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## Commercial Lending in Indian Country: Potential Opportunities in an Emerging Market

### **Abstract:**

This edition of *Insights* explores the commercial lending environment in Indian Country, including the interrelationship of governmental, legal, institutional, organizational, and financial infrastructures. The report examines the major challenges and constraints that have impeded larger scale efforts and describes banking and tribal community responses to these barriers considered critical to successful implementation of commercial lending activities. It discusses several federal programs, including loan guarantee, insurance, and interest subsidy programs that have been important in managing risks in commercial and business development by tribes and individual tribal members. The analysis also addresses the prospects of an increased commercial lending presence in Indian Country by discussing options that banks and other interested parties can use to broaden participation in this market.<sup>1</sup>

The information presented in this report was obtained from various sources including national bankers active in commercial lending in Indian Country, as well as representatives from tribal advocacy groups and economic development entities. The Resource Appendix contains sources of additional information on commercial lending in Indian Country.

### **I. What is Commercial Lending in Indian Country?**

Commercial lending in Indian Country<sup>2</sup> – meaning lending to commercial customers within the geographic confines of reservations/trust lands – is a growing market. Many bankers have already recognized this potential, but in a limited way.

Tribal gaming ventures, resorts, and tourist/recreational projects have proven to be profitable

<sup>1</sup> See also the Native American Banking Resource Directory at <http://www.occ.treas.gov/cdd/resource.htm>. The directory contains descriptions and contact information for organizations that can provide resources to those interested in lending, investing, or providing retail financial services in Indian Country.

<sup>2</sup> Indian Country is defined as land inside the boundaries of Indian reservations, communities composed primarily of Indians, and Indian trust and restricted land. See 18 USC 1151. According to the National Congress of American Indians (NCAI), Indian tribes hold more than 50 million acres of land, or approximately two percent of the acreage in the U.S. Most of these lands are located in the west and southwest. Refer to <http://www.ncai.org/Land-Into-Trust.57.0html>.

for lenders and, consequently, typically do not experience a shortage of financing options. Gaming ventures, in particular, have been profitable for some tribes since the passage of the Indian Gaming Regulatory Act (IGRA) in 1988.<sup>3</sup> These are not, however, the only commercial lending opportunities available in Indian Country. Both gaming and non-gaming tribes have been successful in “asset-based” economic development (see Figure 1, page 7), and economic progress is evident in a number of sectors.

As a result, bankers are evolving their lending strategies beyond gaming-related enterprises to include both tribal and private sector non-gaming enterprises. In some cases, they spoke of the need to replicate the credit structure of gaming transactions to help bring commercial lending in tribal communities to scale. For middle-market businesses in particular, the environment is already competitive, and there is increasingly robust tribal activity. Bankers indicated that this line of business has been profitable, satisfied multiple business objectives, and has experienced delinquency, default, and loss ratios among the lowest in their portfolios.

This is not to say that commercial lending in Indian Country is easy. If it were, more banks would be actively engaged in it. As with any niche market, lending in Indian Country presents certain challenges and requires a specific understanding of how to approach and manage the risks of lending in this market. With sufficient knowledge of these unique challenges, and successful risk mitigation techniques, significant opportunities exist for banks to lend and invest in an array of commercial and industrial development ventures.

## **II. Why is Commercial Lending in Indian Country of Interest to Banks?**

Increasingly positive market conditions, indications of potentially strong demand for capital and credit, and the potential for favorable consideration under the Community Reinvestment Act (CRA) are making the prospect of commercial lending in Indian Country an interesting one for banks.

### ***Market conditions***

Recent changes to the economic landscape in Indian Country have made commercial financing activities a timely topic. A study published in 2005 found that there was socioeconomic improvement in Indian Country, as measured by leading indicators from the U.S. Census, between 1990 and 2000. Median household income for non-gaming tribes rose 21 percent, or nearly twice the national average rate of growth during this decade. This finding suggests that the revenue generated by tribes from gaming enterprises is only one driver of the socioeconomic engine in Indian Country.<sup>4</sup>

Further evidence supporting the growing economic development opportunities in Indian Country is the growth of Native-owned businesses. As of 1997, the most recent year for which published data on job growth are available, Native-owned businesses employed nearly 300,000 people and generated \$34.3 billion in revenue.<sup>5</sup> Between 1992 and 1997, the number of Native-owned businesses grew 84 percent compared with a 7 percent increase for all U.S. firms. Receipts for

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<sup>3</sup> As of November 25, 2005, there were 561 tribal entities recognized and eligible for federal funding and services by virtue of their status as Indian tribes, including Native entities of Alaska. Approximately 220 tribes have some type of gaming operations.

