Strategies for Community Banks to Develop Partnerships with Community Development Financial Institutions

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Purpose

- To inform community banks of strategies to meet community credit and development needs in low- and moderate-income communities and receive Community Reinvestment Act (CRA) consideration through collaborations with community development financial institutions (CDFIs)

Contents

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I. Potential Benefits of Bank/CDFI Partnerships

Potential Benefits of Bank/CDFI Partnerships

- CDFIs are specialized financial institutions that provide financial products and services to underserved markets.
- CDFIs have community development missions and include banks and bank holding companies, credit unions, loan funds, and venture capital funds.
- CDFIs provide credit to markets that may be difficult for traditional banks to serve.
- CDFIs
  - Offer products with flexible underwriting standards
  - Combine a range of below-market financing with their own resources
  - Provide technical assistance with their lending activities

Potential Benefits of Bank/CDFI Partnerships

- Banks can expand their ability to meet the capital and credit needs in low- and moderate-income communities through partnerships with CDFIs.

- Under the Community Reinvestment Act (CRA), community development activities can be delivered directly through, or in cooperation with, a CDFI partner that serves an area which includes the bank's assessment area.

II. Key Characteristics of CDFIs

Key Characteristics of CDFIs

CDFI Banks

- Federally insured and regulated depository institutions with a primary mission of community development

- At least 60% of their financial activities are targeted to one or more low- and moderate-income or underserved communities

CDFI Credit Unions

- Federally insured financial cooperatives that are designed to provide financial services to individuals who are members of the credit union

- Majority have received designation by the National Credit Union Administration as “low-income” credit unions; this designation allows these institutions to accept nonmember deposits and secondary capital, which is an uninsured, fully subordinated debt instrument

Key Characteristics of CDFIs

CDFI Loan Funds

- Non-depository financial institutions that are not subject to federal banking regulations
- More flexible lending policies than regulated banks with ability to finance development projects more easily than many other lenders
- Most are structured as nonprofit organizations and can raise funds from government and philanthropic sources

CDFI Venture Capital Funds

- Financial institutions that make equity investments, equity-like investments, and below-market loans to businesses in underinvested markets, and to companies, in any location, that will provide quality jobs, wealth and training opportunities for low- and moderate-income people
- Provides managerial assistance to the businesses in which they invest, and promote social and financial returns for their investors

III. Types of Financing Support that Banks Can Use to Support CDFIs

Types of Financing Support that Banks Can Use to Support CDFIs

Equity

- Grants
- Ownership Interest in For-Profit Limited Partnership or Limited Liability Company
- Stocks
- Equity Equivalents (EQ2s)

Debt

- Loans
- Secondary Capital

Deposits

- Deposits
- Nonmember deposits

IV. CRA Consideration of Bank/CDFI Partnerships

CRA Consideration of Bank/CDFI Partnerships

- The CRA encourages financial institutions to participate in community development activities by defining them as lending, investment, and financial services-related activities in:
  - affordable housing for LMI individuals;
  - community services targeted to LMI individuals;
  - promotion of economic development by financing or investing in small businesses or farms;
  - revitalization and stabilization of low- or moderate-income geographies; and
  - community development activities that revitalize or stabilize federally designated major disaster areas.

- Because CDFIs certified by the CDFI Fund are required to serve a community development purpose, the Interagency Questions and Answers Regarding Community Reinvestment explicitly recognize loans to and investments in CDFIs as examples of community development loans and qualified investments.

CRA Performance Evaluations

- Banks of all sizes or types that invest in and collaborate with CDFIs may receive CRA consideration in all components of their performance evaluation.
- Loans made to or in collaboration with CDFIs that primarily serve a community development purpose may receive consideration as a community development loan.
- CRA-qualified investments include equity investments, deposits, membership shares and grants in or to financial intermediaries such as CDFIs.
- Community development services include the provision of technical assistance to CDFIs engaged in community development.

CDFI Investment and Lending Activities

- When a financial institution's investments support a CDFI intermediary and that CDFI in turn makes loans to low- and moderate-income individuals or in low- and moderate-income areas, the bank may choose to have its investment considered in three ways:

  1. The total amount of the bank's investment in the CDFI may be considered under the investment or community development test as a community development investment.

  2. A pro rata share (based on the bank's share of CDFI equity) of loans made by the CDFI to the low- and moderate-income borrowers or areas can be considered under the bank's lending performance test.

  3. The bank may choose to allocate a share of its investment amount for consideration under the investment or community development test and allocate the remainder for consideration under the lending test.

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Investments in CDFIs that Serve Areas Broader than a Bank's Assessment Area

- A bank's activity may receive consideration as a community development loan, service or qualified investment if it supports a CDFI that covers a state or regional area that is larger than, but includes, the bank's assessment area(s).
- The bank's assessment areas need not receive an immediate or direct benefit from the bank's participation in the CDFI if the purpose of the CDFI includes serving geographies or individuals located in the bank's assessment areas.
- As long as it has been responsive to community development needs and opportunities in its assessment area, the bank will receive CRA consideration for these activities even if they do not benefit the bank's assessment area.

