



TOOLKIT

COMMUNITY DEVELOPMENT LOAN FUNDS



**Community
Economic
Development
Toolkit**

Disclaimer

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COMMUNITY DEVELOPMENT LOAN FUNDS

Use of this Guide

The Community Development Loan Fund Guide is intended for use by community development organizations for the following purposes:

1. Organizations wanting to learn about Community Development Loan Funds
2. Organizations creating alternative lending and investment programs
3. Organizations seeking services and capital from loan funds

NOTE: For purposes of this guide, focus will be on business lending (to start, expand or invest in business development) and to a lesser degree on personal loans (home, auto or educational loans). This guide is one of five guides covering an array of lending and investment activities including:

1. *Community Development Loan Funds (CDLFs): This broad category includes all loan funds that are not Credit Unions or Equity Investment funds. The information in this section includes the steps and considerations for starting a loan fund.*
2. *Microloan Funds: This is a sub-category type of loan that fund focuses on smaller loans, primarily for start up financing.*
3. *Credit Unions: This is a federal/state designation for a lending institution that meets certain capital requirements, operating guidelines and management systems.*
4. *Equity Investment Funds: Funds that provide equity investment (versus loans) into community development activities.*
5. *Community Development Financial Institutions (CDFIs): This is a Federal US Treasury designation based on organizational and lending standards that allows loan funds access to US Treasury grants through the CDFI Fund (includes most CDLFs, Microloan funds and Credit Unions).*

Organizations interested in expanding access to capital for underserved communities have focused on various forms of loan and investment funds. This guide will begin with Community Development Loan Funds, the broadest category that encompasses all types of loan and investment funds. Loan funds can specialize and focus lending for various products and markets (home or auto loans, business start ups or expansion) in specific neighborhoods or regions.

All forms of loan and investment funds are eligible to become certified Community Development Financial Institutions. This federal certification allows loan and investment access a wider menu of grants and programs designed to bring capital to low income and underserved communities.

Community Development Financial Institutions (CDFIs) is becoming the standard nomenclature categorizing all community development lending and investment entities (albeit not all such entities have obtained the official US Treasury designation, most have and will apply for the CDFI designation because it represents a recognizable industry standard). The Opportunity Finance Network is the association representing all types of lending institutions and has broadly

categorized all lending institutions as CDFIs and subcategorized lending and investment institutions as follows:¹

“As with mainstream lenders, a variety of institutions has emerged to serve the broad range of needs in emerging domestic markets. Although they share a common vision of expanding economic opportunity and improving the quality of life for low-income people and communities, the four CDFI sectors—banks, credit unions, loan funds, and venture capital (VC) funds—are characterized by different business models and legal structures”:

1. *Community Development Banks: Community development banks provide capital to rebuild economically distressed communities through targeted lending and investing. They are for-profit corporations with community representation on their boards of directors. Depending on their individual charter, such banks are regulated by some combination of the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and state banking agencies. Their deposits are insured by FDIC.*
2. *Community Development Credit Unions: Community development credit unions (CDCUs) promote ownership of assets and savings and provide affordable credit and retail financial services to low-income people, often with special outreach to minority communities. They are nonprofit financial cooperatives owned by their members. Credit unions are regulated by the National Credit Union Administration (NCUA), an independent federal agency, by state agencies, or both. In most institutions, deposits are also insured by NCUA.*
3. *Community Development Loan Funds: Community development loan funds (CDLFs) provide financing and development services to businesses, organizations, and individuals in low-income communities. There are four main types of loan funds: microenterprise, small business, housing, and community service organizations. Each is defined by the client served, though many loan funds serve more than one type of client in a single institution. CDLFs tend to be nonprofit and governed by boards of directors with community representation.*
4. *Community Development Venture Capital Funds: Community development venture capital (CDVC) funds provide equity and debt-with-equity-features for small and medium-sized businesses in distressed communities. They can be either for-profit or nonprofit and include community representation.*

The companion “Community Development Financial Institutions (CDFI) Guide” also touches on many aspects of loan funds and should also be reviewed. The CDFI Guide however is usually the “next step” for established loan funds. We would also recommend reviewing the “Business Technical Assistance Guide” since the two community development activities work hand in hand.

Due to recent economic and financial turmoil, commercial lenders and investors have tightened lending requirements, resulting in a “credit crunch” where credit needs are greater than resources. This economic landscape has resulted in commercial financial institutions relying more on community loan funds as the mechanism to better serve niche market needs. Financial institutions now invest and lend more aggressively to financially sound and stable loan funds. Loan funds have built a strong reputation by understanding local credit nuances and needs resulting in sound lending and strong loan portfolios

¹ Opportunity Finance Network, website: www.opportunityfinance.net

Loan funds come in many sizes and focus on a myriad of community development credit needs. Community based loan funds are integrated with training and business technical assistance programs. Together these resources enhance and support the small business industry, a very important part of community development and stabilization. Business programs, services and loan funds are usually managed by the same organization that provides comprehensive business assistance. Loan funds, however can stand alone and become a centralized funding mechanism in partnership with other local and regional business support programs and organizations.

For successful loan funds, the CDFI designation is very important and allows lending programs to grow dramatically. Most foundation and corporate grants and investments from financial institutions look for the CDFI designation before grant or investment discussions begin. Over the last three years, financial institutions have been very actively seeking sound CDFIs to invest in. CDFIs have been a very successful mechanism for financial institutions to meet lending and investment measures required by the Community Reinvestment Act (CRA) and enforced by banking regulators. A high CRA rating is needed if the financial institution has plans to expand in the future.

