Comptroller of the Currency
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# Community Developments

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# Community Development Financial Institutions and CD Banks — Natural Partners for Traditional Lenders

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*Area around the World Trade Center making a comeback with the assistance of CDFIs.*

On the morning of September 11, 2001, lower Manhattan was actually devastated not once but twice: first by the physical destruction of the World Trade Center and the appalling loss of life caused by the terrorist attacks, and then by the resulting near-collapse of the downtown economy.

Lower Manhattan lost nearly 29 million square feet of office space and a half million square feet of retail space. More than 100,000 workers were relocated or laid off. Suddenly they were gone, and the impact on hundreds of small, local owner-operated businesses — restaurants, newsstands, beauticians, fast-food shops — was shattering.

Many had little hope of surviving until the area's economy could recover — unless they could find short-term, low-interest loans, grants, and other assistance to help cover payrolls, supplies, and rent.

Many of these businesses were too high-risk, by conventional criteria, to qualify for assistance from area banks. But Seedco, a nonprofit community development financial institution (CDFI), funded in part by banks, was able to step in. Within days, it was raising funds and hiring laid-off financial experts to implement its Lower Manhattan Small Business and Workforce Retention Project, focused on shoring up endangered jobs at the bottom of the economic hierarchy.

Five months later, Seedco had approved more than $7.7 million in grants, loans and wage subsidies to nearly 300 small businesses, and had an additional $4 million in grants and loans in the pipeline. And in April, Seedco launched a new initiative specifically to help grocers, delis, bodegas and other small food-related businesses in the area.

Through partnerships with national banks, community development intermediaries, such as Seedco, act as the rescue workers of the corners of our economy that get left behind. National banks, CDFIs and community development banks (CD banks) help meet needs, which if not as dramatic as those created by the events of September 11, can be just as great. How these partnerships work, and what they're accomplishing, is the focus of this issue of *Community Developments*.

### *CD banks and CDFIs defined*

A CD bank is a regulated depository institution with a mission of providing financial services to underserved communities where it is chartered to do business. The OCC designates as CD banks those that intend to primarily serve low- and moderate-income individuals, businesses, or areas. To receive this designation, a bank must meet all of the normal licensing requirements of a national bank charter while also indicating in its articles of association that it intends to lend, invest, and provide services to targeted low- and moderate-income communities. City *First* Bank of Washington, D.C., described in these pages, is an example of a *de novo* CD bank.

A CD bank also may be a community development financial institution — a broader category. A CDFI is a financing entity that specializes in providing credit or other financial services to underserved communities. Collectively, the CDFI industry includes four common types of financial intermediaries: banks, credit unions, loan funds, and venture funds. CDFIs can receive Treasury Department certification and then compete for various types of financial support from the Treasury's CDFI Fund. The New Markets Tax Credit program, a new initiative, provides a significant financial incentive for investing in CDFI Fund-certified community development entities that fund business development in lower-income areas. Banks can also receive Bank Enterprise Act awards for increasing their investments in CDFIs.

The CDFI Fund's mission is to facilitate the flow of capital and services to underserved communities and individuals. Articles in this issue from the CDFI Fund and the National Federation of Community Development Credit Unions provide more information on how the CDFI industry operates, and Southern Development Bancorporation describes its role as an owner of three CD banks — all certified CDFIs — financing economic development in the Mississippi Delta.

### *CD banks and CDFIs at work*

CD banks and CDFIs infuse capital into distressed communities and underserved markets. They're often able to provide funding to borrowers — such as renovators of affordable housing and other small-scale entrepreneurs — that traditional banking institutions can't reach alone. In many cases they also provide technical assistance, which can mean incurring higher transaction costs than might be feasible for a conventional bank. Some CD banks also offer basic retail financial services, such as low-balance savings accounts and transaction services, at minimal cost and with accompanying consumer education programs.

