INCREASING LENDING IN YOUR COMMUNITY:

THE CONCENTRIC CIRCLES OF MARKET PARTICIPATION FOR BANKS AND SAVINGS AND LOAN ASSOCIATIONS

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BY

DONALD KELLY

AND

ELSPETH REVERE

WOODSTOCK INSTITUTE 53 WEST JACKSON, CHICAGO, IL 60604 (312) 427-8070

The Woodstock Institute

The Woodstock Institute is a not-for-profit organization based in Chicago. For the past thirteen years, the Institute has carried out applied research and developed and implemented programs which increase private sector investment in modest-income and minority communities for the benefit of those who live there. It designs programs which bridge the gap between the needs of communities and the resources of banks, savings and loan associations, foundations and others.

The Institute provides a variety of services to community-based organizations, financial institutions, foundations and government agencies, including applied research, policy analysis, program design and evaluation.

Elspeth Revere President	Jean Pogge Executive Vice-President

INTRODUCTION

Many commercial banks and savings and loan associations have difficulty identifying a niche for "community lending" within their normal course of business. When criticized by neighborhood organizations or regulators for not meeting community credit needs, bank management often feels that it is being pressured to make bad loans. On the other hand, community groups often have difficulty differentiating between social needs and bankable deals.

There are many reasons why a financial institution decides that it is desirable to stretch itself to meet more of the community's credit needs. It may wish to increase its business, to obtain regulator approval to expand, to abate activist pressure, to improve its image in the community for business purposes, or to assume a direct role in improving the neighborhood environment in order to protect its asset and customer bases. The challenge such a financial institution faces is how to upgrade its community lending activity and reputation while remaining within the parameters of sound business practices.

Woodstock Institute is a not-for-profit organization that specializes in policy analysis and program design in precisely this area. Its clients are typically financial institutions, local governments, and community organizations. A premise of the Woodstock Institute's approach is that the choice is not simply between sound business practices and charity. There are several intervening levels of community lending that can satisfy community credit needs without compromising the business interests and fiduciary responsibilities of the bank.

THE CONCENTRIC CIRCLES OF MARKET PARTICIPATION

The Concentric Circles model which is described in this paper has been developed as a planning tool for financial institutions wishing to address one or more of the following goals:

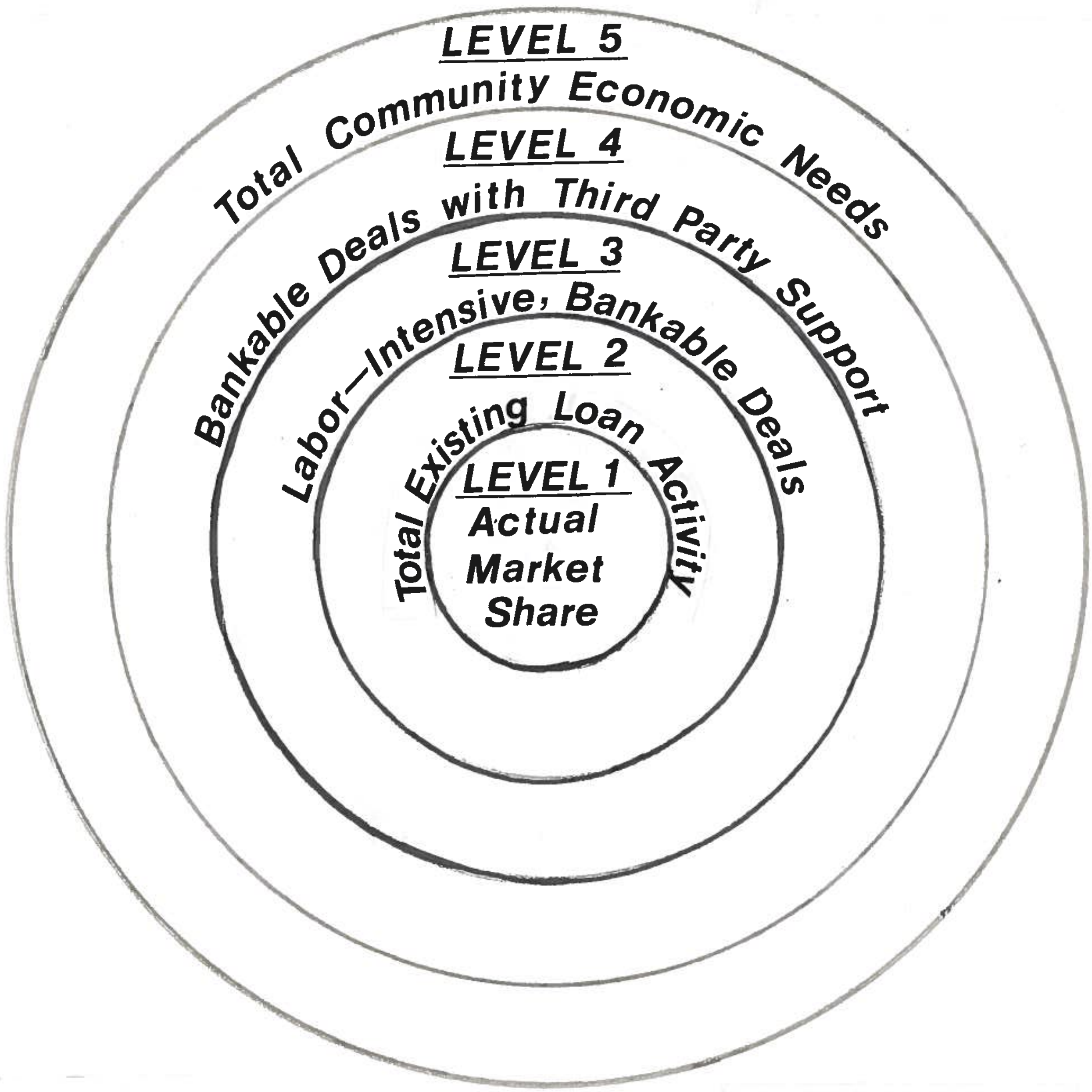
1. Increase lending in the institution's primary service area.