The CDFI designation is determined through a certification process conferred by the CDFI Fund of the Department of Treasury. The designation is for financial institutions (and lending programs including community loan funds) and allows access to Treasury programs and investments. *NOTE: Because the CDFI designation is so important, it will be referred to throughout this guide and will be summarized at the end. The "Community Development Financial Institutions Guide" should be referred to for details on the CDFI Fund and its programs.*

Loan and investment funds play an integral role in a community economic development strategy. Loan funds bring capital to underserved markets that include business finance (start up, micro, non-profit, small and business expansion), real estate development finance (affordable housing, commercial and office, community facilities and industrial) and personal finance (auto, home or personal). Capital enhances economic stability while creating jobs and opportunities for community residents. Creation of personal and community assets is a keystone in building and strengthening communities. Loan funds also bring communities a higher level of technical expertise in business and finance, increasing the potential for sustained community stability and growth.

Financial institutions have become more effective in meeting customer demands in low income and disadvantaged communities through channels created by loan funds. Financially successful funds generate income to cover organizational operating and overhead expenses and can bring additional income to support other community credit needs, such as business technical assistance programs and expansion of lending services (such as auto loans, microloans, home or business loans). A stronger and financially viable lending business enhances the overall success and longevity of your community development organization while supporting community credit needs.

Loan funds play a very important role in community development (revitalization and stabilization). The effects are substantial and include:

For the Organization:

1. Generates additional income for the program
2. Supports and allows for the creation of complementary programs, services and projects
3. Expands staff capacity and capabilities by attracting and retaining experienced professionals in business finance and development

For the community:

1. Increases access to capital
2. Increased access-related resources such as training and technical assistance in the areas of finance and business development
3. Creates personal and community assets
4. Enhances the local economy by supporting important segments of the economic infrastructure including business, residential and industrial sectors

Successful lending efforts (and ancillary financial programs) results in economically stronger communities, stronger workforces, more informed and capable businesses and tenants, and ultimately a stronger and more inclusive economy.

COMMUNITY DEVELOPMENT LOAN FUNDS

The general category of community development loan funds (CDLFs) includes many types of funds created to meet specific market needs and concerns. There is an extensive network of lending entities throughout the country developed by and through various funding sources. These include:

1. Economic Development Loan Funds: Many times managed by local governments, these loan funds are capitalized by various federal funding sources that include Community Development Block Grants (CDBG), repayment from Urban Development Action Grants (UDAG) and the Economic Development Administration (EDA) Grants. The early forms of CDBG, EDA and tax increment funded entities were usually programs within the redevelopment or community development agency, but could be a separate lending enterprise. Other government supported efforts include those by the Small Business Administration (SBA) in the form of Small Business Investment Companies (SBIC)² and Minority Enterprise Small Business Investment Companies (MESBICS)³. Most of these entities are created and managed by local government (or strongly related entities) and have been used to support major inner city revitalization and improvement efforts.
2. The second major category is the private, non-profit loan funds operated by community development organizations used to finance affordable housing, non-profit facilities, local business and industry and other projects targeted to low income distressed communities. Capital for these funds comes from both the public and private sector. This category of loan funds is the focus of this guide.

According to the Opportunity Finance Network, "Community development loan funds (CDLFs) provide financing and development services to businesses, organizations, and individuals in low-income communities. [Loan and investment funds] are defined by the client served, though many loan funds serve more than one type of client in a single institution. CDLFs tend to be nonprofit and governed by boards of directors with community representation."⁴

CDLFs are not regulated entities and deposits or investments into funds are not guaranteed; however most adhere to a standard created by two major entities. The first is a federal program through the Community Development Financial Institution (CDFI) Fund. The Fund has established guidelines to become a CDFI (and be eligible for program grants). The second has been established by the Opportunity Finance Network (OFN). OFN is a non-profit association whose membership requires that prospective members meet performance standards that are appropriate for their particular operating context.

OFN standards are based on:

² SBIC is a private investment company co-funded by the Small Business Administration. SBICs provide businesses with debt or equity financing options. All of the SBICs are privately owned, but they are licensed and regulated by the Small Business Administration. Using their own capital and loan guarantees from the government these financial institutions make equity and debt investments into businesses. A business with a net worth of less than \$18 million and an after tax income of \$6 million will qualify as a small business to receive funding.

³ MESBICs are private institutions that invest (debt and equity) exclusively in companies owned or controlled by members of minority groups. They are regulated by the Small Business Administration and are eligible to sell notes or stock to the SBA to leverage their private capital.

⁴ Opportunity Finance Network, Website: www.opportunityfinance.net

1. Mission and Impact: Primary mission to “strive and to have a positive impact on low income. Low-wealth and other disadvantaged people and communities”⁵
2. Finance Led Strategy: Lending activity history of over two years, be a non-governmental entity and provide affordable, responsible financial products and provide financial services.
3. Commitment to Performance: Meet certain loan and risk management policies and procedures, have audited statements and meet certain capital and portfolio ratios and requirements.
4. Support OFN’s Mission

OFN also provides extensive technical assistance and access to information and data to assist in the start-up, operation and management loan funds.

