

# Profitwise

## News and Views

July 2011

Published by the Community  
Development and Policy Studies Division  
of the Federal Reserve Bank of Chicago

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## News and Views

*Profitwise News and Views* welcomes article proposals and comments from bankers, community organizations, and other readers. It is mailed (either electronically or via U.S. mail) at no charge to state member banks, financial holding companies, bank holding companies, government agencies, nonprofit organizations, academics, and community economic development professionals.

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# Profitwise

## News and Views

July 2011

The Chicago Fed has had a longstanding interest in the work of community development financial institutions (CDFI) and the evolution of the development finance industry. In this edition of *Profitwise News and Views*, we provide overviews of two conferences that addressed ways the industry is changing, organizing, and increasing its impact. In Milwaukee, CDFIs from across Wisconsin met in December to consider forming a statewide association, and to hear ideas about shared resources and collaboration from both researchers and practitioners. In Chicago, staff from the Reserve Bank and Board of Governors worked with the Opportunity Finance Network (OFN) to stage a small business finance conference one day prior to OFN's annual Midwest regional meeting, which was also held at the Reserve Bank. Principal topics included aspects of the Small Business Jobs Act passed in fall 2010 and key changes to SBA programs designed to facilitate increased lending to small businesses in redeveloping communities.

# CDFIs and Banks: Addressing the Financing Needs of Small Businesses

by Jeremiah P. Boyle

The Federal Reserve Bank of Chicago's Community Development and Policy Studies division recently joined the Opportunity Finance Network (OFN), National Community Investment Fund (NCIF), and Federal Reserve Board of Governors to host the CDFI and Bank Small Business Finance Conference in Chicago.

The purpose of the conference was to explore the evolution of mission-driven lending and community-level banking to promote greater access to credit for small businesses. The passage of the Small Business Jobs Act in the fall of 2010, and recent changes to programs at the U.S. Small Business Administration (SBA) provided the backdrop for discussing how banks and CDFIs can help increase lending to small businesses in underserved communities.

Dan Sullivan, executive vice president and research director at the Chicago Fed, opened the conference, pointing out that there are 94 certified Community Development Financial Institutions (CDFIs)<sup>1</sup> in the Seventh Federal Reserve District. "The Chicago Fed has studied and supported the work of the U.S. Treasury Department's Community Development Financial Institution Fund since it began 15 years ago," Sullivan explained. "Such involvement with CDFIs supports the mission of our division of Community Development and Policy Studies, which is to assist banks with CRA and fair lending compliance, promote community development and broad access to financial services, and conduct research on consumer and community development issues that informs policymakers, advocates, and the banking industry."

"Small businesses need to play an important role in the economic recovery, but they must have access to credit to do so. In part for this reason, the Federal Reserve has kept rates exceptionally low for an extended period," Sullivan said. "And during the height of the crisis, we

**For small businesses to grow and thrive in our communities, we will need to promote private sector lending and investment, a well-developed network of technical assistance providers, and innovative, hybrid organizations like micro-lenders and other types of CDFIs...**

also developed several innovative tools to facilitate the flow of credit to small businesses. For instance, the Term Asset-Backed Securities Loan Facility, or TALF, provided liquidity to the secondary markets for business loans."<sup>2</sup>

In 2010, the Federal Reserve hosted more than 40 meetings exploring small business credit supply and demand during the financial crisis.<sup>3</sup> The Fed's

Sullivan summarized one of the findings of those sessions saying, "The need for a more robust infrastructure of business development and support has never been greater. For small businesses to grow and thrive in our communities, we will need to promote private sector lending and investment, a well-developed network of technical assistance providers, and innovative, hybrid organizations like micro-lenders and other types of CDFIs that can effectively deliver funds and services to businesses."

## The CDFI-bank relationship

The first panel comprised four nonbank CDFIs – three loan funds and one investment fund – and focused on how CDFIs have partnered with large, regulated financial institutions and community banks in the past; how those relationships are holding up during the financial crisis and recession; and how those relationships need to evolve in the post-crisis environment.

Calvin Holmes, president of the Chicago Community Loan Fund (CCLF), served as the panel's moderator. CCLF is a \$30 million CDFI that provides credit and pre-development financing to small real estate developers. "There are enormous opportunities ahead for banks and CDFIs to collaborate, to expand, and to improve the capital delivery system to lower-wealth people and places that support the creation of small businesses and jobs, as well as other community development projects," he said.

Wisconsin Women's Business Initiative Corporation (WWBIC), a statewide

economic development corporation and certified CDFI, focuses on women and minorities, and low- and moderate-income individuals. Their products and services include business education, micro-loans, small business loans, and individual development accounts supported by the “Make Your Money Talk” financial education program.

Historically, WWBIC’s President Wendy Baumann explained, banks have participated in WWBIC’s classes, workshops, and business financing seminars, as well as serving on the organization’s board and loan committees. During the crisis, as banks diminished their lending to small businesses, WWBIC “took a whole bunch of what the banks were not doing, and we found those as really, really great credit risks. They might go back to the banks, or they might stick with us,” Baumann said, “but I think the banks are going to appreciate the CDFI, and that we were there for those bank customers.” Baumann also pointed to the important grants and equity investments that banks make to CDFIs to support general operations.

IFF is a \$190 million regional<sup>4</sup> CDFI that lends to all nonprofit sectors that serve low-income or special needs populations, including: child care, charter schools, health care, all of the traditional human services, and affordable housing. IFF’s CEO Joe Neri highlighted IFF’s Investor Consortium, a credit facility that he said is, “indicative of where we have been as a lender, and where we need to go in the CDFI industry, and in our relationships with banks.”

IFF makes long-term loans up to \$1.5 million that the Consortium packages into a collateralized note. The Consortium’s participating banks buy the notes, making long-term pledges that match IFF’s long-term notes. The Consortium’s 2 percent cash reserve and long-term, limited recourse notes allow IFF to continue to grow and meet the needs of its borrowers, an important element in the sustainability of the model.

An IFF note may include loans to child care and health care facilities, charter schools, or other human services, allowing participating banks to invest in a diversified stream of various kinds of nonprofit loans.

The Consortium is “an elegant vehicle” for both IFF and its partner banks, Neri said. “Banks get a diversified portfolio, and IFF gets match-funded capital that allows us to do capital planning, and it is a limited recourse vehicle. We all have capital ratios that have been stressed in the last couple of years because we’ve been meeting the credit crisis,” Neri pointed out.

National Community Investment Fund (NCIF) is a nonprofit private equity trust that invests in small community banks that work with low- and moderate-income communities. NCIF has more than \$150 million in assets under management, including \$27 million invested in 44 institutions nationally, and \$128 million in New Markets Tax Credits. NCIF has also created a free, Web-based tool for measuring the Social Performance Metrics<sup>5</sup> of community development banks.

NCIF’s CEO Saurabh Narain pointed out that 20 banks became certified as CDFIs during 2010, perhaps motivated by the CDFI Fund’s Community Development Capital Initiative (CDCI), “one of the largest infusions of capital by the federal government to these banks.”<sup>6</sup> Nonetheless, only 86 of the 7,800 financial institutions in the country are designated as CDFIs. “We’d like to believe that there are many other institutions doing great work,” he said.

Narain noted capital and liquidity issues that community development banks are facing as they emerge from the crisis. As capital ratios decline, regulated financial institutions are forced to increase capital or reduce the balance sheet by reducing lending. The flight of deposits from some banks has created a liquidity issue in some instances, although CDFI banks have

done reasonably well maintaining their deposit bases. “But as we think about the future,” Narain said, “we’ll need more stable sources of deposits, more liquidity available apart from capital, so that these institutions can continue doing great work.”