<sup>4</sup> Jonathan B. Taylor and Joseph P. Kalt, “American Indians on Reservations: A Databook of Socioeconomic Change Between the 1990 and 2000 Censuses,” The Harvard Project on American Indian Economic Development, January 2005.

<sup>5</sup> Economics and Statistics Administration, U.S. Census Bureau, May, 2001.

Native-owned businesses rose 170 percent, compared with a 40 percent increase for all U.S. firms over the same period.

A number of factors contributed to these economic gains.

- Some gaming tribes assisted non-gaming tribes with funding for economic development purposes.<sup>6</sup>
- There has been significant growth in the establishment of Native American Community Development Financial Institutions (CDFIs). These CDFIs provide technical assistance and capacity-building to entrepreneurs in Indian Country.<sup>7</sup>
- A number of tribally-owned corporations qualified for SBA 8(a) designation and successfully participated in the federal government's contract procurement program.<sup>8</sup>
- Historically, tax incentives have made locating and operating businesses in Indian Country more economically feasible.<sup>9</sup>

### ***Commercial credit needs***

Despite these positive indicators, bankers and tribal representatives continue to note gaps in meeting commercial credit needs and loan demand in tribal communities. These gaps create multiple opportunities for banks.

A study prepared for the Department of Health and Human Services in 2004, for example, reported that a lack of investment capital, both debt and equity financing, was identified by study participants as a critical development issue, making it difficult to start new businesses or expand existing ones.<sup>10</sup> An earlier study noted that small business loans were rated as "difficult to access" or "extremely difficult to access" by 63 percent of the tribal respondents surveyed.<sup>11</sup>

Similarly, nearly 70 percent of tribal respondents in the same study noted that larger-sized loans

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<sup>6</sup> In California and Arizona, gaming tribes are required by law to contribute certain percentages of their income to capitalize funding pools that provide sources of revenue for other tribes in those states.

<sup>7</sup> As of September 2005, there were 36 Native CDFIs. In May 2005, 16 of the certified Native CDFIs were categorized as business loan funds, corresponding to the strong need identified for this type of capital. Refer to <http://www.oweesta.org/> for more detailed information regarding certified and non-certified Native CDFIs.

<sup>8</sup> The 8(a) business development program is designed to assist eligible small, disadvantaged business concerns compete in the U.S. economy through business development. The applicant business concern must possess reasonable prospects for success in competing in the private sector as demonstrated to SBA by, among other criteria, substantial business management experience, adequate capital, and a record of successful performance on contracts from governmental and nongovernmental sources in its industry category. The regulations for the SBA 8(a) Business Development Program are found at 13 CFR 124. Under this program, Congress has provided businesses owned by tribes and Alaska Native Corporations (ANCs) unique rights that give them substantial advantages in the federal procurement process. These rights offer federal agencies and contractors powerful incentives to enter into contractual relationships with tribes and ANCs. They also provide private contracting firms substantial incentives to create teaming, subcontractor, or mentor/protégé relationships with tribal companies. Among these special rights, or exemptions, is the ability of tribal 8(a) firms to receive sole source contracts with no maximum dollar amount. Congress has also permitted tribes to have multiple 8(a) firms, allowing the "affiliation" provisions of the regulations to be applied more favorably to tribal companies. Refer to "Manual on the Benefits of Doing Business on Indian Reservations and with Indian-Owned Reservation Businesses," prepared for the Intertribal Economic Alliance for the Bureau of Indian Affairs, 2004.

<sup>9</sup> Two tax incentives contributed to the growth of Indian-owned businesses: the Indian Employment Tax Credit, and the Accelerated Depreciation on Indian Reservations. Both of these incentives expired as of December 31, 2005, although the provisions are included in the pending Tax Relief Extension Reconciliation Act of 2005.

<sup>10</sup> Walter Hillbrant et al., "Overcoming Challenges to Business and Economic Development in Indian Country," submitted to the U.S. Department of Health and Human Services, August 2004.