Lending and Investment Program Feasibility Concepts: Operating a loan fund is a business. Loan funds can generate income for organizations if they are operated properly and have the right level of activity. Key management terms and concepts include:

1. Cost of Funds: Your loan pool may include various sources of grants and investment funds. Some will come in at different interest rates. The blended rate is the average rate for your loan pool. If you received all grants the rate would be “0” but if you received an investment or loan, the rate might be 2-5%.
2. Interest Rate Spread: The spread is the differential between cost of funds and what the rate of return is for your funds (average interest rate you are charging).
3. Breakeven: This is the minimum rate (above the cost of funds) you need to charge to cover your expenses.
4. Fund Expenses and Overhead: Expenses include business operations (loan and portfolio management), business management and marketing, office and staff costs. These are expenses that should be paid from the income derived from the “interest rate spread”. If your income does not cover expenses, you will need to secure ongoing funding for operations.
5. Loan Loss: This is the expected rate of losses in bad loans. All funds have provisions for loan losses and the more aggressive the fund is (willing to take more lending risks), the greater the losses could be. Successful funds estimate loan losses well below 5% (which at one time was a standard commercial lending loss expectation).
6. Loan Loss Reserve: Loan loss reserves are funds set aside that may be needed to repay any loans or investments made to your fund. If your fund consists of a mix of loans investments and grants, and a portion (or majority) of the bad loan needed to be repaid to a lender or investor, you would draw the funds from a loan loss reserve. If one loan went bad and your fund lost \$25,000., you would need to tap into the reserve to repay the lender or investor. The riskier your lending is or if you have had historically high loan losses, you would need a higher loan loss reserve. High loan loss reserves do not benefit your fund since they are dollars that are set aside and are not “working” as outstanding loans or generating interest income.
 In financial institutions and in larger funds, loans in portfolio are rated. Those with greater risk or in various stages of distress (late payments) will have a higher percentage set aside for potential loan losses.
7. Feasibility: Income needs to exceed expenses. The larger the lending pool (and level of funding you have out to borrowers) the greater your potential returns are. Similarly,

⁵ Ibid

smaller sized funds have a more difficult time generating income to cover expenses. Smaller loans have greater relative operating costs because handling and processing costs for each transaction is about the same whether the loan is for \$500 or \$5,000,000.

Start-up or Expansion / Becoming a Community Development Loan Fund (CDLF)

The following section will discuss various strategies and steps that should be considered if you are a start up loan fund or if you are expanding to gain CDFI designation. We will look at the following:

1. Start-up loan fund:
 - A. As a new fund
 - B. Through a partnership
2. Existing, slightly experienced loan fund
3. Existing, experienced loan fund

Start-up CDLF: Starting a loan fund is very difficult due to costs. Funding is needed for business operations and for the loan fund. A lending track record is needed to attract financing or to become eligible for a technical assistance grant through the CDFI Fund.

The following is a suggested guide for organizations that have clearly identified needs and strong support to create a fund. Support from your organization and board is critical. The fund should be targeted to a specific market segment: micro businesses, small businesses, affordable housing or consumer financing. There are two potential ways of becoming a CDLF, one starting from scratch and one through partnerships.

Strategy 1: New Fund (If your plans call for the creation of a new fund or start up). A significant amount of funding and predevelopment work is needed for developing the business plan, marketing and management plans. Consider applying for a CDFI Technical Assistance Grant. You will also need funding for operations and for the loan fund. If this is the case, consider the following steps:

1. Fund Initiation: Secure seed funds to allow for staff or consultant assistance for the following: (funding could be lower if your staff has the time to conduct the preliminary research)
 - A. Concept Paper: Creation of a one to two page summary that includes a summary description of your organization, needs, size, management, and potential resources available for the business and fund.
 - B. Community Support: Obtain support from entities that represent your target market
 - C. Public and Private Sector Support: Identify support from entities that represents your target market
 - D. Identify potential sources for predevelopment funds
 - E. Seek grants (or plan to self-finance)
2. GO/NO GO: The information researched above will allow you to develop the concept paper. This will allow your organization to decide if the creation of a loan fund makes sense and is feasible. Securing predevelopment funds will be essential especially if you are trying to create a large fund. The concept paper will be the basis of the business and marketing plan. Determination of the scope, size, and direction of your loan fund should provide a good indication of feasibility. Sources of initial capital are secured through foundation and

corporate grants and, in some instances, from local government programs, especially if there is a targeted market with tremendous needs.

Financial institutions often provide corporate grants to penetrate markets by effectively partnering with community organizations that represent and serve these communities. You must make the case, present need, and indicate how your organization's role will enhance the effort. (See Development Tips at the end of the Guide)

Your organization must assess how the proposed program costs will benefit the overall economic development strategy of the community and organization while assessing impacts to individual CED projects and programs. The creation of a loan fund offers substantial benefits to the community and its economic well being.