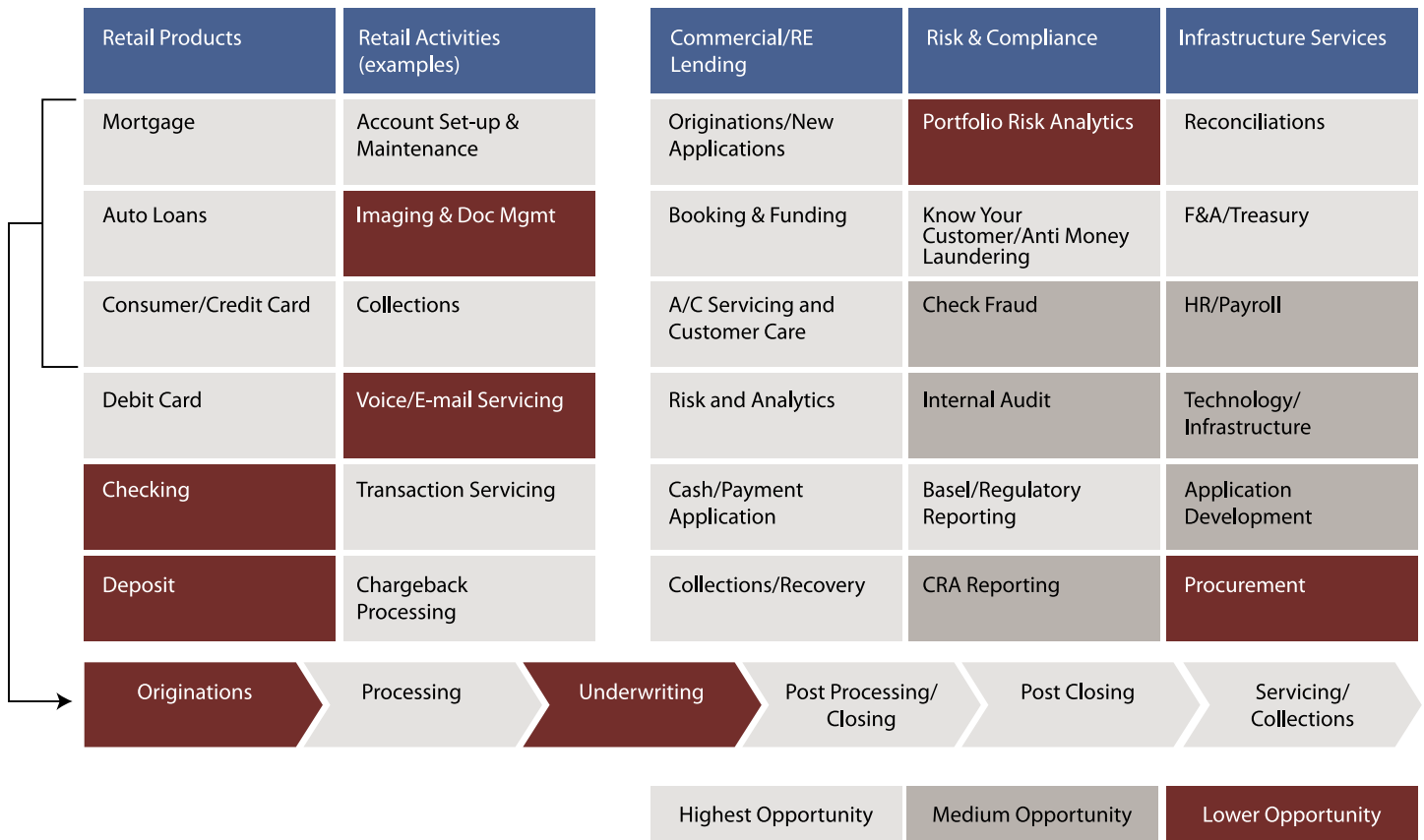
As the panel’s discussion segued to looking to the future of the bank-CDFI relationships, Narain raised a concern about what he called “regulatory arbitrage.” CDFIs have been focused on ensuring a continuing flow of credit to their communities and customers. All of the panelists noted that, as the financial crisis peaked, CDFIs saw a significant increase in both the volume and quality of their lending. “And then it stopped,” Narain said, “primarily because of this capital issue.”

He went on to talk about the two ways to address capital issues. One is to raise capital from the capital markets. While it is an equity investor, NCIF did not make a single capital investment in a bank during 2010, in part because, “I don’t want to risk putting money into an institution that may be shut down the next day.”

The second way to address the capital issues is to reduce the institution’s asset size. “We should avoid a situation where banks and other CDFIs are forced to sell those loans at a significant discount. I’d like to save that value, because that value will come back into CDFIs.”

As a potential solution to preserve the future value of assets that need to be removed from a bank’s balance sheet, Narain offered the following example. One of the banks in the NCIF portfolio, which had been taken over by a private equity investor, transferred all of its “bad loans” into a distressed loan pool out of the bank and into the holding company, improving its standing with the FDIC. In similar scenarios, Narain continued, it might be the role of CDFIs’ large bank partners to help create the structures wherein those distressed asset pools

**Figure 1: Potential for common organizational infrastructure**



**Source:** National Community Investment Fund.

could be retained under a separate equity structure, providing the expertise to help regain the value embedded in those assets. “I want to make sure that equity is the most important thing in the future,” he emphasized.

Narain also asserted that the industry is “entering into an era of strategic collaboration now.” Pointing to the matrix in Figure 1, he suggested that community development banks and CDFIs might benefit from collaborating on a “shared service platform.” “Not every institution needs to have mortgage processing, check cashing, and compliance systems. Could we consider creating a shared back office for the CDFI banking sector in collaboration with the larger banks?” Narain asked. Such back office support would help CDFIs do more loans in local communities and create jobs.

Addressing the future of bank/CDFI relationships, IFF’s Neri emphasized

CDFIs’ intermediary function with their partner banks in nontraditional credit markets. Both IFF and WWBIC reported the surge of higher quality credit applicants that they were seeing at the height of the crisis – a group of borrowers that had moved from the traditional to the nontraditional credit markets. CDFIs stepped in to provide credit to these borrowers, leaving some constrained in their ongoing lending by limited access to capital.

“If you look at our balance sheets, we’ve used a lot of our capital and assets solving the problems of the last two years and meeting the needs of those very good customers.” Emphasizing the flexibility and sustainability of the Investor Consortium, Neri stated that IFF intended to seek additional investors to expand that model as a regional tool to meet capital needs across its five-state market.

Another interesting development, Neri observed, is that some of the largest financial institutions have been working with CDFIs for an extended period. Those large institutions understand CDFI balance sheets, and what has happened in the last two years. He noted specific initiatives recently announced by Goldman Sachs, JPMorgan Chase, and Bank of America. Those institutions were combining their recent investments with grants specifically designed to address CDFIs’ capital issues, and increasing CDFIs’ net assets to facilitate more lending volume.

“So these are two trends that I think will impact our future discussions on CDFIs and banks,” Neri concluded. “One is more flexibility around limited recourse, or off-balance sheet vehicles for capital to flow through CDFIs to access our expertise; the other is out-and-out grants of capital, so that we can accommodate further lending.”

**Figure 2: At a glance: the Small Business Lending Fund (SBLF) for community banks**

<b>Overview</b>	Through the Small Business Lending Fund, the U.S. Department of the Treasury provides Tier 1 capital to community banks and other eligible institutions. Each institution pays dividends at rates that go down as its small business lending goes up.		
<b>Eligibility</b>	<ul style="list-style-type: none"> <li>- Insured depository institutions with assets of less than \$10 billion, not controlled by a holding company or an entity with assets of \$10 billion or more (as of the end of the fourth quarter of calendar year 2009)</li> <li>- Bank and savings and loan holding companies with consolidated assets of less than \$10 billion</li> <li>- Treasury will publish separate terms for mutual institutions, Subchapter S corporations, and community development loan funds; this guidebook does not apply to these institutions</li> </ul> <p>Institutions currently or recently on the FDIC problem bank list (or similar list) are ineligible.</p>		
<b>Amount of Funding</b>	Senior perpetual noncumulative preferred stock (or equivalents) qualifying as Tier 1 capital		
	Depository institutions:	<ul style="list-style-type: none"> <li>- Up to 5% of risk-weighted assets (RWA), if assets are \$1 billion or less</li> <li>- Up to 3% of RWA, if assets are more than \$1 billion, but less than \$10 billion</li> </ul>	
	Holding companies:	<ul style="list-style-type: none"> <li>- Up to 5% of RWA, if consolidated assets of all depository institution subsidiaries are \$1 billion or less</li> <li>- Up to 3% of RWA, if consolidated assets of all depository institution subsidiaries are more than \$1 billion, but less than \$10 billion</li> </ul>	
Treasury may require matching private capital and limit SBLF funding to 3% of RWA, even if assets are \$1 billion or less.			
<b>Qualified Small Business Lending</b>	Qualified Small Business Lending for purposes of the Small Business Lending Fund is defined as follows:		
	Qualified Small Business Lending includes all:	so long as:	
	<ol style="list-style-type: none"> <li>1. Commercial and industrial loans</li> <li>2. Loans secured by owner-occupied nonfarm, nonresidential real estate</li> <li>3. Loans to finance agricultural production and other loans to farmers</li> <li>4. Loans secured by farmland</li> </ol>	<ul style="list-style-type: none"> <li>- the original principal and commitment amount is \$10 million or less</li> <li>- the loan is not to a business with more than \$50 million in revenues and excluding loan portions guaranteed by the U.S. government or for which a third party assumes risk.</li> </ul>	
An institution that receives capital from the Small Business Lending Fund will supplement its Call Report with a supplemental report that identifies Qualified Small Business Lending.			
<b>Dividend Rates</b>	Dividend rates upon funding and for the following nine calendar quarters, adjusted quarterly (based on outstanding loans at the end of the second previous quarter):	<b>Lending Increase</b>	<b>Dividend Rate</b>
		Less than 2.5%	5%
		2.5% or more, but less than 5%	4%
		5% or more, but less than 7.5%	3%
		7.5% or more, but less than 10%	2%
	10% or more	1%	
Dividend rate for the tenth quarter after funding through the end of the first four and one-half years:	If lending has increased at the end of the eighth quarter after funding	Rate set as above for the tenth quarter	
	If lending has not increased at the end of the eighth quarter after funding	7%	
Dividend rate after four and one-half years (if funding has not already been repaid):	9%		
<b>Entry and Exit</b>	<ul style="list-style-type: none"> <li>- The application deadline for C Corporation banks is May 16, 2011. Treasury encourages eligible institutions to submit their application as soon as possible to allow sufficient time for processing.</li> <li>- Provide a small business lending plan, approximately two pages in length, to the institution's regulator (not directly to Treasury).</li> </ul>		
	Repay SBLF funding at any time with regulatory approval.		
<b>More Info</b>	For general inquiries and questions, please call the Small Business Lending Fund information line at (888) 832-1147. For communications pertaining to a specific institution, please e-mail <a href="mailto:SBLFInstitutions@treasury.gov">SBLFInstitutions@treasury.gov</a> , a Treasury e-mail address.		