<sup>11</sup> "Native American Lending Study," U.S. Department of the Treasury, Community Development Financial Institutions Fund, December 2000.

(defined as loans greater than \$100,000) to businesses operated by tribes or individual tribal members and private equity capital (both start-up financing and venture capital investments) were “difficult to obtain” or “impossible to obtain.” Bankers and tribal representatives specifically cite the lack of operating capital as a critical gap in tribal development projects.

These credit and capital gaps are wider in some industrial sectors than they are in others. Several years ago, when asked to identify the sectors most in need of credit and/or capital on their reservations, survey respondents included construction; tourism, hospitality and recreation; and, utilities and telecommunications among the top four areas.<sup>12</sup> As of 2004, tribes were increasing their participation in a number of business areas, including the service sector (tourism, retail, and information technology), natural resource exploitation (mining and forestry), and construction and manufacturing.<sup>13</sup> There are currently significant examples of economic development activities underway in these sectors, as illustrated by the asset-driven development efforts noted in Figure 1 (see page 7).

### ***CRA considerations***

Another reason banks participate in commercial lending in Indian Country is that it presents community reinvestment opportunities. Many of the commercial lending activities that banks undertake in Indian Country may receive favorable consideration under CRA either as small business loans or community development (CD) loans. Community development loans must demonstrate a primary purpose of community development.<sup>14</sup> A recent and notable change to the CRA regulations could increase incentives for banks to provide credit in Indian Country.<sup>15</sup>

This change, which affects all banks, revised the definition of “community development” by amending the category of activities that “revitalize or stabilize low- or moderate-income areas” to include areas designated by the agencies as “distressed or underserved non-metropolitan middle-income geographies”.<sup>16</sup> Middle-income tribal census tracts, previously ineligible for favorable CRA consideration, may now be eligible if they meet the distress criteria for rates of poverty and unemployment, for example, or are in thinly populated locations.

Additionally, interagency CRA guidance explains when banks may receive favorable consideration

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<sup>12</sup> “Native American Lending Study,” op. cit.

<sup>13</sup> Walter Hillbrant et al., op. cit.

<sup>14</sup> A loan, investment or service has as its primary purpose “community development” when it is designed for the express purpose of revitalizing or stabilizing low- or moderate-income (LMI) areas, designated disaster areas, or distressed or underserved nonmetropolitan middle-income geographies, providing affordable housing for, or community services targeted to, LMI persons, or promoting economic development by financing small businesses and farms that meet the requirements set forth in 12 CFR 25.12 (g). An activity is considered to promote economic development if it supports permanent job creation, retention, and/or improvement for LMI persons or in LMI areas, including areas targeted for redevelopment by federal, state, local or tribal governments. Interagency Questions and Answers Regarding Community Reinvestment, 66 CFR 36620, 36625 – 26, dated July 12, 2001.

<sup>15</sup> OCC Bulletin 2005-28, dated August 24, 2005, transmitting revised CRA regulations, 70 FR 44256, dated August 2, 2005, codified at 12 CFR Part 25, effective September 1, 2005.

<sup>16</sup> “Nonmetropolitan,” meaning an area outside of a Metropolitan Statistical Area, generally refers to rural areas. Nonmetropolitan census tracts in which banks will receive consideration for revitalization and stabilization activities will continue to include low- and moderate-income tracts but will also include middle-income, nonmetropolitan tracts designated by the banking agencies as “distressed or underserved.” The designation is based on one or both of two sets of criteria: “distress” criteria including poverty rates, unemployment, and population loss; and criteria that indicate a community may have difficulty meeting essential community needs (“underserved”), based on population size, density and dispersion. See the revised CRA regulations at 12 CFR 25.12(g).

for loans and investments that are not in the bank’s assessment area(s). The guidance provides that banks that do not have tribal or trust lands in their service areas, but are adequately addressing community development needs within their own assessment area(s), may receive CRA consideration for tribally-related community development activities located in the broader statewide or regional area(s) that include their assessment area(s).<sup>17</sup>

Table 1 below illustrates how financial institutions evaluated under the lending, investment, and service tests may benefit from engaging in economic development activities in Indian Country.<sup>18</sup>