3. Pre-development Activities:
 - A. Business Plan/Market Analysis: Conduct a market analysis and develop a business plan for the fund.
 - B. Management Plan:
 - 1.) Fund Management: Included are the documents that define lending parameters, lending guidelines, requirements the application process.
 - 2.) Loan Management: Included are the loan management functions (loan approval process, closing, documentation, and loan management (billing/collections process)).
 - 3.) Portfolio Management: Guidelines and standards on risk management (loan loss tolerance, reserves and risk rating of loans).
4. Board: Creation of the Board of Directors is a very important step that builds the foundation for a successful loan fund.
 - A. Proper balance between mission (helping improve distressed communities) and risk (lending guidelines and requirements) is maintained by board representation.
 - B. Fundraising: Fundraising is a critical need for loan funds and having representatives from entities that either funds/invests in loan funds or are in peer industries that can support loan fund activities is critical.
 - C. Management: Expertise in lending, business or law provides the necessary input and oversight of lending activities and overall success.
5. Loan Committee: The loan committee should in many ways mirror the balance of the board of directors but have focus on management issues. The committee must have members versed in understanding of the lending guidelines and policies of the fund. Experienced lenders can typically be recruited from financial institutions that invest or lend into the fund.
6. Start Up Lending Activities
7. Application for a CDFI certification. Once you receive certification you are eligible to apply for a Technical Assistance Grant (to conduct or upgrade your business plan) or for a Financial Assistance Award (grant for your loan pool). *NOTE: You can apply for a Technical Assistance Grant to start a CDFI and loan pool from scratch, but these are in very high demand and are very difficult to obtain. The more experience you have, the greater the possibility of receiving a grant.*

Strategy 2: Partnership: If there are other loan funds or CDFIs operating in your area (or nearby), you may want to consider partnerships that will leverage their expertise with your understanding of local needs. This strategy allows you to build capacity and expertise and maintain a goal of creating your own loan fund (and potentially obtain CDFI certification at a later date). Some of the strategies include:

1. **Expansion of Service Area:** If it is possible, an existing loan fund or CDFI could expand its coverage area to include your geography. You could become a marketing arm for their products and services and possibly provide space, coordinate meetings or provide language services.
2. **Creation of a Dedicated Fund:** If there is significant interest and resources for creating a fund, you may want to consider creating one and having the CDFI or neighboring loan fund manage it. There are significant ongoing expenses for operations and all “back-room” operations (loan servicing and management). Your organization could participate in developing the lending guidelines and standards, or possibly be on the loan committee for the fund. This intermediary step allows you to gain experience that you will need if you create your own fund.

The partnership structure is important if you are considering operating a small loan fund or provide smaller loans. Remember, the management and handling costs for a small loan are the same as for larger loans. In addition, the larger the loan pool (and the greater the amount of funded loans) generates more interest income used for operations and management. For these smaller pools, it may financially wise to have another institution service and manage your loan fund. Another strategy to lowering operating costs is to partner with other organizations that could handle marketing, training and technical assistance.

Existing slightly experienced loan fund: If your organization has some experience in lending or wants to build a lending track record, you can immediately apply to become a Certified Development Entity (CDE) through the US Treasury’s CDFI Fund. Although the definition focuses on New Markets Tax Credits, a CDE’s activities meet CDFI standards and provide an established certified lending track record for organizations. As a CDE you will be able to apply for CDFI certification and a Technical Assistance Award. The process to become a CDE is straightforward and relatively simple.

As defined on the CDFI website, “a CDE is a domestic corporation or partnership that is an intermediary vehicle for the provision of loans, investments, or financial counseling in Low-Income Communities (LICs). Benefits of being certified as a CDE include being able to apply to the CDFI Fund to receive a New Markets Tax Credit (NMTC) allocation to offer its investors in exchange for equity investments in the CDE and/or its subsidiaries; or to receive loans or investments from other CDEs that have received NMTC allocations.”⁶

Existing or experienced loan fund: If you are currently operating a loan fund, you should consider applying to the CDFI Fund for certification. The certification process is straightforward (check at www.CDFIfund.gov). Once you receive certification, you are eligible to apply for a Technical Assistance Award (to allow you to create the business, marketing and management plans) for your CDFI. You can also apply for a Financial Assistance Award that provides capital for your new or expanded loan fund.

Development Tip: Manage Expenses: Managing your income and expenses is essential for your long term survival.

1. Partnerships with other related lending entities allow you to expand your market and cut down on your own expenses in the areas of marketing, loan processing and loan management.

⁶ CDFI Fund Website, Op Cit

2. Loan losses decrease the size of your loan pool and lower your potential income
3. Reserves impact your business success. These are funds set aside that do not generate income.
4. Your lending guidelines and approvals also impact your success. The greater risks your fund incurs; the greater the potential losses.
5. The expenses for marketing, processing and managing a small loan are the same as expenses for a larger loan.
6. Partnering and sharing of loan management and portfolio management functions are an excellent means of managing and reducing expenses.
7. If you already have loan processing and management experience, you may want to market this capacity and generate additional income by managing funds for partner organizations.

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS (CDFIs)

Microlending programs, most CDLFs and credit unions are eligible entities under the CDFI program. *NOTE: (Please refer to the Community Development Financial Institution (CDFIs) Guide for specific details).*

The key programs include CDFI Certification, Technical Assistance (TA) Awards and the Financial Assistance (FA) Awards. These programs are designed to enable CDFIs to leverage private capital to meet the demand for affordable financial products and services in economically distressed communities.

The mission of the Community Development Financial Institutions Fund is to “expand the capacity of financial institutions to provide credit, capital and financial services to underserved populations and communities in the United States”⁷ The CDFI Fund has several programs that enhances access to capital. Upon receiving certification, CDFI’s are eligible to compete for technical assistance grants, capital grants, New Markets Tax Credits as well as other targeted incentive programs.

