Remarks of

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Good morning, thank you for inviting me. It's always great to travel to Memphis, and I appreciate that so many of you have come out this morning to talk about community development financing.

I'm joined by my colleagues Nancy Gresham Jones, our Community Affairs Officer here in the OCC's southern district and Hershel Lipow who for many years worked for the City of Memphis on economic development programs and hails from northern Mississippi. And I would also like to recognize our community affairs colleagues who are with us today, Clinton Vaughn from the FDIC and Kathy Cowan from the Federal Reserve Bank's Memphis Branch, who I also would like to thank for hosting today's event.

I want to recognize what the civic leadership of banks and community development organizations in Memphis has been able to accomplish over the years, particularly how you've been able to bring so many organizations together to work toward common goals. When we look at successful strategies across the country, it's just this type of collaboration that seems to make a real difference in communities across the country.

Today, I want to share some thoughts around the keys to successful partnerships between banks and CDFIs. One of the defining characteristics of the CDFI field is its diversity, and we can see a lot of that variety in the room today. We have a CDFI bank, Tri-State Bank of Memphis, that has been serving the community for 68 years. We have a community development credit union, Hope Credit Union. Bill Bynum of Hope has been a visionary leader in community development here in the Mid-South.

And we have several CDFI loan funds here with us—United Housing, a NeighborWorks affiliate, on the housing side, Alt Consulting and ACCION that work on small business finance, and River City Capital Investment Corporation doing small business and community development lending.

CDFIs are mission-driven lenders, dedicated to delivering responsible, affordable lending to low- and moderate-income people and communities, with a goal of helping these people and communities to join the economic mainstream. For many CDFIs, certification by the U.S. Treasury

Department is one means of demonstrating their mission orientation. CDFI Fund certification is required for access to CDFI Fund programs, and in some cases CDFI certification may help organizations by providing them with greater regulatory flexibility. Certification confirms an organization's mission of community development and the fact that it provides products and services to economically distressed communities.

Before I go into a more in-depth discussion of the various forms that bank/CDFI partnerships can take, I'd like to make a key point: CDFIs themselves can be great bank customers. They may be borrowers and they certainly need deposit and interest bearing accounts, treasury services, and credit cards just like any other business customers.

As I go through examples of how banks and CDFIs can partner, and I hope as we do that it will be apparent how these partnerships can help both banks and CDFIs meet customer and community credit needs. In fact, the most successful ventures often involve some form of partnership that builds on the strengths and benefits that each of the participants bring to the table.

CDFIs can help a bank access additional community development business, such as a construction loan on an affordable housing project or a participation interest in an economic development project. Although not all community development work will meet a bank's customary hurdle rate, there are many types of transactions that can be profitable, in a fair and reasonable way.

CDFIs are often able to reach borrowers that mainstream lenders do not or are unable to serve under their institution's guidelines. This is an important point, because it is difficult for competitors to be collaborators. There may be some overlap, but unless a partnership helps both organizations expand what they are doing, a partnership probably doesn't make any sense. Both parties need to benefit.

Through a referral program, CDFIs can provide a way to help a client that does not meet a bank's underwriting requirements. I'm sure bank loan officers would appreciate having a way to help their customers by referring them to a CDFI that could meet their needs. Also CDFIs can work with borrowers to improve their financial capabilities. The article in your package about the Business Resource Group provides a good description of an experienced CDFI that provides technical assistance to small business borrowers to increase their bankability.

We've seen that partnership relationships work best where there is a very clear understanding of the roles of the respective parties, and there is a strong discipline that prevents encroachment on each other's customer base. For the bank, it also takes a good understanding of the CDFI's credit guidelines and services. Just because a loan is not a good fit for your bank does not mean it is not a good fit for a CDFI with the right loan products and supportive services.

For the bank, referrals can help to keep their customers. The bank may not be able to make a business loan themselves, but they serve their customer well when they can make a referral that results in meeting the customer's needs, and the bank is still able to keep the checking accounts and credit card relationships. And one day that customer may meet the bank's loan criteria, and they will remember what a loan officer did for them when they needed help.

