I. INTRODUCTION

The purpose of this guide is to provide information that will help community banks identify and evaluate opportunities to partner with CDFIs. CDFIs are specialized financial institutions that provide financial products and services to populations and businesses located in underserved markets. These institutions have community development missions and a reputation for lending responsibly in low-income communities.

Many traditional community banks have exceptional records in serving the credit needs of low- and moderate-income communities in their market areas. In recent years, however, economic problems in these markets and challenges in the economy have caused home mortgage and small business lending in these communities to decline. In addition, there are particular challenges in serving the unbanked, and many low- and moderate-income people are either unbanked or underbanked, which means that they rely on cash transactions or nontraditional providers for financial services. An estimated 34 million U.S. households are unbanked or underbanked, and depend on alternative financial services to meet all or some of their credit needs.[6]

Barriers to Serving Low- and Moderate-Income Borrowers and Communities

Some community banks may face significant barriers to serving low- and moderate-income borrowers and communities in their market areas. Banks may have concerns about risk and profitability or limited resources to sustain effective marketing to reach low- and moderate-income households. Some banks may lack the knowledge about creditworthy borrowers in these communities or the expertise to lend to low-income borrowers. The inability of some banks to serve certain geographies may result from market failures, such as inaccurate or incomplete information about these communities. Information externalities, which prevent banks from recapturing the costs of gathering market information and developing expertise in providing financial services to low-income borrowers, may have impeded the formation and full development of credit markets in low- and moderate-income communities.[7]

CDFIs Designed to Address Barriers

CDFIs fill a niche in the nation's financial services delivery system by specializing in providing credit to borrowers and communities that may be difficult for some traditional banks to serve. Many borrowers may be creditworthy but lack credit history, or have a poor past experience with alternative or predatory credit providers or a minimal amount of personal savings.
To address the credit needs of this market, CDFIs offer products with tailored but prudent underwriting standards, combine a range of below-market financing with their own resources, and offer technical assistance with their lending activities to help make sure that financial resources are effectively managed. CDFIs are familiar with the local market and skilled in using a variety of risk-mitigating programs, such as guarantees, subordinated loans, low-cost funding, and pooled risks to lower costs and increase the chances of success for a borrower.

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6 Federal Deposit Insurance Corporation, 2011 FDIC National Survey of Unbanked and Underbanked Households. Washington, DC: Federal Deposit Insurance Corporation, September 2012. Available at *http://www.fdic.gov/householdsurvey/2012_unbankedreport.pdf.*

7 Michael S. Barr, "Credit Where it Counts: The Community Reinvestment Act and its Critics," New York University Law Review, Vol. 80 (May 2005), p. 513. Available at *http://papers.ssrn.com/sol3/papers.cfm?abstract_id=721661.*

Evolution of the CDFI Industry and Bank/CDFI Partnerships

CDFIs emerged in response to the lack of access to responsible credit and capital in minority and economically distressed communities. Community development investment activity originated after the Civil War with the establishment of mutual institutions that were, in part, dedicated to serving immigrant and minority populations,[8] and credit unions that originated early in the 20th century.[9] In the late 1960s and early 1970s, nonprofit community development corporations were established to promote economic development in inner-city and poor rural areas. During this same period, federal and state-funded revolving loan funds were created to provide financing for small businesses in these areas. The modern CDFI industry began to take shape in the 1970s with the passage of the CRA, the growing concern about the social consequences of investment decisions in low-income communities, and the establishment of community development credit unions and banks.

In the 1990s, the CDFI industry grew significantly following the establishment of the CDFI Fund as a new agency within the U.S. Department of the Treasury to provide financial assistance to CDFIs and their partners. Another major catalyst to the rapid growth of CDFIs in the 1990s was the federal government's decision to strengthen the criteria for bank evaluations under the CRA.[10] In particular, the 1995 CRA regulations, which explicitly emphasized community development loans, services, and investments as important CRA activities, increased investor interest in CDFIs. Subsequently, formal CRA interpretations specifically referenced support for CDFIs as examples of qualified community development activities.

Benefits of Bank/CDFI Partnerships

Many CDFIs partner with traditional financial institutions to help expand the bank's lending and services to underserved markets. In addition to CRA consideration, bank/CDFI partnerships benefit banks by providing them an opportunity to expand their markets to reach low- and moderate-income communities and other underserved areas without the need for additional operational support. CDFIs bring specialized skills and experience in serving markets and borrowers in low- and moderate-income communities that many banks, particularly small banks or those with a specialized product focus, may not have the necessary expertise or resources to provide.

Through partnerships with CDFIs, banks can expand their ability to meet the capital and credit needs in low- and moderate-income communities within a bank's assessment area. CDFIs may allow banks to pool the risks and costs of serving markets that banks are not familiar with or believe to be too risky or costly to serve themselves. The pooling of risks and costs occurs when CDFIs assemble the funds and resources from various investors, multiple banks, government, and foundations.[11] Over time, CDFIs support the growth of small companies and the economic health of households to help them benefit fully from access to conventional credit and deposit services offered by partner banks.

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8 Board of Governors of the Federal Reserve System, "Partnership for Progress - Minority Banking Timeline." Available at: ***http://www.fedpartnership.gov/minority-banking-timeline/.***

9 J. Carroll Moody and Gilbert Fite, The Credit Union Movement: Origins and Development, 1850-1980, 2nd Edition, Kendall/Hunt Pub. Co, Dubuque, Iowa (1984).

10 CDFI Coalition of Community Development Financial Institutions, "What are CDFIs?" Available at ***http://www.cdfi.org/about-cdfis/what-are-cdfis/***.

11 Mark Pinsky, "Growing Opportunities in Bank/CDFI Partnerships," Community Developments, (Summer 2002). Available at ***http://www.occ.gov/static/community-affairs/Summer-01.pdf.***