The CDFI designation allows lending programs access to compete for CDFI resources, but these resources are in very high demand. Since the start of the program in 1994, the competitive bar has risen dramatically and organizations receiving grants have significant experience in operating a successful loan fund or conducting lending activities. Therefore, we highly recommend that organizations closely study the application guidelines found at www.cdfifund.gov.

CDFI PROGRAM BENEFITS

The CDFI certification is a requirement that will allow you to access CDFI program funds. These programs include: *Note: Source material for this section is from the CDFI website at: www.cdfifund.gov. The website includes annual changes in the program or special programs, for example the 2011 application process included the Healthy Food Financing Initiative that made 12 awards for \$25 million. The goal of this program is to use CDFI capacity to make investments in a range of health food projects serving food deserts including grocery stores, mobile food retailers. Farmers markets, cooperatives, corner stores, bodegas or other food related items (including health foods).*

CDFI Financial Assistance and Technical Assistance: To be eligible for an FA award, a CDFI must be certified by the CDFI Fund before it applies for the award. Prospective applicants that are not yet certified must submit a separate certification application to be considered for FA during a funding round.

Both certified and non-certified CDFIs are eligible to apply for TA awards. However, non-certified organizations must be able to become certified within two years after receiving a TA award. The TA awards will cover expenses needed to build the capacity of organizations to become eligible for CDFI designation.

2011 CDFI Award Categories:

⁷ Community Development Financial Institutions Fund “CDFI Certification Application”, Department of Treasury, June 2007, pg 4

1. Financial Assistance: Certified CDFIs may receive awards in the form of grants, loans, equity investments, deposits and insured credit union shares
2. Technical Assistance: Non-certified CDFI's may apply for TA (not both) to build organizational capacity. If you have not been certified, TA could help you get certified. These funds do not require matching funds.
3. Healthy Foods Financing Initiative: Awards to CDFIs to address the need for healthy foods in their markets (USDA and HHS support)

CDFI Application for Technical Assistance Awards: This award supports your organization towards building systems and capacity to apply for the Financial Assistance Awards.

CDFI Application for Financial Assistance Awards: This award is a grant that can be used to improve organizational systems and as seed capital (or expansion capital) for your loan fund. This is a grant and can be used for your loan fund at 0% interest.

Summary Steps to Becoming a CDFI: To gain CDFI designation the steps are relatively simple. The work is in the planning and application process.

Process:

1. Technical Assistance to developing the organization and program structure
2. Obtain Community Development Entity (CDE) designation
3. Financing participation /partnership (strategy to gain experience)
4. Application for Technical Assistance Awards
5. Developing the CDFI organizational and program structure
6. Apply for CDFI status
7. Request for CDFI funding
8. Other investments and matches
9. Make loans
10. Manage loans

OTHER NOTES:

Service Gaps: One criticism of CDFI lending programs has been the “uneven landscape” that results in gaps in service. Most effective CDFIs operate in small geographies (communities, cities and counties) while larger entities might serve states or multi-state areas. Some of the larger lending institutions may be national but they may not serve all communities with the same lending products.

Areas served by CDFIs with lending products may not meet local needs. Many CDFIs serve only one segment of lending activity such as businesses, real estate or personal, which may not match with needed credit service in a given area.

This issue presents an opportunity for a CDFI to expand or for a new CDFI to emerge, especially if there is need and interest amongst the residents and constituency affected by the lack of capital.

SOURCES OF FUNDS:

1. Federal, State and Local

a. Small Business Administration

- i. Microloan Program: Funds to nonprofit community-based MDOs with loans capped at \$35,000 recently increased to \$50,000 pursuant to the Jobs Act. The average loan is \$13,000. For FY 2010, \$25 million was allocated to the program.
- ii. Program for Investment in Micro-entrepreneurs (PRIME): In 2010 there were 92 grants made from a \$8 million dollar pool. Grants up to \$250,000 can be awarded to MDOs to fund direct assistance to customers of funds or to build the MDOs own resources or capabilities.
- iii. Community Advantage Program: The Community Advantage Program is a three-year pilot program that will allow MDOs and other lenders that target underserved populations to access the SBA 7(a) program (with loans up to \$250,000).
- iv. The 7(a) Loan Program includes financial help for businesses. These special requirements are: loan proceeds may be used to establish a new business or to assist in the acquisition, operation, or expansion of an existing business.

For example, funds are available for loans to businesses that handle exports to foreign countries, businesses that operate in rural areas, and for other very specific purposes:

1. Special Purpose Loans: Businesses impacted by North American Free Trade Agreement, support for Employee Stock Ownership Plans and pollution control.
 2. Export Loan Programs
 3. Rural Business Loans
 4. Advantage Loan Initiative: Focus on underserved communities.
 5. Community Advantage Approved Lenders: Pre-approved organizations.
 6. Express & Pilot Programs: Streamlined expedited loan procedures for specific target borrowers.
- v. The 504 Loan Program provides approved small businesses with long-term, fixed-rate financing used to acquire fixed assets for expansion or modernization. 504 loans are made available through Certified Development Companies (CDCs) which are SBA's community based partners for providing 504 Loans. 504 Loans are typically structured with SBA providing 40% of the total project costs, a participating lender covering up to 50% of the total project costs, and the borrower contributing 10% of the project costs. In special circumstances, a borrower may be required to contribute up to 20% of the total project costs

b. Department of Treasury: CDFI Fund

- i. CDFI Certification: Certification Program for loan funds to become eligible to apply for CDFI programs
- ii. Technical Assistance: Grants allow certified CDFIs and established entities seeking to become certified to build their capacity to provide affordable financial products and services to low-income communities and families. Grants may be used for a wide range of purposes including equipment, materials, or supplies; for consulting or contracting services; to pay the salaries and benefits