Referrals from banks can be a great source of customers for CDFIs. And CDFIs also appreciate having established relationships with banks so they can refer borrowers that are ready for conventional financing. Properly structured, referral relationships s can be a win-win for both parties.

One area we are watching is the potential impact that the CDFI exemption from the Ability-To-Repay rules may have. If a bank is reluctant to make a mortgage loan to a customer because the loan would not meet the requirements for a Qualified Mortgage, would it make sense for a bank to refer the borrower to a CDFI that has an effective program for providing responsible, affordable mortgages? It seems like this could potentially offer a great opportunity for mutually beneficial referral relationships.

Subsidies and grants are another key tool that CDFIs can use to attract banks as partners. Nonprofit CDFIs often grow and develop as a result of public and charitable subsidies and grants. These funds are commonly used to offer technical assistance to small businesses or to defray the cost of offering lower-priced and more flexible loan products. High performing CDFIs are experts in understanding how to access and use these funds, and how apply them to maximum benefit. If these funding sources are not initially available, CDFIs are often instrumental in securing them from government sources or private philanthropic entities.

In fact, in some cases banks can receive public incentives for investments in CDFIs. The CDFI Fund's Bank Enterprise Award program is an example of this. Under this program banks can receive grants from the CDFI Fund for providing financial support to CDFIs.

In doing some background research while preparing for this presentation, I saw that the CDFIs attending our session today have done a good job of accessing Treasury's CDFI fund monies. I saw many here were awardees for technical assistance and financial assistance awards as well as

New Markets Tax Credits and Bank Enterprise Awards. And I was encouraged to see that ACCION is an SBA Community Advantage lender.

However, the key for CDFIs is figuring out how to leverage those subsidies through partnerships with mainstream financial institutions. Successful partnerships hinge on each partner identifying its strengths and working together to build on their synergies.

Loan participations offers another opportunity for banks and CDFIs to partner. Any lender in the room can probably recall a situation where a prospective borrower had a loan request that looked good in many ways, but it was just outside of loan policy. Maybe it was too big, or it exceeded a bank's lending limit. Maybe the loan's cash flow was acceptable, but there was insufficient collateral for the amount requested, or the business had a bad year last year and lost some money. Perhaps the business loan request came from a solid performer who was stretching to start a new business line, and while the first 75 percent of the cash flow was really solid, that last 25 percent presented more risk than the bank was willing to take. These are all great opportunities for loan participations, and a great opportunity for bank/CDFI partnerships.

If you've financed a community development project, chances are you've been in a type of participation with multiple public and private participants in a deal. If you've used the SBA 504 program, you've been involved in a participation loan. This tool can be extended to a variety of financing situations.

It may be easier to illustrate the benefits of partnership with a concrete example. In your packet, you have a publication entitled "Financing Business Development and Expansion in Rural America." In this publication you will find an article about Northern Initiatives, a CDFI in Michigan. Northern Initiatives was founded by two groups: A university that saw the need for partnerships to help the regional survive economically, and a CDFI bank that brought a business perspective to community development lending.

Northern Initiatives, is a loan fund that talks the same language as banks—collateral and guarantees, credit policy, financial statements—and it wasn't long before loan officers from the banks and the CDFI started talking about doing business together. A bank would have a customer looking for a loan where the bank could not make the numbers work, but they didn't want to lose that customer to another bank. Could the CDFI take a look? They did, and sometimes the CDFI was able to close the deal. Over time, loan officers from the banks and the CDFI developed a clear sense of each other's lending guidelines. However, CDFIs will stress the importance of discipline among their loan officers in understanding when a loan should be made by the CDFI, and when it should be provided by the bank. As you can imagine, it can be very difficult for a CDFI lending officer, who finances only the most difficult of deals, to turn down the one deal that pencils out perfectly because "that one is ready for a bank." Although the Northern Initiatives example provides a concrete illustration of a working partnership, there are many, many other examples.

I would now like to discuss how banks can partner with individual CDFIs to help them grow and prosper. Banks have been among the largest investors in CDFIs. Banks can provide loans, lines of credit, grants, deposits, in-kind contributions, volunteer staff time and expertise, or provide equity investments to CDFIs. They can partner around product development, or share a common infrastructure. Often banks will partner with CDFIs in multiple ways.

