924 Cherry Street, 2nd Floor
Philadelphia, PA 19107
(215) 923-5363   Fax (215) 923-4755

CDFI Fund
U.S. Department of the Treasury
1500 Pennsylvania Ave., NW
Washington, DC 20220
(202) 622-8662   Fax (202) 622-7754

National Association of Community Development Loan Funds
924 Cherry Street, 2nd Floor
Philadelphia, PA 19107
(215) 923-5363   Fax (215) 923-4755

National Federation of Community Development Credit Unions
120 Wall Street, 10th Floor
New York, NY 10005-3902
(212) 809-1850   Fax (212) 809-3274

Woodstock Institute
407 S. Dearborn Street, Suite 550
Chicago, IL 60605
(312) 427-8070   Fax (312) 427-4007