- of certain personnel; and/or to train staff or board members. The CDFI Fund makes awards of up to \$100,000
- iii. Financial Assistance: Awards of up to \$2 million are made to certified CDFIs under the FA component of the CDFI Program. A CDFI may use the award for financing capital, loan loss reserves, capital reserves, or operations. FA awards are made in the form of equity investments, loans, deposits, or grants, and the CDFI is required to match its FA award dollar-for-dollar with non-federal funds of the same type as the award itself.
 - iv. Other Programs: Other CDFI Fund programs include:
 1. Bank Enterprise Award (BEA): This program provides financial incentives to institutions to expand investments in CDFIs and to increase lending, investment, and service activities within economically distressed communities over a specific time period.
 2. Capital Magnet Fund (CMF): provide competitively awarded grants to CDFIs and qualified nonprofit housing organizations. CMF awards can be used to finance affordable housing activities as well as related economic development activities and community service facilities. Awardees will be able to utilize financing tools such as loan loss reserves, loan funds, risk-sharing loans, and loan guarantees to produce eligible activities whose aggregate costs are at least ten times the size of the award amount.
 3. Financial Education and Counseling (FEC): Through the FEC Pilot Program, the CDFI Fund provides grants to eligible organizations to enable them to provide a range of financial education and counseling services to prospective homebuyers
 4. New Markets Tax Credits: The NMTC Program attracts investment capital to low-income communities by permitting individual and corporate investors to receive a tax credit against their Federal income tax return. This is in exchange for making equity investments in businesses and commercial projects that creates jobs in low income communities. *NOTE: The NMTC program has become a very important tool for Community Economic Development. Please review the separate Guide on New Markets Tax Credits for more details.*
 5. Native American CDFI Assistance Program (NACA): Focused program supporting activities for Native American communities
 6. Certification for Community Development Entities (CDE): Benefits of being certified as a CDE include being able to apply to the CDFI Fund to receive a New Markets Tax Credit (NMTC) allocation.
 - c. United States Department of Agriculture:
 - i. Rural Microentrepreneur Assistance Program (RMAP): Maximum loan: \$500,000. Low interest, 20 year loans with 2-year deferral of payments, to capitalize a revolving microloan fund. The microlender must establish & maintain a 5% loss reserve from their funds. Loan proceeds are to be used for relending as fixed rate microloans (\leq \$50,000) to rural microentrepreneurs.
 - ii. RMAP Technical Assistance Grants: (\$100,000 maximum size) to allow a microlender to provide technical assistance to their microloan borrowers. They can pay administrative expenses of the microlender, but not more than 10% of the grant. Maximum TA grant award is \leq 25% of microlender's RMAP loan portfolio.

- iii. RMAP Enhancement Grants (\$25,000 maximum size) to allow a microlender to increase its capacity to serve rural microenterprises. Enhancement grant awards are *not* tied to the operation of an established RMAP loan fund. RMAP grants cannot provide more than 75% of the cost of the project.
 - d. Health and Human Services, Office of Community Services, Community Economic Development: Community Economic Development Grants: discretionary grant funds to Community Development Corporations (CDC) for well-planned, financially viable, and innovative projects to enhance job creation and business development for low-income individuals. Up to \$800,000 is available for projects that include revolving loan funds, real estate development and business start up and expansion.
 - e. Department of Housing and Urban Development:
 - i. Community Development Block Grants (CDBG): Microloan funding is an eligible activity under the CDBG program. Use of funds is determined by citizens input into the CDBG process by the participating jurisdiction (local or state government). Many jurisdictions have allocated funds for MDO support and all types of small business activities.
 - ii. Community Service Block Grants (CSBG): Loan funds are also supported through CSBG funding through eligible state and local jurisdictions. Most of the local jurisdictions are community action agencies or a local government affiliate that determines use of CSBG funds.
- 2. Foundations and Private Sector:
 - a. Grants: Foundations have been a strong supporter of microenterprise lending and development. Most of the support is conducted on a relationship basis.
 - b. Investments: To a great degree, banks and financial institutions have made equity type investments into loan funds, primarily CDFIs. They have also actively provided deposits in credit unions. Program Related Investments have been made by larger national foundations in the past and focused on specific industry support. The California Endowment has recently made a substantial investment into a fund to support the development of markets in “food deserts” as part of national “healthy food” initiatives. The fund is in partnership with the NCB Bank (previously known as the National Coop Bank).