**Source:** Small Business Lending Fund: Getting Started Guide for Community Banks. Available at [www.treasury.gov/resource-center/sb-programs/Pages/Small-Business-Lending-Fund.aspx](http://www.treasury.gov/resource-center/sb-programs/Pages/Small-Business-Lending-Fund.aspx).

WWBIC's Wendy Baumann related stories of two restaurants in Milwaukee. Both had existing loans called, despite profitable operations and a spotless record of repayment. Each of the restaurants survived, thanks to WWBIC's intervention. Both restaurants had been clients of the same bank which, coincidentally, was also a significant investor and supporter of WWBIC's lending and technical

assistance programs. Her point is that a well-developed referral and communication system between the banks and the CDFIs can avert "panic searches" for credit, especially for clients with healthy businesses.

Summarizing the panel discussion, Chicago Community Loan Fund's Calvin Holmes emphasized that "CDFIs and banks are again rolling up their sleeves and designing products and programs

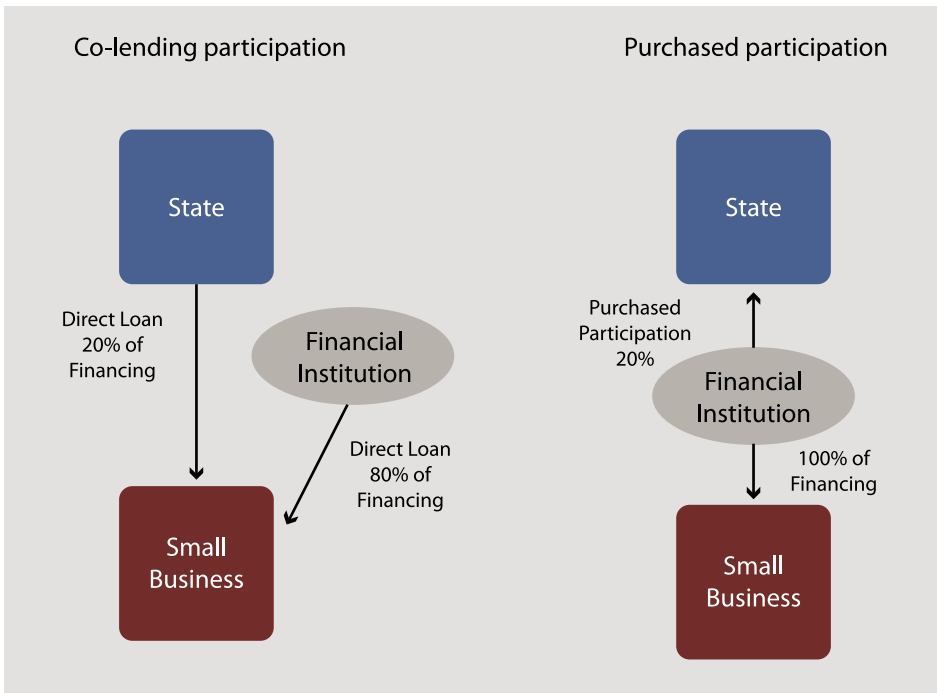
together to intentionally serve the full marketplace, including specific segments of the community."

### The Small Business Jobs Act and other federal small business programs

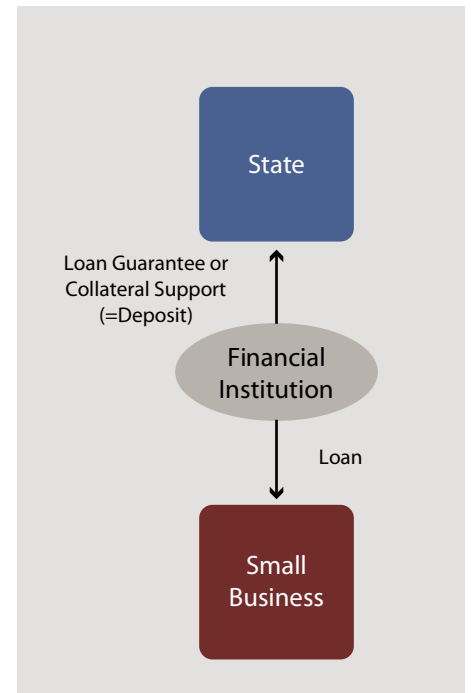
The next panel brought together representatives of the U.S Treasury Department and the Small Business

**Figure 3: Sample SSBCI program structures**

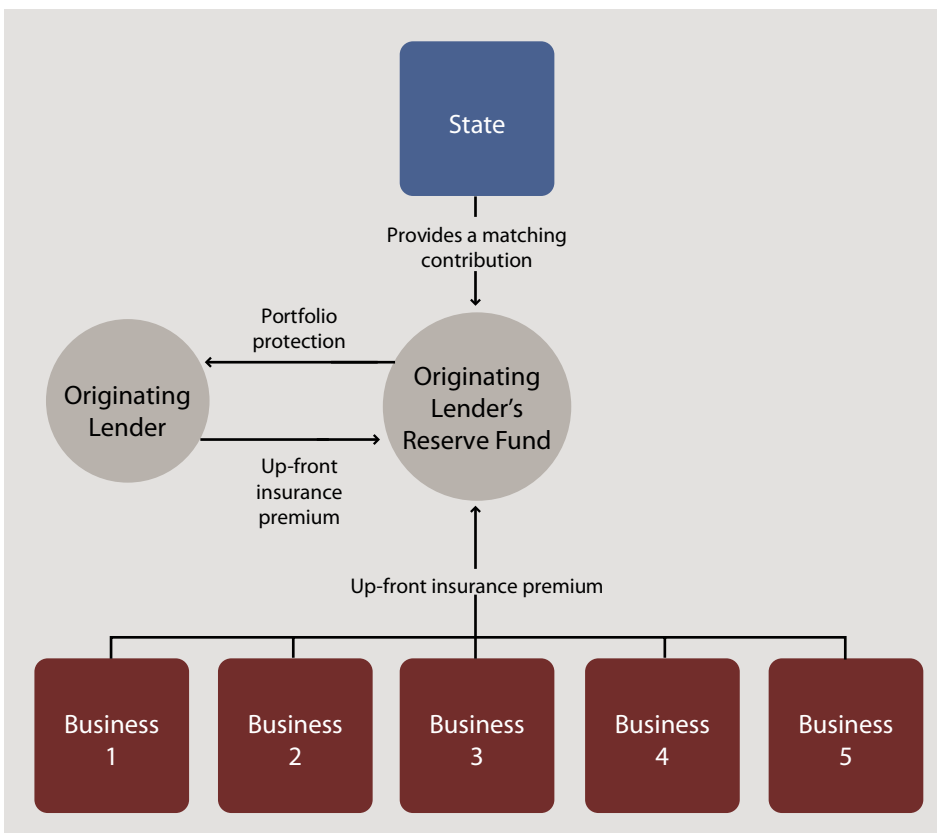
Loan participation programs (co-lending participation or purchased participation)



Other Credit Support Programs: Loan guarantee programs and collateral support programs



Other Credit Support Programs: Typical Capital Access Program (CAP) Structure



Source: U.S. Department of Treasury.

Administration (SBA) to address recently created programs and the evolution of existing programs at the federal level. The Small Business Jobs Act (Act), signed into law in September 2010, created the Small Business Lending Fund (SBLF) and the State Small Business Credit Initiative (SSBCI), and updated many of the SBA's small business lending programs. This panel covered each of the Act's elements in turn.

Jason Tepperman, director of the Treasury Department's \$30 billion Small Business Lending Fund, began: "We are all working as hard as we can to get small business lenders back to extending credit to creditworthy borrowers in a responsible way. The SBLF is an initiative designed exclusively for community banks and community development loan funds as part of the effort to help further this goal."