Having a CD bank designation or CDFI certification enables these non-traditional financial institutions to raise capital from bank investors as well as from nonbank financial service companies, foundations, religious institutions, individuals, and government. The benefits flow both ways. CD banks and CDFIs can access the capital they need to grow, and investor banks can reach underserved communities without taking on the costs and risks of building their own local infrastructures. Bank of America, for example, describes in these pages its strategy of investing in CDFIs.

### *Developing partnerships*

Traditional banks can simply invest in CD banks and CDFIs, actively partner with them, or even form new ones. As you'll read, the range of options is wide and growing. (Our Compliance Corner article, *Expanding Your CRA Reach with CD Banks and CDFIs*, outlines how these activities can benefit a bank's Community Reinvestment Act status.)

The most basic form of partnership is through direct financial support: bank investments, deposits, and loans. According to the National Community Capital Association, bank investments as a proportion of CDFI borrowed funds grew from 12 percent in 1994 to 25 percent in 2000, and the average investment grew from $131,659 to $279,129. The Social Investment Forum reports similar increases in investments in CDFIs — with their assets growing 41 percent between 1999 and 2001, to over $7.6 billion.

Partnerships between traditional banks and CD banks and CDFIs also can involve having senior officers of an investor bank serving on the board of the CD bank or CDFI. We've included information about exceptions to the Depository Institutions Management Interlocks Act that permit this kind of arrangement. Similarly, partnership activities, such as loan participations, whole loan sales, and providing operational support services, are among the many mutually beneficial arrangements that traditional banks can establish with CD banks and CDFIs.

Alternatively, some banks with a nationwide or regional focus may prefer to invest in CD banks or CDFIs indirectly through a third party. Intermediaries such as the National Community Capital Association (NCCA) and the National Community Investment Fund (NCIF) have provided leadership in this growing industry by developing performance standards and measures that bring to light the strongest producers (see on line articles). NCCA and NCIF have developed funds that serve as national intermediaries to reinvest individual bank funding in CD banks and CDFIs throughout the country. By investing in CD banks and CDFIs through NCCA or NCIF, investor banks can leverage these national intermediaries' underwriting expertise and portfolio diversity, thereby reducing risk.

### *Challenges facing CD banks and CDFIs*

Financing community development is hard work. CD banks must attract capital, develop a loan and deposit base, and assemble top-flight staff during their start-up periods, just as traditional community banks must do. But CD banks face the added challenge of simultaneously addressing the needs of lower-income areas while still meeting regulated requirements for safe-and-sound operations. CDFIs face similar challenges but have greater flexibility to take on risk since they are not regulated financial institutions.

As a result, CD banks must find investors willing to focus on more than financial returns alone; they must develop a loan base in areas where opportunities to make good loans may be scarce; and they must attract capable senior staff despite being unable to offer the financial incentives typically available at traditional banks. In one article in this issue, a veteran officer of Shorebank (the original CD bank) assesses the challenges a *de novo* CD bank should expect to face.

### *OCC support for CD banks*

In recognition of the important role that CD banks can play as chartered full-service financial institutions, the OCC provides various services to encourage their success. For example, we've developed guidance for organizers of CD banks that describes the issues they need to address to be successful in obtaining a national charter in fulfilling their mission. We also offer technical assistance and guidance. An OCC team of experts is available to meet with CD bank organizers to discuss any questions they may have, and to review a draft of the charter application (a service not offered to traditional charter applicants).

I’m encouraged by the trends we’ve witnessed showing a marked increase in bank involvement with CD intermediaries. Banks and these intermediaries are, in our view, natural partners. By now many leading CD banks and CDFIs have been at work for years, acquiring “street smarts” and building a substantial record of accomplishment. They can and do develop innovative ways to revitalize communities by helping people who have the will and grit to succeed against tough odds. When banks supply the capital, technical assistance, and expertise to improve those odds, they perform a valuable public service. It’s my hope that this issue of *Community Developments* will prompt additional investments in our neediest urban and rural communities.