DEVELOPMENT TIPS:

Consider what community needs are and design the lending or investment activity appropriately. Consider what resources you have or can access to help determine size and scope of your program. Some key development tips to remember include:

1. If you are starting a new fund, do the initial investigative research and concept paper to determine if the project is feasible. The concept paper will also be your base tool to present to potential funding and resource partners and becomes the basis for your business plan. As you gather data, your concept paper should be continually updated. This information will become the basis of your business plan.
 2. Instead of starting your own fund, consider partnerships to bring the resource to your community or to create a specialized fund that can be managed by an existing CDFI or loan fund. This may be an intermediary step for you to gain experience if you later want to create and manage your own fund.
 3. Become a Community Development Entity (CDE) and get CDFI Certification. This is especially true if your organization has a lending program.
 4. The CDFI designation only allows you to apply for CDFI Fund resources. They are very competitive. It is important to build your capacity and track record.
 5. Once you get a CDFI designation make sure conventional lending institutions are part of your planning/development process. Enlist them as supporters (on your board, advisory board or project committee). Remember, conventional financial markets have realized the importance and successes of CDFIs and seek CDFIs to place investments.
 6. Your board of directors and loan committee are very important to the growth and success of your loan fund.
 - a. Board: Creation of the Board of Directors is a very important step that builds the foundation for a successful loan fund.
 - i. Proper balance between mission (helping improve distressed communities) and risk (lending guidelines and requirements) is maintained by board representation.
 - ii. Fundraising: Fundraising is a critical need for loan funds and having representatives from entities that either funds/invests in loan funds or are in peer industries that can support loan fund activities is critical.
 - iii. Management: Expertise in lending, business or law provides the necessary input and oversight of lending activities and overall success.
 - b. Loan Committee: The loan committee should in many ways mirror the balance of the board of directors but have focus on management issues. The committee must have members versed in understanding of the lending guidelines and policies of the fund. Experienced lenders can typically be recruited from financial institutions that invest or lend into the fund.
 7. Manage Expenses: Managing your income and expenses is essential for your long term survival.
 - a. Partnerships with other related lending entities allow you to expand your market and cut down on your own expenses in the areas of marketing, loan processing and loan management.
 - b. Loan losses decrease the size of your loan pool and lower your potential income
 - c. Reserves impact your business success. These are funds set aside that do not generate income.
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- d. Your lending guidelines and approvals also impact your success...the greater risks your fund incurs; the greater the potential is for losses.
 - e. The expenses for marketing, processing and managing a small loan are the same as expenses for a larger loan.
 - f. Partnering and sharing of loan management and portfolio management functions are an excellent means of managing and reducing expenses.
 - g. If you already have loan processing and management experience, you may want to market this capacity and generate additional income by managing funds for partner organizations.
8. Additional Capital: The CDFI Financial Assistance Award is a grant that can start your lending program, but you should look at it as an opportunity to locate additional matching funds to expand your loan pool.

It is important to determine who in the marketplace, has interest in supporting your lending activities.

Your board, advisory board, or project committee should have members who represent financial institutions, local businesses and corporations, and local government and community leaders. They can become your spokesperson(s) and can convene meetings with their peers to market interest in your fund.

Engagement and discussions with the banking regulators; Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of Currency (OCC) and Federal Reserve Bank (FRB) regarding your fund are a very important activity. These institutions can be an important resource for knowing who might be interested in supporting lending activities or are interested in your community. They are also great resources for convening meetings with financial leaders to generate interest in your fund.

Final Note:

Community development loan funds can specialize in its market and services. Becoming a loan fund is not easy and requires a strong commitment from the organization and the members of the development team. With experience the natural progression is to gain CDFI certification and access its many resources. With this added capacity, organizations can become equity investors or can expand their services to the entire community by creating a credit union. The goal can be accomplished with the support of the community, local government and interested financial institutions. It is most important to have staff dedicated to the project and if they do not have the expertise, locate resources to support and guide the effort.

This document is intended to be a guide that outlines some of the key issues and identifies possible solutions and steps. It is not intended to be your source since every project has its own issues, concerns and peculiarities and its own unique solutions. The document is not intended to encourage any organization into project development but only to lay out some of the key steps and issues once the decision is made to proceed.

APPENDIX A - FOR MORE INFORMATION: Resources Websites:

Opportunity Finance Network: (www.ofn.org) “Opportunity Finance Network (OFN) is a national network of community development financial institutions (CDFIs) investing in opportunities that benefit low-income, low-wealth, and other disadvantaged communities across America.

OFN Members are performance-oriented, responsible investors that finance community businesses, sparking job growth in the areas that need it most, and delivering both sound financial returns and real changes for people and communities.

Our Network has originated more than \$23.2 billion in financing in urban, rural, and Native communities through 2009. With cumulative net charge-off rates of less than 1.4%, we have demonstrated our ability to lend prudently and productively in unconventional markets often overlooked by conventional financial institutions.”

Coalition of Community Development Financial Institutions (CDFI Coalition): (www.CDFI.org) “Formed in 1992 as an ad-hoc policy development and advocacy initiative, the Coalition of Community Development Financial Institutions (CDFI Coalition) is the lead national organization in the United States promoting the work of community development financial institutions (CDFIs). Through its member organizations, the Coalition represents CDFIs working in all 50 states and the District of Columbia. This national network of CDFIs includes community development loan funds, community development banks, community development credit unions, microenterprise lenders, community development corporations and community development venture capital funds. The CDFI Coalition coordinates industry wide initiatives to increase the availability of capital, credit and financial services to low-income communities across the nation.”

Community Development Financial Institutions Fund: (www.cdfifund.gov) “Through monetary awards and the allocation of tax credits, the CDFI Fund helps promote access to capital and local economic growth in urban and rural low-income communities across the nation.

Through its various programs, the CDFI Fund enables locally based organizations to further goals such as: economic development (job creation, business development, and commercial real estate development); affordable housing (housing development and homeownership); and community development financial services (provision of basic banking services to underserved communities and financial literacy training).