We know that small businesses are more dependent on local sources of credit, often from community banks and loan funds, than their larger counterparts who have access to capital markets. The



## Wisconsin's Capital Access Program

Wisconsin's CAP program, as implemented by the Milwaukee Economic Development Corporation, was presented as a case study.

Carol Maria works for Wisconsin Business Development Finance Corporation (WBD), a 30-year-old SBA 504 lender that originates about 150 SBA 504 loans, and assists borrowers with accessing about 100 SBA 7(a) loans each year. WBD has 320 members, of which 55 serve as advisors and 12 serve as board members. The organization's leadership "made it our mission to provide the knowledge and services and resources that help job creation and build communities," Maria said. Recently, WBD received its certification as a CDFI.

Maria spoke about the Milwaukee Economic Development Corporation's (MEDC) CAP program as "a unique tool" for WBD's member banks. She said, "It is a self-funded insurance program that is very easy to use." Under the program, participating banks sign a "participation agreement" that sets the "rules under which banks can participate in the loan-loss funding." Thereafter, the bank originates loans as it normally would and can enroll a borrower in the CAP program, using a one-page enrollment form, within 10 days of extending the loan. MEDC then matches the contribution made to the loan guarantee fund by the bank and the borrower.

A unique feature of the Wisconsin CAP program is that the CAP program administrator is allowed to fund the match at higher than a one-to-one match. "In our CAP program," Maria explained, "we'll match nonbank lenders at 1½-to-1 because those organizations' access to loan-loss capital is more constrained than that of a regulated financial institution."

MEDC's CAP program has supported 900 loans, with the CAP funds being leveraged at a rate of 38-to-1. About 90 percent of the CAP loans went to businesses employing 50 or fewer workers. The average loan size is \$50,000 and the charge-off rate is roughly 5 percent. There are currently 12 banks participating in the program, and MEDC intends to double the number of participating institutions in the calendar year.

A participating bank is required to hold the reserve (both the premium collected from the borrower and the CAP match) at their institution. If it's a nonbank lender, the CAP administrator designates a depository to hold the reserve.

SBLF will provide capital to community banks – defined as institutions with assets of \$10 billion or less. Institutions under \$1 billion in assets can receive up to 5 percent of their risk-weighted assets<sup>7</sup> from the fund. Banks between \$1 billion and \$10 billion of total assets can receive up to 3 percent of risk-weighted assets. Those banks receive all of the money from Treasury up front.

The dividend rate – the bank's cost of funds under the program – will start no

higher than 5 percent, and it may be lower. The more small business lending that a bank does, the lower the cost of the funds will be. The rate goes down as small business lending goes up. This gives banks a simple but compelling incentive to lend more.

The Treasury Department measures the bank's total increase in small business lending each quarter against the baseline. The baseline is defined as the average of the four quarters, ending

June 30, 2010. "What matters is the volume of loans outstanding, irrespective of whether that comes from new production or renewals. There is no quarterly growth level that is required as part of the program," noted Tepperman.

The SBLF enables community banks to access Tier 1 capital<sup>8</sup> at rates as low as 1 percent. For banks that increase their small business lending over the baseline levels by 10 percent, their cost of funding will be 1 percent. For increases less than 10 percent, banks can receive rates between 2 percent and 4 percent.

This rate is adjusted each quarter so that as a bank increases its lending, it can benefit from the lower rates. Two years after a bank enters the program, the rate is then locked in for the next two-and-a-half years based on the level of lending at the end of the second year. "That is because we want institutions to make their best effort to find creditworthy borrowers and extend credit to them in the near term, when local businesses need it most," Tepperman explained.

The SBLF defines small business lending to cover much of the business lending that community banks engage in, including commercial and industrial loans, owner-occupied commercial real estate loans, loans to finance agricultural production, and loans secured by farmland. "This is a different definition of small business lending than is used in call reports or for the purpose of calculating SBA loans," Tepperman emphasized. "Our hope is that with this capital and these incentives, the Small Business Lending Fund can help prime the pump for lending from Main Street banks to Main Street businesses."

Nonbank loan funds may also receive up to 5 percent of their assets in capital, and this will likely take the form of an equity-equivalent type investment, and will carry a flat rate of 2 percent that will continue for eight years before it increases to 9 percent. These

differences, both in incentive and duration, are intended to reflect the unique market conditions and circumstances that loan funds address. The Act also sets out minimum eligibility criteria that loan funds need to meet.

The SBLF is designed to enable community banks and loan funds to continue operating the way they do today while expanding their capacity to extend more credit to creditworthy small businesses.

The one-page application is available at [www.treasury.gov/sblf](http://www.treasury.gov/sblf). Banks must also submit a two-page small business lending plan to their regulators. Applying does not create an obligation to participate. After they receive approval from Treasury, institutions can decide whether they would like to participate. There are no prepayment penalties or fees or other conditions that require continued participation. Reporting

requirements take advantage of information that banks already report on their quarterly call reports to minimize the reporting obligations associated with the program.

Cliff Kellogg, director of the Treasury Department's State Small Business Credit Initiative, discussed the Small Business Credit Initiative, designed to fund state capital access and other credit support programs. Many states operate innovative programs to promote small business lending and investing, the types of programs threatened by state budget cuts during the crisis. SSBCI is designed to provide federal funds to states to support their small business lending programs. Both new and existing state programs could be eligible for the program.

In all, \$1.5 billion is available for all states and territories and the District of Columbia. The Act requires states to

demonstrate that for every dollar of federal funding, 10 dollars in new private sector lending is originated by all types of institutions that can participate in the state programs supported. A state's application for SSBCI funding must also explain outreach efforts to communities and populations with low penetration by the traditional financial sector.

There are two general categories of eligible state programs. The first are called Capital Access Programs (CAP); 20-25 states currently operate CAP programs. Other Credit Support Programs (OCSP) is the second category, encompassing an array of collateral enhancement and credit insurance programs (see figure 3).

"I think CAP programs are the most elegant programs for encouraging small business lending that is slightly higher risk than normal credit standards might tolerate," Kellogg said.

**Table 1: State Small Business Credit Initiative (Seventh Federal Reserve District states)**

State	Credit initiative allocation	Expected new lending (10:1 match)
Illinois	\$78,365,264	\$783,652,640
Indiana	\$34,339,074	\$343,390,740
Iowa	\$13,168,350	\$131,683,500
Michigan	\$79,157,742	\$791,577,420
Wisconsin	\$22,363,554	\$223,635,540
<b>Total</b>	<b>\$227,393,984</b>	<b>\$2,273,939,840</b>

Source: [www.treasury.gov/press-center/press-releases/Documents/document5tg896.pdf](http://www.treasury.gov/press-center/press-releases/Documents/document5tg896.pdf).

**Table 2: Fourth quarter SBA loan volume (national)**

	2009		2010		2011	
	Number	Dollar	Number	Dollar	Number	Dollar
7(a)	9,070	\$1,945,846,000	14,644	\$3,873,816,000	19,574	\$9,091,822,000
Average Loan Size		\$214,536		\$264,533		\$464,485
504	1,384	\$841,786,000	1,993	\$1,156,021,000	2,344	\$1,350,614,000
Average Loan Size		\$608,227		\$580,041		\$576,201

Source: U.S. Small Business Administration.

In a CAP program, the borrower pays a small insurance premium matched by a state contribution; the bank controls all of the loan decision-making, and that insurance premium goes into a reserve fund that is used to protect the bank from loss due to default for the entire portfolio of loans. "It is a very nice alignment of incentives in the sense that banks receive top-loss coverage for up to the amount of the cash in the reserve fund; but if losses are greater than that, then the bank must absorb them as they would in their conventional portfolio," Kellogg said.

The second category of programs eligible for SSBCI funding includes a variety of state programs that have differing requirements. The businesses may be larger than CAP participants, and there are special requirements for the state to prove that they have the capacity to supervise their programs effectively.

States must have applied by June 27, 2011. The amount of the award for each state is determined by a formula set forth in the statute, so it is not a competitive award. The amount for which each state is eligible is posted on the Treasury Department Web site. Once the application is received, it is reviewed quickly and funds are dispersed to the states as rapidly as possible. "The goal is to strengthen the state programs quickly and efficiently. Once the states are funded, then the action will shift to the lending community to make sure that banks and loan funds use the state programs to the fullest extent possible," Kellogg concluded.

Jim Hammersley, deputy assistant administrator for the Office of Policy and Strategic Planning for the U.S. Small Business Administration (SBA) presented an overview of "What's new at SBA?" Table 2 shows SBA's national loan volumes in the fourth quarter for each of the last three years.

The number of loans funded by the SBA's 7(a) program increased by 135 percent, and the 504<sup>9</sup> program increased

by 70 percent during the crisis. The dollar volume of 7(a) loans increased by 379 percent. A little less than half of all SBA loans (the insured portions) are sold to the secondary market and ultimately to investors. For a lot of lenders, the liquidity afforded by the existence of that secondary market is important. During the crisis, this market effectively ceased to function. "That gave us a scare," Hammersley said.