2. Improve Community Reinvestment Act (CRA) performance and rating.

3. Develop a strategy to address changes taking place in the neighborhood which constitutes the primary service area.

4. Develop greater rapport with local organizations.

The following diagram of Concentric Circles helps to visualize the different levels of serving community lending needs between actual market share and the total monetary needs of a community economy. (Note: this five-level system has been devised by Woodstock Institute and is not the same as the CRA rating system used by regulators.)



Level 1 — What is My Institution's Actual Market Share?

The first and smallest circle represents your institution's current actual lending. When compared to the next circle (level 2) it shows **your market share** of the total lending that is being carried out by all banks and savings and loan associations within your primary service area.

This circle is probably much smaller than you would expect when you compare it to Level 2. If you feel that there is little local demand for your services, Level 1 can be compared with Level 2 to find out whether other institutions have located demand that you have missed.

Level 2 — How Does My Institution Stack Up? The Circle of the Existing Loan Activity Being Served by All Lenders in the Target Area

This circle represents the bankable deals that are actually made by all financial institutions doing business in your community. These loans are sound, obvious and competitive. They go to the financial institution which has tailored the best product, developed the best marketing and advertising strategies, cultivated the best reputation, and is aggressive enough to beat the competition to the punch.

If other institutions are more active in your area than you are, it may in part be due to your marketing approach or the inappropriateness of your products to neighborhood needs.

Level 3 — Can the Market Be Expanded? The Circle of Labor-Intensive, Bankable Deals

A yet larger circle consists of bankable deals that are out there to be made but which have been passed over because of their labor intensiveness. This category refers primarily to sound loans that are too small to be normally considered worth the bank's while. Because larger deals have the advantage of economy of scale, they are preferred over small deals. This is a question of cost, not risk.

Also included in this market segment are other labor-intensive, albeit sound loans, such as real estate rehabilitation loans to not-for-profit developers, (which often are complicated by several sources of financing), financing of mixed-use properties with both apartments and commercial space, and non-traditional deals that fall between the cracks of standardized loan policies but which could be made were extra effort and creativity put into structuring them.

This type of loan is the one which is often the most needed in the community. It is the type of loan in which the bank's knowledge of the local businessmen and the neighborhood's housing needs can be called upon to reduce both cost and risk, it is the one which is most necessary in revitalizing communities, and it is the one in which the local institution can develop a market niche that outsiders are unlikely to challenge.

Level 4 — Forging New Partnerships: The Circle of Bankable Deals with Third Party Support

This circle represents that segment of the total economic needs for money that would be creditworthy were third party participants brought into the picture, providing insurance, subsidy, equity, or technical assistance. In this market zone fall marginally bankable deals that become feasible with credit enhancement mechanisms such as loan guarantees, interest rate subsidies, or equity participations. Examples include government mortgage bond loan programs, SBA commercial loans, and the FHA loan insurance programs.

Through use of some of these mechanisms, existing products can be tailored to the needs of the businesses and homebuyers in your community.

Level 5 — The Circle of Total Community Economic Needs

The large circle represents the universe of economic resources, both credit and direct assistance, that is needed by people, businesses and institutions within the service area of the bank. Included in this large circle is the entire spectrum, from bankable credit needs of creditworthy borrowers for housing and business loans to the needs of the very poor for income maintenance and the needs of charitable organizations which provide health, education and other services to the poor.