Investments in Minority- or Women-Owned Financial Institutions and Low-Income Credit Unions

- A bank's investments in a minority- or women-owned financial institution or low-income credit union, including one designated as a CDFI, will receive favorable CRA consideration even if the CDFI is not serving the assessment area of the investing institution or the broader statewide or regional areas that include the investing institution's assessment area.

- Banks may receive CRA consideration for community development activity undertaken by minority- or women-owned financial institutions and low-income credit unions as long as these activities help to meet the credit needs of local communities in which the minority- or women-owned institutions or low-income credit unions are located or chartered.

V. Steps to Consider When Evaluating Partnership Opportunities

Identifying and Evaluating Potential CDFI Partners

- Business Strategies Match
- Service Area Match
- Financial Returns and Risks Determination
- Financial Soundness/Due Diligence

Risk Mitigation

To help manage risks associated with bank/CDFI partnership activities, community banks can consider indirect investing in CDFIs through intermediaries.

- **National Intermediaries**
  - **Opportunity Finance Network** – http://www.opportunityfinance.net
  - **National Federation of Community Development Credit Unions** – http://www.natfed.org
  - **Community Development Venture Capital Alliance** – http://www.cdvca.org
  - **National Community Investment Fund** – http://www.ncif.org
  - **Oweesta** – http://www.oweesta.org
  - **Calvert Foundation** – http://www.calvertfoundation.org

Leveraging Partnership Resources

- Investments in CDFIs provide an opportunity to leverage public and other private resources to meet community development needs.
- Leveraging partnership resources allows banks the opportunity to make a greater community development impact than their investment dollars could provide on their own. These programs can provide a cushion for lenders and an incentive for bank/CDFI partners to make larger loans and expand lending in very low-income areas.
- Various public and private sector programs can provide equity, grants, loans, and loan guarantees to partnership activities.
- Funding programs that can be beneficial to bank/CDFI partnerships are those administered by various federal government agencies, including the U.S. Departments of the Treasury, Interior, Small Business Administration, and the Federal Home Loan Bank.

Leveraging Partnership Resources - CDFI Fund

The U.S. Department of the Treasury CDFI Fund's award programs are the largest source of funding designed for certified CDFIs and financing entities planning to become certified within three years.

CDFI Fund programs that can be beneficial to banks include:

- Bank Enterprise Award Program
- New Market Tax Credits Program
- CDFI Certification

The CDFI Fund provides a full description of their programs at http://www.cdfifund.gov/what_we_do/programs.asp

Leveraging Partnership Resources - Federal Home Loan Bank

The Federal Home Loan Banks (FHLB) provide long-term, low-cost funding for home mortgage loans and other community development activities to members that meet FHLB criteria.

Community banks and CDFIs are eligible for membership in the FHLB system.

FHLB members can apply for community development grant funds, including:

- **Affordable Housing Program** - This program provides grants for the purchase, construction, and rehabilitation of housing for low-income households.

- **Community Investment Program** - This program provides below-market loans to members for the long-term financing of housing and economic development that benefits low-income borrowers and communities.

These programs are managed by the Community Investment Office of FHLB's regional banks. http://www.fhlbanks.com/contacts_council_fhlbanks.htm

VI. Range of Partnership Options

Range of Partnership Options

Bank/CDFI partnership options include:

- **Providing Equity Capital Using Traditional Equity Instruments**
- **Providing EQ2s (nonprofit CDFIs)**
- **Providing Funds Using Traditional Debt Instruments**
- **Providing Deposits (CDFI depositories)**

Range of Partnership Options

- **Providing Capital Using New Markets Tax Credits**

  Community banks can provide capital to community development entities (CDEs) – intermediary groups that are certified by the CDFI Fund – to take part in the New Markets Tax Credit Program to make loans and investments in low-income communities.

  In return for the equity investment, the CDE provides the investor bank with new markets tax credits.

  The tax credit is worth 39 percent of the investment made in the CDE.

  The credit is a dollar-for-dollar reduction in federal tax liability, and the value of the credit is spread over seven years.

Range of Partnership Options

- **Collaborating with Banks to Invest in Loan Pools and Consortiums**

  Two or more financial institutions can invest funds in a pool and make a loan to a CDFI for a larger amount than either bank may have been willing or able to make independently.

  The risk associated with partnering with the CDFI is minimized because the banks are liable only up to the amount of their investment.

  The lending pool can be organized as a lending consortium in which the participating banks pool their funds as investments in a consortium.

Range of Partnership Options

- **Collaborating with CDFIs in Loan Participations**

  Loan participations are loans made by a traditional bank and CDFI partner to a specific borrower and serviced by either the traditional bank or CDFI.

  Loan participations can be made with equal risk sharing for the lead lender and participating lenders.

  Alternatively, loan participations can be made on a senior/subordinated basis, where the lead lender is paid first and the subordinate loan participation is paid only if enough funds are left over.

Range of Partnership Options

- **Providing Technical Assistance**
- **Providing Loan Servicing**
- **Providing Bank Services**

Strategies for Community Banks to Develop Partnerships with Community Development Financial Institutions

Electronic copy can be downloaded at:
http://www.fdic.gov/consumers/community/cdfi/index.html

Hard copy can be ordered at: http://vcart.velocitypayment.com/fdic/

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