As a part of the Obama Administration's goal to double exports in five years, SBA has several initiatives in place or under development to help businesses export goods. There are about 250,000 small businesses that export, out of an estimated 29 million small businesses nationwide.

SBA programs that support exports include the 7(a) International Trade Loans and Export Working Capital Loans, offering a 90 percent guarantee for loans up to \$5 million. Export Express also offers a 90 percent guarantee and streamlined application process for loans up to \$350,000 and a 75 percent guarantee for loans between \$350,000 and \$500,000. And finally, SBA provides \$90 million in grants for states to help small business exporters.

The SBA's 504 program is a commercial real estate-secured product in which there is a 50 percent first mortgage from a conventional lender, a 40 percent loan made by a certified development company, and 10 percent from the borrower. The secondary market for those first mortgages disappeared and, unlike the secondary market for the 7(a) loans,<sup>10</sup> it has not recovered. The American Recovery and Reinvestment Act (known as the stimulus bill) allowed the SBA to intervene in that secondary market to provide the necessary liquidity to support this kind of lending to small businesses.

SBA has done approximately \$100 million in pools. Under the 504 Secondary Market Program, the investor picks up 80 percent and that investor gets a full faith and credit and a timely payment guarantee from the SBA; the pool originator (typically a broker/dealer) is required to hold 5

percent "skin in the game;" and the lender holds 15 percent.

Congress also adopted an "alternative size standard" for defining small business. Now, to qualify for an SBA loan, the maximum net worth of the applicant cannot exceed \$15 million, and the average net income after taxes of the applicant cannot exceed \$5 million. That makes the size standard much simpler than in the past.

Hammersley also noted that SBA lending for new equipment seems to be responding to tax law changes. Specifically, the stimulus bill allowed 100 percent depreciation on equipment up to \$500,000 for 2011. SBA lending for equipment spiked up following enactment of that provision.

The Small Business Jobs Act enacted further changes to SBA programs. Historically, the SBA 504 loan program could not be used for refinancing, because the 504 program is supposed to be a job creation program, not strictly a real estate program. The Jobs Act authorized refinancing in the 504 program for two years. It is intended to prevent foreclosures and keep people working.

With this new authority to allow refinancing in the 504 program and the support for the secondary market, participating bank lenders can offer small businesses with commercial real estate related issues an opportunity for the bank to do a 504 first mortgage. If liquidity is an issue, the lender may be able to sell it. A local certified development company can make a 40 percent second mortgage at rates that are currently below 6 percent – historic lows. "Now is the time to be locking in these rates, it's a 20-year fixed rate; it's quite a deal," Hammersley said. "[Banks' clients] will be able to stay in their building and hopefully continue to live happily ever after."

The Small Loan Advantage Program recognizes that for smaller loans – loans up to \$250,000 – lenders don't necessarily always need a complete credit analysis. The Small Loan Advantage Program is available to banks participating in the SBA's

## Community Advantage Program

### Q&A with SBA's Jim Hammersley

"I would like to talk with you about Community Advantage," said Jim Hammersley, deputy assistant administrator at SBA. "Our impetus in developing this program was recognizing that CDFIs, CDCs, and other nonbank lenders in many cases have better access to groups that typically were not able to access the traditional banking channels," Hammersley explained. "One of our core missions is to help those folks get financing. I'm not saying the private banking community isn't doing their best to do that. This looks like an opportunity to reach those folks in a way that doesn't currently exist."

Questions and answers regarding the Community Advantage pilot program are summarized below.

**Mr. Hammersley:** I thought we could chat a little bit about whether you think this is a good fit for what you already do..."

**Attendee response:** We are already an SBA micro-lender, so we already have experience with the SBA and the types of regulations that come with being in that program. So I think it's a natural extension for us to be interested in finding out more. We are doing small loans, so if it's a very extensive process it might end up being more difficult than it's worth.

**Q:** Can CDFIs use CDFI [Fund] capital to make the loans? As we understand it, there's a general prohibition against pairing SBA capital with other programs. How is Community Advantage going to work with CDFI capital or micro-lending capital?

**Mr. Hammersley:** CDFIs may use CDFI capital to make SBA loans. We anticipate that they will be using some of these funds for the reserve accounts required under Community Advantage. The federal funds that may not be used in connection with SBA loans are SBA micro-loan proceeds and SBA Intermediary Lender Program (a new program in the jobs bill) funds.

**Q:** The program provides CDFIs a guarantee they otherwise are not able to obtain and it's also going to provide them that secondary market. So I think for the CDFI small business lenders, it's an exciting development. For micro-lenders it's more complicated. Then there's this whole CDC community that doesn't have capital available to them. Will there be a tool offered along with the license that makes capital acquisition for the CDC community easier?

**Mr. Hammersley:** That's an interesting point. In fact, this will not happen right away. But we have securitization regulations for the unguaranteed portions and, conceivably, someone could pool a whole bunch of CDC unguaranteed portions together and use that money to fund that and use the premiums off the guaranteed portion to fund the reserve.

**Q:** I do think that access to capital to fund these types of loans on the nonguaranteed portion may be somewhat difficult. Obviously, if you're going to sell them on the secondary market, you can recoup that and re-loan that out, but you have to have a bridge there.

Is there any way to streamline the application process? I worked for a bank for 13 years and we did a lot of 7(a) loans, so I'm familiar with the standard operating procedures. There are a lot of application regulations that you have to go through. Is it going to be the same process as what the banks are looking at?

**Mr. Hammersley:** It's going to be the same procedures. We did redo the basic procedures a couple of years ago and dropped it down substantially in size. Our E-Tran process is an electronic application that is available 24/7/365, and it's literally just a drop down menu, fill in the blank process. If you put an answer in that doesn't work, it won't let you go anywhere. We anticipate requiring use of E-Tran for Community Advantage.

CDFIs may have an advantage versus banks. A bank has to make a determination that you wouldn't make a loan on conventional terms. So the first step is usually that the applicant fills out your standard bank application. Then, if it turns out they need SBA, they start filling out the SBA paperwork, which, if they're using our basic application package, is a separate set of paperwork that asks the same questions.

In the Community Advantage Program, we're using a simplified package. The idea is that once you've got this information you don't need to get it again. You just take it off of that document and put it into E-Tran. So it's definitely intended to be a little bit easier than a standard 7(a) loan from a community bank, using all the standard processes.

**Q:** Do the CDFIs or mission lenders have to apply to be certified to do these loans?

**Mr. Hammersley:** Yes. Some of you are up to speed on doing 7(a) loans. Some of you probably have never done a 7(a) loan. While it is just a standard credit, you do have to comply with the statutory requirements of the program, including disclosures. It is a federal program and it carries all of the requirements that tend to come with them.

**Q:** In addition to the application, a lot of CDFIs and micro-lenders will have to get used to the authorization process. Maybe you want to describe that requirement.

**Mr. Hammersley:** A "Loan Authorization" includes a menu of authorization provisions that you pick from. For example, there's a paragraph that, if it's this type of interest rate, you pick this; if it's that type of interest rate, you pick that. It becomes the driving document. It has all of the requirements that you need to settle this loan properly. And if you follow the boilerplate documents and you follow the loan authorization, you're going to be in pretty good shape.

**Audience follow up:** So for CDFIs, that translates into you'll become more uniform in your closing documents. The authorization, to be shorter, requires more uniformity.

I think CDFIs have a tendency to pool loans in different classes. So that's one of the barriers I think that SBA has to recognize.

**Q:** What's the certification process for those who have not been approved as an SBA lender?

**Mr. Hammersley:** It's a series of questions that allow you to tell us your story in effect. I do small business loans. Here's the resume of our people. Our typical customer is "X." And our market area is "Y." Our servicing personnel include . . . things like that.

**Q:** Is there a requirement that CDFIs have a third-party credentialing entity?

**Mr. Hammersley:** No, you'll apply to us and we'll make a decision one way or the other. We'll be looking at the information and making a decision internally.

**Q:** Are there any ongoing reporting requirements related to the program?

**Mr. Hammersley:** The 7(a) Program has ongoing reporting requirements for anyone making 7(a) loans (not just CDFIs). You, as a lender, submit a monthly status report on your borrower(s). Ninety-six percent of what gets reported comes in electronically. What we look for every month is the interest paid to date and whether the borrower made a payment or not, how much was P&I, those types of things.

To find out more about the Community Advantage Program, visit the SBA Web site at <http://www.sba.gov/advantage>.

Preferred Lender Program. It allows streamlined loan approvals and carries the 7(a) program's 85 percent guarantee up to \$150,000, and 75 percent guarantee on loans up to \$250,000. It is intended to make smaller loans a little easier to originate and underwrite.

Finally, Community Advantage is SBA's newest program. Community Advantage allows nontraditional lenders – CDFIs, CDCs, and other lenders serving traditionally underserved markets – to originate loans eligible for the SBA 7(a) guarantee.