**Table 1**  
**Activities That May Receive CRA Consideration**

<b>Lending Test</b>	<ul style="list-style-type: none"> <li>• A bank makes small business loans to members of a tribe or tribal enterprises.</li> <li>• A bank provides a CD loan to a nonprofit organization serving a tribal community.</li> <li>• A bank makes a CD loan to construct a facility on a reservation that provides jobs for LMI persons.</li> </ul>
<b>Investment Test</b>	<ul style="list-style-type: none"> <li>• A bank contributes funds to support the operations of a CDFI that promotes economic development on a reservation.</li> <li>• A bank invests in an equity fund that makes loans to businesses that serve a reservation and provide jobs for LMI persons.<sup>19</sup></li> </ul>
<b>Service Test <sup>20</sup></b>	<ul style="list-style-type: none"> <li>• A bank officer serves on the board of directors of an organization that promotes credit availability on reservation-based communities.</li> <li>• A bank provides technical assistance on financial matters to a Native CDFI that addresses economic revitalization needs, such as by developing business or commercial loan underwriting standards.</li> <li>• A bank offers financial literacy training through a tribal community organization.</li> </ul>

<sup>17</sup> Interagency Questions and Answers Regarding Community Reinvestment, 66 FR at 36626-27.

<sup>18</sup> Under the revised CRA regulations, intermediate small banks are evaluated under a “streamlined” lending test and a CD test, and are not required to collect and report data regarding small business loans. Institutions evaluated under the lending, investment, and service tests, however, must collect and report these data.

<sup>19</sup> For national banks, these investments may require a filing under the OCC’s public welfare investment regulation, 12 CFR 24 (“Part 24”). Under Part 24, community development investments must meet the requirements for primarily promoting the public welfare and investment limits. Activities undertaken by the community and economic development entity or community development project, in which the bank invests, must primarily benefit LMI persons or LMI areas, or other areas targeted for redevelopment by a government entity. Activities that would qualify under Part 24 also include “qualified investments,” under the newly expanded definition, that would receive consideration under 12 CFR 25.23 during the bank’s CRA examination.

<sup>20</sup> In addition to meeting the definition of “community development,” CD services must also be related to the provision of financial services. See Section 25.12(j)-1, Interagency Questions and Answers Regarding Community Reinvestment, 66 FR at 36627.

## **Figure 1**

### **Success Stories**

Asset-based development involves building wealth through natural resources, such as oil, minerals, agriculture, wildlife and forests, and cultural property, including tribal intellectual property, such as customs, cultural practices, and traditions. Tribes use their natural and cultural resources to support culture-based business, commercial, and industrial development. A number of success stories document recent tribal economic development progress.

- The Mississippi Band of Choctaw Indians (MBCI) currently manages a portfolio comprising small business, industrial, and retail activities. The MBCI were successful in attracting and promoting industrial development on their reservation before establishing gaming operations. The tribe is one of the 10 largest employers in Mississippi, with an annual payroll of close to \$125 million, and has reinvested more than \$210 million in economic development projects in the state.
- The Gila River Indian Community in Arizona expanded beyond gaming-related resort development to include, among other industrial projects, construction of a commerce and business park.
- The White Mountain Apache tribe developed sophisticated forestry, wildlife, and recreational management capabilities. Among other accomplishments, the tribe manages one of the most productive sustained-yield timber operations in the western United States.
- Other examples include the Navajo Nation, which has national monuments and other scenic attractions on the reservation, and Three Affiliated Tribes, which is developing tourism-related activities, including a cultural interpretation center.
- Alaska Native Corporations (ANCs) have a dominant presence in the construction and manufacturing sectors, effectively using their status under the SBA 8(a) program in construction, telecommunications, and energy-related projects.

These tribes successfully created an investment climate that is attractive to Native and non-Native parties. Tribes enjoying a high level of economic success also have a major impact on the broader economic base of their geographic areas. The multiplier effect of tribes with thriving economies represents additional opportunities for banks to expand their customer base.

### **III. How Does Commercial Lending in Indian Country Work?**

Commercial lending in Indian Country requires bankers and their tribal customers to agree on how loan facilities can be structured to address particular factors unique to lending in Indian Country while providing bankers with attractive and safe and sound lending opportunities.