The conversation usually starts with grants, and for good reason. Grants are very valuable to loan funds, but they can often be the most difficult funds to raise. Yet grant funds often offer the most flexibility because they can be used for many purposes, such as:

- Helping to cover the cost of a loan fund's operations;

- Developing the organization's infrastructure, such as an accounting or loan management system;
- Providing seed capital to develop new products;
- Providing capital or loan loss reserve that will allow a CDFI to raise additional funds in order to build their loan portfolio; or
- Helping CDFIs offer loan products that are more flexible and at lower cost.

Grants can also form the backbone of a broader partnership strategy. For instance, the SBA developed the Community Advantage program to open 7(a) lending to unregulated, community-based lenders. In order to participate, a CDFI needs (1) at-risk capital for loan losses, (2) at-risk capital for the unguaranteed portion of the loans, and (3) lending capital for the guaranteed portion of the loans. A bank may partner with a CDFI under this program by making a grant to fund a loan loss reserve and a warehouse line of credit to fund the guaranteed portion of the 7(a) loans. The guaranteed portion can then be sold on the secondary market, so that the line of credit will be out for only relatively short periods of time. The bank and CDFI can work together on referrals. Developing a business technical assistance program could also improve the chances for success. This type of relationship can help the CDFI scale up very quickly, and help to ensure prudent investments from the CDFI's partners.

Banks have been one of the primary sources of lending capital for CDFIs, often through the provision of senior or subordinated debt for loan funds. Properly underwritten and managed, these loans can provide a modest return to the bank. Some banks offer CDFIs equity equivalent investments, or EQ2s, that are a type of hybrid debt/investment instrument.

CDFIs that we've spoken with have consistently voiced their support for the expertise that bank personnel can provide, particularly in the areas of lending, marketing, accounting, and compliance. Bank officers are often welcome on loan review or audit committees. Some CDFIs will offer board seats to senior bank officials, but that may not always be an option because of governance requirements. These relationships are often mutually beneficial.

Last but certainly not least, another potential benefit that banks can derive from partnerships with CDFIs is opportunities to fulfill their Community Reinvestment Act objectives in helping to meet the credit needs of the communities in which they operate.

The Community Reinvestment Act regulations explicitly recognize loans and investments in CDFIs as community development activities. For loans and investments in a CDFI to receive CRA consideration, the CDFI must primarily lend or facilitate lending to promote community development.

Investments in CDFIs can take a variety of forms, including deposits, membership shares, and grants. Banks may receive CRA consideration based on the amount of an investment or a pro rata share of the loans made as a result of that investment.

Technical assistance to CDFIs, including developing loan application and underwriting standards, lending employees, or serving on boards and committees of CDFIs, is eligible for CRA consideration as a community development service. Other examples of services that qualify for CRA consideration include developing secondary market vehicles or programs, assistance in marketing financial products, furnishing financial services training for staff, contributing accounting or bookkeeping services, and assisting in fundraising. Loan referrals may also receive CRA consideration if the bank reviews the borrower’s eligibility for bank financing and it is bank policy to refer “second chance” loans to the CDFI.

I would like to conclude by saying that Nancy Gresham Jones, Clinton Vaughn, and Kathy Cowan are available to assist you in developing bank/CDFI partnerships here in Memphis.

In addition, I would like to mention that OCC has numerous resources for banks and CDFIs on www.occ.gov, where we have a CDFI and CD Bank Resource Directory that offers a one-stop-shop, including links to regulatory, public, and private resources. In your packet, you will also find a list of links to articles that give examples of various partnerships. Many of the publications that are on the web page are in your package.

In June, we expect to publish a new “Insights” report on bank/community development loan fund partnerships. We hope this report will prove useful to those who are new to bank/CD loan fund partnerships, as well as those who have been doing this work for years. If you provide me your business card, I will make sure you receive a copy of this report.

Thanks very much for your participation in today’s meeting. I would be happy to answer any questions.