California Association for Micro Enterprise Opportunity (CAMEO): (www.microbiz.org) “CAMEO’s mission is to promote economic opportunity and community well-being through Micro Enterprise development.

Our member organizations provide entrepreneurs with small business financing such as loans and credit, technical assistance and business management training.

As California’s statewide Micro Enterprise association, CAMEO is the voice for Micro Enterprise in California. We expand resources and building capacity for its member organizations – over 160 lenders, training programs, job creators, agencies and individuals dedicated to furthering Micro Enterprise development in California

National Community Reinvestment Fund (CRF,USA): (www.crfusa.com): “Community Reinvestment Fund, USA (CRF) helps change the lives of people living in economically distressed communities across the country. We supply capital to local community development lenders so they can meet goals like these:

- Grow small businesses
- Increase affordable housing
- Create and preserve jobs
- Build child care centers
- Develop community facilities

At the same time, we enable financial institutions, socially-motivated investors, and accredited individuals to reach their social investment goals.

CRF operates the leading national secondary market for community and economic development loans—a market CRF pioneered. We purchase economic development and affordable housing loans from community development lenders. We then pool them into asset-backed debt securities and New Markets Tax Credit (NMTC) investment funds, which we privately place with institutional investors”

FOR MORE INFORMATION: *Websites, Organizational Examples*

National Specialized Fund:

Low Income Investment Fund (LIIF): (www.liif.org) “LIIF is a community development financial institution (CDFI) that provides innovative capital solutions that support healthy families and communities. As a CDFI, LIIF invests in projects that have high social value but may not be able to access the services offered by traditional financial institutions. In this way, LIIF connects low income communities with the capital markets. LIIF offers a wide range of products, including community capital loans, New Markets Tax Credits, grants and technical assistance. LIIF’s mission-driven approach combined with its market and industry knowledge have distinguished it as a CDFI that creates flexible, affordable financing solutions that work for community organizations and investors. In 2011, LIIF invested over \$1.1 Billion.”

NCB Capital Impact (NCB, formerly the National Coop Bank): (www.ncbcapitalimpact.org) “As a national nonprofit organization and a certified Community Development Finance Institution, NCB Capital Impact improves access to high-quality health and elder care, healthy foods, housing, and education in low-income communities.

Our impact is built on a diverse and extensive network of alliances, our depth of experience, and a cooperative approach. We partner with public and private organizations that are like-minded in mission, and dedicated to long-term success. NCB Capital Impact has deployed \$1.6 Billion in loans, investments and assistance.”

Regional CDFIs:

Clearinghouse CDFI: (www.clearinghousecdfi.com): “At Clearinghouse CDFI we believe in providing equal access to credit in neighborhoods of all income levels and ethnicities. We spend the

time and energy required to find creditworthy borrowers whose projects create assets in the community. These borrowers, because of their unique circumstances, are rejected or not even considered by traditional lenders.

Community development lending must be profitable in order to be sustained. As with conventional lenders, we carefully evaluate each applicant's ability to repay the loan. Unlike traditional lenders, we do not have predefined loan programs. We analyze each loan application individually. Every loan we make benefits the community in a measurable way.

Clearinghouse CDFI is a Community Development Financial Institution serving low-income communities and families throughout the State of California. Through our two lines of business, Core and NMTC lending, we have funded \$760 million in loans and equity investments in low-income communities. Our 1,232 loans have assisted borrowers such as nonprofits and other community development groups to create 3,005 affordable housing units, enable 846 first-time homebuyers, create 4,270 construction and permanent jobs, and serve 215,000 clients of low-income communities annually."

Coastal Enterprises Inc (CEI): (www.ceimaine.org) "CEI in 2012 is a Maine-based organization with strategic expansions outside of Maine, serving more rural communities directly or through alliances and having an ever greater impact on poverty, which is documented with data. The organization has a high financial sustainability ratio, thanks to new and expanded sources of funds through private giving, public funds, and income from funds and venture capital. CEI has a metric for looking at the balance of the 3 Es—economy, equity and environment—through all initiatives, and has a group in place measuring impact, scanning for opportunities, and developing policy."

Community Based Funds:

Fresno Community Development Financial Institution (FCDFI): (www.fresnocdfi.org) "Fresno CDFI is a comprehensive financial services, training, and asset development institution for low- and moderate-income residents and businesspersons. Since our inception in May 2008, our professional, seasoned, and multi-lingual staff – experienced in micro-finance, credit counseling, business plan development, and advocacy for low-income families – has helped hundreds of entrepreneurs realize their dreams. We serve a 9-county region in Central California."

People Incorporated Financial Services: (www.peopleinc.net) "People Incorporated Financial Services was created in 2001 to address business development financing needs throughout Virginia. This People Incorporated affiliate administers the microenterprise development and small business financing activities for People Incorporated

As a Community Development Financial Institution certified by the U.S. Department of Treasury, People Incorporated Financial Services offers loans, development services and financial products to small and emerging businesses. People Incorporated Financial Services works to strengthen local economies in 17-jurisdiction service areas.

People Incorporated Financial Services has extensive experience providing small business and microenterprise development and lending services in low-income communities, and is the only CDFI headquartered in rural Virginia. Since its inception in 1992, the People Incorporated Financial Services loan portfolio has grown to include 308 microenterprise and business loans, which to date have created 475 jobs and retained 180 more."



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