## Conclusion

The SBA's Community Advantage Program is one of several recent additions to the array of programs and resources that Community Development Financial Institutions (CDFIs) bring to their mission of providing access to credit in low- and moderate-income communities. The Small Business Lending Facility for Community Development Loan Funds was specifically designed to help nonbank loan funds in the same way that the Small Business Loan Fund was designed to help community banks. The CDFI Bond Program that was also authorized in the Small Business Jobs Act could help fund the ongoing programs and operations of mission-focused lenders. The missions of both banks and CDFIs converge around small business development and job creation. The consensus at the meeting is that the partnership between CDFIs and banks is quite valuable, with room to evolve into a much more robust driver of community stability and revitalization.

The Treasury Department, the Small Business Administration, and state programs will continue to promulgate rules and regulations to implement the programs discussed at this conference. The Federal Reserve, National Community Investment Fund, and Opportunity Finance Network will continue to help efficiently and effectively implement these programs. These entities will also continue to encourage and support efforts to leverage the unique strengths and capabilities of banks and CDFIs working in tandem to improve fair and equal access to credit in historically underserved communities.

## Notes

- 1 "A certified Community Development Financial Institution (CDFI) is a specialized financial institution that works in market niches that are underserved by traditional financial institutions. CDFIs provide a unique range of financial products and services in economically distressed target markets, such as mortgage financing for low-income and first-time home buyers and not-for-profit developers, flexible underwriting and risk capital for needed community facilities, and technical assistance, commercial loans, and investments to small, start-up, or expanding businesses in low-income areas. CDFIs include regulated institutions, such as community development banks and credit unions, and nonregulated institutions, such as loan and venture capital funds." Accessible at [http://www.cdfifund.gov/what\\_we\\_do/programs\\_id.asp?programID=9](http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=9).
- 2 For a discussion of the TALF Program, see Sumit Agarwal, Jacqueline Barrett, and Mariacristina De Nardi. 2011. "The Asset-Backed Securities Markets, The Crisis and TALF," in *Profitwise News and Views*, Community Development and Policy Studies division of the Federal Reserve Bank of Chicago. April 2011. Accessible at [http://chicagofed.org/webpages/publications/profitwise\\_news\\_and\\_views/2011/pnv\\_april2011.cfm](http://chicagofed.org/webpages/publications/profitwise_news_and_views/2011/pnv_april2011.cfm).
- 3 For a summary of those meetings, see Jeremiah Boyle. 2010. "Addressing the Financing Needs of Small Businesses in the Seventh Federal Reserve District" in *Profitwise News and Views*. Community Development and Policy Studies division of the Federal Reserve Bank of Chicago. December 2010. Accessible at [http://chicagofed.org/digital\\_assets/publications/profitwise\\_news\\_and\\_views/2010/PNV\\_Dec2010\\_ReEd\\_FINAL\\_web.pdf](http://chicagofed.org/digital_assets/publications/profitwise_news_and_views/2010/PNV_Dec2010_ReEd_FINAL_web.pdf).
- 4 IFF is an active lender in Illinois, Indiana, Iowa, Missouri, and Wisconsin.
- 5 For information about NCIF's Social Performance Metrics, visit <http://www.ncif.org/index.php/services/spm>.
- 6 For details about the CDFI Fund's Community Development Capital Initiative, visit the U.S. Treasury Department's Web site at [www.treasury.gov/initiatives/financial-stability/investment-programs/cdci/Pages/comdev.aspx](http://www.treasury.gov/initiatives/financial-stability/investment-programs/cdci/Pages/comdev.aspx).
- 7 "For the total and Tier 1 risk-based capital ratios, the capital components are compared to a risk-weighted assets base, thereby providing a closer link between a bank's capital needs and its risk profile. In computing this asset base, the capital standards assign bank assets and off balance sheet items to one of four general categories of credit risk, as determined by such risk factors as the type of obligor on each asset and the existence of any collateral or guarantees. Each category receives its own risk – weight 0, 20, 50, or 100 percent – and the greater weights are applied to those items generally thought to pose more risk to a bank. The dollar amount of items a bank has in each risk category is then multiplied by the appropriate risk weight, and the resulting figures are added across the categories to derive the bank's overall risk-weighted assets measure. As a result, higher risk assets will make a more prominent contribution to this risk-weighted base and, thus will require greater capital backing." Kenneth Spong. 2000. *Banking Regulation: Its Purposes, Implementation, and Effects*, Fifth Edition. (Federal Reserve Bank of Kansas City, Division of Supervision and Risk Management), pp. 88-90. Available at <http://kansascityfed.org/publicat/bankingregulation/RegsBook2000.pdf>.
- 8 "Tier 1 capital represents the most permanent form of capital and the highest quality of capital that is available to absorb losses. The components of Tier 1 capital consist of: common stockholders' equity; noncumulative perpetual preferred stock; and minority interests in the equity accounts of consolidated subsidiaries. Tier 1 capital thus represents the most stable and readily available form of capital for supporting a bank's operations." Kenneth Spong. 2000. *Banking Regulation: Its Purposes, Implementation, and Effects*, Fifth Edition. (Federal Reserve Bank of Kansas City, Division of Supervision and Risk Management), p. 87. Available at <http://kansascityfed.org/publicat/bankingregulation/RegsBook2000.pdf>.
- 9 The SBA 504 Program is "designed to encourage economic development within a community . . . by providing small businesses with long-term, fixed-rate financing to acquire major fixed assets for expansion or modernization." Details of how the SBA 504 loan product works can be found at <http://www.sba.gov/content/cdc504-loan-program>.
- 10 "The SBA guarantees that these loans will be repaid, thus eliminating some of the risk to the lending partners. So when a business applies for an SBA loan, it is actually applying for a commercial loan, structured according to SBA requirements with an SBA guaranty." For details about the 7(a) program and all the other SBA programs, visit the SBA's Web site at <http://www.sba.gov/content/what-sba-offers-help-small-businesses-grow>.

## Biography

**Jeremiah P. Boyle** is managing director of Economic Development for the Federal Reserve Bank of Chicago's Community Development and Policy Studies Division. Mr. Boyle has served as an advisor to the Milwaukee Urban Entrepreneur Partnership and as a member of the Governor's Advisory Council on Financial Literacy in Wisconsin. Before joining the Fed, Mr. Boyle served in Chicago Mayor Richard M. Daley's administration as an assistant commissioner of Planning and Development. He has served as economic development coordinator for the Village of Arlington Heights, Illinois; and held several positions with the North River Commission, a nonprofit housing and economic development group in Chicago.

Mr. Boyle holds a BA in political science and a master's degree in urban and regional planning from the University of Illinois at Urbana-Champaign, and an MBA from North Park University in Chicago.

# Community Development Financial Institutions: At the Crossroads in Wisconsin

by Steven Kuehl

Wisconsin has 21 community development financial institutions (CDFIs). Collectively, approximately \$1.5 billion has been allocated to these organizations since the inception of the CDFI Fund at the U.S. Treasury.<sup>1</sup> In addition, Wisconsin community development organizations have been awarded approximately \$1.3 billion in New Markets Tax Credits; 41 percent of this amount went to CDFIs.<sup>2</sup>

In December 2010, the Federal Reserve Bank of Chicago's Community Development and Policy Studies division and the Helen Bader Foundation convened a workshop that brought together Wisconsin's CDFIs. This occasion marked the first group meeting of CDFIs from across the state. During the day-long event, participants discussed issues of common concern and explored opportunities for the industry to move forward through collaborative efforts, and potentially form an association.

The workshop featured panel discussions on approaches to CDFI sustainability and on the benefits and drawbacks of CDFIs taking a unified approach to matters of mutual interest. The highlight of the workshop was the keynote address provided by Donna Fabiani of the Opportunity Finance Network (OFN). This article summarizes the presentations and proposals made by panelists, as well as Ms. Fabiani's remarks.

## Panel discussion: approaches to CDFI sustainability

Mike Berry, director of Policy Studies at the Federal Reserve Bank's Community Development and Policy Studies (CDPS) division, moderated the panel discussion, noting the Fed's long-term interest in the work of CDFIs and partnership with the other institutions represented on the panel, the Aspen Institute, and the National Community Investment Fund.