Many financial institutions participate in Level 5 through a charitable giving program. Most are frustrated by the small amounts that they are able to give compared to the extent of the need experienced by residents of their communities. While charitable giving is commendable and such programs should be continued, an effort by the bank to meet the community's needs through expanding its business in levels 2, 3 and 4 can have a much greater economic impact on the primary service area than philanthropy alone.

Within This Perspective Certain Statements are Evident:

1. Whatever the bank is currently doing, no matter how small or limited, it is serving a community need for credit. (Level 1)

2. The bank can increase its role in meeting the community's needs for credit while remaining totally within the traditional world of banking by simply being more aggressive and succeeding in achieving a larger share of the existing market. (Level 2)

3. The bank can serve an even greater portion of the social credit needs of the community **without incurring greater risk** or compromising the quality of its portfolio. It can do this by expending more time (and money) on bankable but labor-intensive deals. (Level 3)

4. The bank can attain a high level of corporate social responsibility without throwing money away by thoughtfully working with third parties, in order to make marginally bankable deals bankable. When done selectively and skillfully, this approach need not incur an unacceptably high level of risk nor an intolerable amount of extra work. (Level 4)

5. The Bank cannot be expected to penetrate the world of economic need beyond Level 4 as a lending institution with fiduciary responsibility. Level 5 activity is simply a form of charity and should be recognized as such. The Bank may wish to have a role in this part of community life but the role will be one of a contributor rather than one of a lender.

USING THE CONCENTRIC CIRCLES MODEL

Your institution may find it useful merely to review the concentric circles model and to think about it as a conceptual guide for organizational planning. However, the model may also be used as part of a rigorous process of planning which results in informed decision-making and a conscious strategy of increasing market participation. This process involves seven main steps:

1. Defining your primary service area. Generally, your primary service area is the neighborhood or group of neighborhoods listed in your CRA statement. It should include the census tracts or counties (in rural areas) immediately surrounding your office and the area from which many of your customers come. If possible, it should coincide with locally recognized boundaries.

2. <u>Analyzing lending in your primary service area.</u> A clear sense of "who is doing what" in your primary service area can begin to be determined by analyzing Home Mortgage Disclosure Act (HMDA) data for each census tract. This will provide information on any commercial bank or savings and loan association in your metropolitan area that has made housing loans in the census tract. While this data does not include housing lending activity of mortgage bankers or information on commercial lending, it can tell you which depository institutions are actively serving your area with housing loans.

3. <u>Analyzing your own lending.</u> This total picture can then be compared with your own housing lending. Your institution's HMDA report will contain that information.

4. <u>Assessing service needs in your primary service area.</u> To determine the credit needs of your own community, gather information on population size, makeup and income; housing type, age, condition and amount owner-occupied; and the number and types of businesses. Supplement this information with conversations with community

representatives including business owners, self-help and advocacy organizations, and charitable institutions. Ask them what types of financial services they (and their clients) need that are not available.

5. Assessing your current products, marketing and advertising. Review your current products to make sure that they are meeting most of the community's credit needs. Make sure that brochures, advertising and marketing efforts will reach neighborhood residents.

6. Developing a plan of action. Select one or more neighborhood credit needs that should be better met. Consider offering some new products and marketing/advertising old ones better. Be prepared to involve your bank in more labor-intensive lending.

   If third party support is necessary to reduce risk, identify the type and source and investigate the procedures necessary to participate. Spend the time to write down the plan of action with specific target achievements. Share the plan with management and those employees responsible for implementation.

7. Implement the plan and review your progress after an appropriate amount of time to make sure that it is working properly.

CONCLUSION

Community credit needs, market needs, market opportunity and good business often overlap to a greater extent than is recognized by most financial institutions. Whether the financial institution wishes to focus on retail commercial lending, industrial finance, real estate, or consumer credit, there is generally an opportunity to improve and expand its services to increase market share and better serve the needs of the neighborhood without sacrificing portfolio quality or overall profitability.

The Concentric Circle Model can provide a methodology for reviewing options and making choices which will increase lending, expand customer base, increase profitable business, and significantly contribute to the economic well-being of the community in which it is located and of which it is a part.

HOW THE WOODSTOCK INSTITUTE CAN HELP

The Woodstock Institute is available to provide consultation to financial institutions wishing to assess their community lending activity and to develop or improve their community lending strategies.

The Institute can prepare background reports containing relevant community statistics. It maintains multi-year housing lending data (HMDA) for all metropolitan areas throughout the country and can prepare information on lending activity in specific communities.

The Institute can review current products and marketing efforts, and develop more effective approaches for addressing community needs. It can evaluate the costs and benefits of various credit enhancement approaches and help match them with bank programs.

Finally, the Institute can help you to assess which strategies are most appropriate to your institution's goals, and can help you to define an effective and workable plan that meets the needs of your institution and your community.

Woodstock Institute, 53 W. Jackson, Chicago, IL 60604 (312) 427-8070