Robin Newberger, a senior business economist in CDPS and the first speaker, began by defining what is meant by CDFI "sustainability."<sup>3</sup> A series of research projects involving the Chicago Fed and the Aspen Institute have sought to address this question in different ways by: analyzing available data; conducting surveys; and interviewing organization (CDFI) principals to develop representative case studies. Findings from these efforts revealed nuanced approaches to CDFI sustainability, differing across organizations, but sharing, at their core, the successful balancing of mission, organizational capacity, and capitalization to achieve maximum sustainable impact. Among CDFIs studied, about 60 percent defined sustainability as 100 percent recovery of the organization's costs. Conversely, 30 percent of the CDFIs surveyed that cost recovery is not a goal, and rely on

varying forms of subsidy to meet mission goals. Those CDFIs that highly valued cost recovery pursued several strategies, including scaling up loan volume, increasing efficiencies, and striking strategic alliances and partnerships. They also introduced profitable products and services, and then cross-subsidized between those that were profitable and those that were not. For CDFIs not pursuing cost recovery, often the markets served are the most difficult to serve. Subsidy is not simply a means to balance revenue and expenses; the markets they serve often require training and technical assistance, and they experience greater underwriting and servicing costs than more developed (credit) markets. They also use grants and other subsidy to develop technology innovations, and to explore and open new markets. Newberger concluded that, for the majority of CDFIs, sustainability and subsidy are not opposites; subsidy is an integral part of sustainability, and organizations must manage both (well) to achieve mission goals and remain viable entities.

Kirsten Moy, from the Aspen Institute, discussed collaborative approaches to CDFI sustainability.<sup>4</sup> She noted that there are many advantages to CDFI collaboration, such as greater scale, more efficiency, lower costs, and benefits gained from forming strategic alliances; however, true collaboration

among diverse peers associated through a loose alliance is difficult to achieve. Collaborations take many forms: joint fund raising, group purchases, shared operational infrastructure, and management expertise, as well as shared training platforms. Collaborations can result in broader and deeper experience and knowledge, notably in policy expertise, which translates into the potential for more regulatory influence through shared advocacy, as well as, usually, greater local control of smaller organizations. Moy remarked that collaboration, aside from business motivations, often stems from necessity, enabling organizations to survive by changing fundamental business practices. Often, forming a collaborative results in turning an unsustainable organization in chronic stress into a new, vibrant organization ready to pursue more rewarding opportunities.

Moy noted the fragmented nature of the CDFI industry, which comprises mostly small, locally focused organizations. Consolidation in the mainstream financial industry underscores the contrast between

partnerships, the industry can create intermediaries and statewide platforms that make sense. An effective collaborative network would likely have a larger impact on regulation, policy, and more success in attracting capital.

Impact measurement is critical to furthering the mission of CDFIs, commented Saurabh Narain of the National Community Investment Fund (NCIF), an organization that promotes and facilitates the work of CDFI depository institutions (banks and credit unions). Narain noted that depository institutions must be self-sustaining, profitable, in fact, to meet regulatory requirements. Mission-focused depositories are not exceptions, even if there are benefits to be realized by collaboration at some levels. NCIF has developed a practical methodology that identifies depository institutions with a community development mission, even if they do not have the Treasury designation. NCIF's Social Performance Metrics tool uses publicly available data to measure the social impact of depository institutions. The tool measures the degree of lending and deposits attributable to low- and

to funders (e.g., government, foundations, angel networks) that their impact is demonstrably increasing. Narain stated that building the economic vitality of LMI areas depends on jobs. Institutions that lend in low-income communities to businesses and other potential employers need to collaborate in order to move beyond making relatively few isolated loans if the goal is sustainable (and self-sustaining) communities.

## Perspective from the Opportunity Finance Network

Donna Fabiani, executive vice president for Knowledge Sharing, provided the keynote address. The Opportunity Finance Network (OFN) is a CDFI membership organization that identifies and invests in opportunities that benefit low-income and low-wealth people in the United States. Its 180 CDFI (primarily loan funds) members represent a diverse set of organizations by type, size, markets served, and products offered. OFN's membership spans the country, serving urban, rural, and native communities often overlooked by traditional financial institutions. Only a small minority of members are banks, credit unions, or venture capital funds. OFN members have a range of asset sizes: 23 percent have assets below \$5 million, and about 50 percent have assets below \$15 million. The remainder of its membership has assets above \$15 million; several members have assets in the hundreds of millions of dollars. OFN serves its markets by offering all types of lending to all sectors served by CDFIs, such as business, housing, community facilities, and some consumer loans. OFN has a proven track record of success, with cumulative net charge-off rates of less than 1.6 percent for FY 2009.<sup>6</sup>

OFN currently provides a range of products and services to build the capacity and scale of the CDFI industry. OFN also developed its own rating system, known as the CDFI Assessment and Ratings System (CARS). CARS is a CDFI assessment and rating system, managed by OFN, that provides

## Often, forming a collaborative results in turning an unsustainable organization in chronic stress into a new, vibrant organization ready to pursue more rewarding opportunities.

mainstream and mission-focused financial institutions. Accordingly, collaboration holds real payoffs for CDFIs; small institutions working individually at the margins have greater difficulty attracting (large) bank partners, as well as public resources, and thereby risk diminishing their impact even further. Through collaboration and strategic

moderate-income (LMI) census tracts.<sup>5</sup> It provides a way to recognize institutions that impact LMI communities and thereby, in theory and practice, channel more funding and resources to them. Through collaboration and by providing high quality and accurate metrics, institutions that work in low- and moderate-income communities can show



an assessment of a CDFI's impact and financial performance. It helps potential investors to identify CDFIs that match their social objectives and risk parameters, making it easier for investors to underwrite CDFIs and likewise easier for CDFIs to attract investor capital. Further, Fabiani pointed out that the CARS evaluation process also helps CDFI management itself, by providing in-depth analysis of its own portfolio, operations, and management, and helping to identify the institution's strengths and weaknesses. Such a rigorous and thorough evaluation takes a penetrating look deep into a CDFI and provides incisive information that makes the organization stronger. Aside from supporting CDFIs in direct ways, OFN also conducts policy work focused on increasing funding for CDFIs and tries to increase the visibility and awareness of CDFIs in the media and through other avenues. It also collects data, conducts industry research, and annually publishes a survey on CDFI market conditions.

Fabiani discussed OFN's Strategic Plan for 2011–2026. She mentioned that planning for such a distant time horizon was difficult, but thought provoking and useful nonetheless. The plan was formulated through a year-long process and included input from hundreds of CDFIs (both members and nonmembers), funders, investors, researchers, policymakers, and others with industry insight and concern for its long-term health. The purpose of the plan is to set forth how OFN will lead the community development finance industry forward over the next 15 years. The plan focuses on broadening membership to include more regulated CDFIs, such as banks and credit unions, as well as more venture capital funds. The plan also emphasizes increasing the different types of lending that CDFIs underwrite, especially consumer credit. Fabiani remarked that larger financial institutions are deciding to downsize their consumer lending activities, citing expected increases in expenses associated with this type of lending.

The plan notes that this trend represents a growth opportunity for CDFIs, and OFN will assist them with expanding consumer lending to meet the needs in low-income communities.

The new plan also refined OFN's mission, which is to lead CDFIs and their partners to insure that low-income and low-wealth people and communities have access to affordable responsible financial products and services. The refined mission assumes a leadership role for OFN, but it also assumes a leadership role for CDFIs in their communities. Fabiani pointed out that the new mission also added the word "services." Consequently, OFN will seek to provide not only financing products, but services as well. The OFN strategic plan envisions the CDFI field expanding

**...collectively,  
CDFIs can  
accomplish more  
together than  
each can  
individually.**

to fill in the gaps left by more traditional lenders, and that by 2026, CDFIs will serve many more communities and much broader and deeper markets with a more complete set of products and services than they do today. Fabiani stated that OFN is committed to helping lead the way by assisting CDFIs to accomplish their own missions through fostering an operating environment that is truly helpful to broadening the impact of CDFIs within their communities.

### **Panel discussion: do we all play in the same sandbox?**

How different are Wisconsin's CDFIs from each other? Do they approach

funders, underwrite risk, share risk, obtain and service customers in completely different ways? Can Wisconsin's CDFIs learn things from one another and from other states? Are there any economies of scale to be found? Panelists discussed these questions as well as the benefits and drawbacks to taking a collective approach to issues of common concern facing CDFIs operating in Wisconsin.

Melanie Stern, of the National Federation of Community Development Credit Unions, serves as the coordinator for the New York Coalition of Community Development Financial Institutions (NYC-CDFI).<sup>7</sup> Ms. Stern discussed how the NYC-CDFI started, its successes, and gave some examples of failures and challenges faced along the way. She stated that the whole is bigger than the sum of its parts; i.e., collectively, CDFIs can accomplish more together than each can individually. She then discussed what the NYC-CDFI is currently doing and its plans for the next few years.

As an organization, the NYC-CDFI comprises community development banks, community development credit unions (CDCUs), nonprofit loan funds and venture capital loan funds. There are about 100 members, with about 45 being CDCUs; however, not all members are certified by the CDFI Fund (approximately 80 percent are certified). By assets, the venture capital funds are the smallest; the largest are the nonprofit loan funds. However, among the organizations represented in the federation, community development banks lend the most dollars, followed by nonprofit loan funds. The NYC-CDFI has managed to engage all of these types of organizations in the coalition primarily by coalescing around funding and particular kinds of issues.

In 1986, the idea of a New York Corporation for Community Banking was being developed, but the National Neighborhood Banking Corporation did

not come about until 1990. The group seeking to form the coalition comprised leaders from loan funds, CDCUs, micro-finance groups, venture capital funds and community banks. By 1994, this group had successfully pressed for the creation of a federal CDFI Fund, and only one year later they established the New York Coalition of CDFIs. Stern stated that because a core group of dedicated people came together to push the idea for a CDFI Fund at the federal level, it was much easier to overcome barriers to a state coalition in New York by building on the prior federal success.

Since 1995, the NYC-CDFI has engaged key partners and funders. The Empire State Development Corporation (ESDC), which is a quasi-governmental development agency, as well as the New York State Banking Department and New York State Credit Union League, have all partnered with NYC-CDFI. Recently, a new statewide microfinance organization has also participated in a number of activities. Most funding comes from banks and foundations.

A key to the success and viability of the NYC-CDFI was having a paid time staff person. Stern explained that serving as coalition coordinator was only a small portion of her job at the federation; nevertheless, she was not a volunteer. NYC-CDFI does have a volunteer steering committee, but paid staff allows the organization to address more issues and projects.

NYC-CDFI members see themselves as essentially united, despite differences on specific issues and sometimes competing for outside funding. Stern commented that competition for funds between members has been mitigated by trying to expand the pool of available funds. The first big victory was the 1995 creation of a pool of funds administered exclusively by CDFIs that was a grant program for women and minority-owned businesses. Despite turbulent budget times since its creation, the fund has doubled in size

from approximately \$1.5 million to \$3 million. Currently, this is the biggest pool of funds ever made available and its recent growth is largely due to the 2009 addition of stimulus funds. Stern also mentioned that a state revolving loan fund attracts federal dollars, and thereby provides a mechanism for distribution to CDFIs on a large scale.

Stern stated that the NYC-CDFI has become the “Go-to Group for all things CDFI in New York State.” NYC-CDFI has built a reputation that allows it to be the preeminent organization for issues surrounding CDFIs and economic development. Stern is constantly getting calls from organizations, the press, and government, asking for her opinion or advice on issues such as the design of products or services, underwriting guidelines, or drafts of legislation affecting the industry. NYC-CDFI also conducts consumer advocacy work, such as galvanizing coalition members to oppose bills it deems are not consumer-friendly. Further, it conducts its own impact data survey, publishes a quarterly newsletter, conducts training, and hosts an annual conference to coalesce around issues of common concern. Building such a respected reputation enables NYC-CDFI to exert influence and to help shape important factors that affect the outcome of the industry.

Since 1995, the NYC-CDFI has pushed hard for the creation of a New York State CDFI fund separate and distinct from the federal CDFI fund. It was an enormous task that took more than ten years; but in 2007, through the coalition’s advocacy, the New York State legislature passed and the Governor signed a bill creating a New York State CDFI Fund. However, the bill carried no appropriation. Notwithstanding the lack of money, Stern considers the creation of a state fund a big legislative victory, as it provides a mechanism for funders to know with certainty how those funds will be disbursed and targeted. The state fund will be housed at ESDC.

Historically, ESDC has been a small business lender; having a new pool of CDFI-targeted funds to address needs, such as affordable housing, creates new opportunities. Stern believes that NYC-CDFI’s drafted report, which underscored to the legislature the impact that CDFIs have on job creation, is what led directly to its passage.

Karl Pnazek, from CAP Services, stated that Wisconsin’s CDFI community would benefit greatly from educating the rest of the state’s financial community about the fundamentals of community development financial institutions and the role they play in the state.<sup>8</sup> He noted that many bankers, businesses, funders, local governments, and legislatures simply are not familiar with CDFIs; consequently, CAP Services spends much time educating about CDFI basics, particularly to lenders who often mistakenly view CDFIs as potential competitors. Pnazek has found that despite much awareness of the mission and impact of many CDFIs throughout the state, there is a failure to recognize that these same organizations are actually CDFIs. Lacking such knowledge, Wisconsin’s financial and legislative communities do not yet understand that CDFIs are efficient entities for leveraging private capital and for using (New Markets and Low-income Housing) tax credits to increase economic development.

Salli Martyniak, of Forward Community Investments (FCI), sees much value in Wisconsin’s CDFIs coming together to form a statewide alliance or association.<sup>9</sup> She began to form this belief during the depths of the financial crisis, when she found that FCI was experiencing great difficulty gathering investments in more stable economic times. She discovered FCI was not alone. Martyniak believes that a collective organization comprised of the state’s CDFIs, had it existed at the time, would have been a much quicker and more efficient mechanism to understand and communicate information about the

difficult economic environment in which CDFIs were then operating. Further, such a statewide organization would have many recurring benefits today, including: robust communication of information quickly to all members; educational components both inside and outside of the CDFI community; increased investor awareness; and serving as a resource for advocacy focused around issues of common interest.

## Conclusion

In the aftermath of the financial crisis, Wisconsin's relatively small CDFI community came together for the first time to discuss the industry's sustainability and how the state's CDFIs may wish to work cooperatively to promote community development, and address matters of mutual interest. To be sustainable, a CDFI must price and deliver services to meet mission goals and earn some level of return. This conference explored a few ways to consider collaboration across CDFIs to address organizational sustainability from different perspectives, but also to address how CDFIs might take a greater role in policy development and advocacy as a more unified set of organizations. Measuring the impact of CDFIs is also critically important to ensuring that mission goals are achievable and meaningful; NCIF, OFN, and NYC-CDFI presented details on the ways that they measure performance and help to shape the future of the CDFI industry, but also the advantages of CDFI associations. Collaboration among diverse peers is difficult to achieve, but offers many promising benefits. To date, Wisconsin's CDFIs have operated more or less independently and locally. The panel sessions and speakers offered some potential benefits to be realized by taking a broader view, working in collaborative ways to share technology, information, training, and other resources, and forming consensus and a collective voice around key policy topics.

## Notes

- 1 United States Department of the Treasury, CDFI Fund, Certified Community Development Financial Institutions – Alphabetical By State and City as of 2/28/2011, p. 36. Available at <http://www.cdfifund.gov/docs/certification/cdfi/CDFI%20List%20-%20By%20State-%20202-28-11.pdf>.
- 2 Detailed information about the CDFI Fund's New Markets Tax Credit awardees can be found on their searchable Web site at <http://www.cdfifund.gov/awardees/db/basicSearchResults.asp>.
- 3 For a more detailed examination of the sustainability of the CDFI field within the context of increasing industry scale and the use of subsidy, see Moy et al., *Approaches to CDFI Sustainability*, The Aspen Institute, Economic Opportunities Program, prepared for the Community Development Financial Institutions Fund, U.S. Department of the Treasury, July 2008. Available at <http://www.aspeninstitute.org/sites/default/files/content/docs/CDFISustainabilityStudy11.08.pdf>.
- 4 Ms. Moy also helped launch AssetPlatform.org, which is a new resource for staff at nonprofit organizations that provides financial education, coaching, and asset development services. The AssetPlatform delivers high quality products and services (including training, calculators, assessment tools, consumer-friendly financial products, and links to experts) to the desktops of front-line staff, so they can more effectively serve their communities.
- 5 NCIF seeks to identify Community Development Banking Institutions (CDBI) and drive socially responsible investment to them. They have developed a comprehensive CDBI screening system that provides key information about the community development mission of banks. To learn more about NCIF Social Performance Metrics, visit their Web site at <http://www.ncif.org>.
- 6 For more detailed information, visit the Opportunity Finance Network's Web site at <http://www.opportunityfinance.net/about/about.aspx>.
- 7 For more detailed information, visit the New York Coalition of Community Development Financial Institution's Web site at <http://www.cdco.coop/i4a/pages/index.cfm?pageid=1287>.
- 8 For more detailed information, visit the CAP Services Web site at <http://www.capservices.org>.
- 9 For more detailed information, visit the Forward Community Investments Web site at <http://www.forwardci.org>.

## Biography

**Steven W. Kuehl** is the economic development and Wisconsin state director for the Community Development and Policy Studies Division of the Federal Reserve Bank of Chicago. Mr. Kuehl conducts seminars and workshops, and prepares articles and other written materials dealing with economic development, the Community Reinvestment Act (CRA), and fair lending laws and regulations. Since joining the Reserve Bank in 1995, he has been a commissioned senior examiner on consumer compliance and CRA examinations, as well as manager for Consumer Complaints, HMDA Processing, and the Advisory Service Program. Mr. Kuehl holds a BS in finance and economics from Carroll University, and a Juris Doctor from Chicago-Kent College of Law. He is admitted to practice in Illinois and the United States District Court for the Northern District of Illinois.

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*Profitwise News and Views* is published by the  
Community Development and Policy Studies Division  
of the Federal Reserve Bank of Chicago  
230 S. LaSalle Street  
Chicago, IL 60604-1413

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