Bankers described how, with increasing knowledge about, and experience with, commercial and industrial projects in Indian Country, they were more comfortable managing the risks described in Section IV. Their recommendation to banks new to Indian Country, particularly smaller banks that would like to enter this market, is to get to know the staff at the Bureau of Indian Affairs, the U.S. Department of Agriculture, and the Small Business Administration as part of their credit risk strategies. Bankers noted that use of these agencies' loan guarantee programs was critical for them to move forward with Indian Country transactions.

Bankers looking to enter this market may also benefit from the work of nonprofit entities that are providing training and technical assistance to many tribes. These groups are seeking partnerships and alliances with financial intermediaries and other nonprofit groups, as well as the private sector.

National banks can participate in a number of ways in, as one banker characterized it, this “new frontier” of capacity-building by promoting, developing, and providing funding for business and entrepreneurial literacy.

### **What programs are available to mitigate lender risks?**

The OCC recognizes that each of the challenges identified in Section IV may pose certain credit and regulatory risks. The remote locations of reservation-based communities, coupled with the lack of physical infrastructure, including telecommunication facilities, can make doing business in those geographies difficult. In this discussion, we identify several federal government loan guarantee and related programs that are available to banks interested in penetrating this market, which can mitigate some of the risks inherent in addressing the challenges.

The use of guarantees as secondary support for debt repayment may be particularly appropriate for highly leveraged or start-up projects, which are typical of commercial developments in Indian Country. These programs include the Small Business Administration (SBA) 7(a) loan guaranty program, the U.S. Department of Agriculture (USDA) Business and Industry (B&I) loan guarantee program, and the Bureau of Indian Affairs (BIA) loan guarantee, loan insurance, and interest subsidy programs.

The following government programs have been used effectively by several national banks, involving a number of tribes, on different trust lands.<sup>21</sup>

#### ***BIA Loan Guarantee Program***

The BIA will guarantee up to 90 percent of a loan made by a bank to an Indian business, provided that the activity will contribute to reservation-based economic development. The application is made to the BIA regional office, after the lender has approved the loan subject to the guarantee. The maximum loan amount guaranteed for individual tribal members is \$500,000, with \$12 million as the limit for loan guarantees to tribes and tribal enterprises. BIA will evaluate requests for guarantees on a case-specific basis.

BIA charges the lender a premium for the guarantee coverage. The premium is two percent of the guaranteed portion of the loan. Lenders may pass this cost on to the borrower, by charging a one-time fee, or by adding the cost to the principal amount of the borrower’s loan.

#### ***BIA Loan Insurance Program***

This program provides a way for Indian businesses to obtain insured loans under \$250,000 more quickly, and with less cost, than under the loan guarantee program. Under this program, banks certified by the BIA may make loans in amounts up to \$250,000 without obtaining prior BIA approval. The fee charged is one percent of the insured portion of the loan. The insurance program may be a viable way for smaller Native businesses to obtain insured loans under \$250,000 more efficiently.

#### ***BIA Interest Subsidy Program***

This program involves payment by BIA to reimburse part of the interest payments made by borrowers for loans made under the guarantee or insurance programs. It is available to borrowers whose projected or historical earnings before interest and taxes, after adjustment for extraordinary

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<sup>21</sup> Some of the program-specific information was obtained from “Manual on the Benefits of Doing Business on Indian Reservations and with Indian-Owned Reservation Businesses,” op. cit.



items, is less than the industry norm. Interest subsidy payments are issued for the term of the loan, up to three years. If extensions are justified, they may be granted for two one-year periods. BIA will make subsidy payments on a specific loan for no longer than five years.

Most of the bankers interviewed for this report use the BIA loan guarantee program. Several of them have used all three programs.<sup>22</sup> In some cases, bankers have layered the loan guarantee, loan insurance, and interest subsidy features on a loan or loans.

### ***USDA B&I Loan Guarantee Program***

The B&I Loan Guarantee Program is intended to improve, develop, or finance business, industry, and employment, and improve the economic and environmental climate in rural communities. The guarantee fee charged, which may be passed on to the borrower, is two percent of the original loan amount. The fee may be reduced to one percent if certain criteria are met; for example, the business is located in a community that is experiencing long-term population decline and job deterioration. Eligible borrowers include Indian tribes or federally recognized tribal groups.<sup>23</sup>

Loan proceeds may be used for machinery and equipment, buildings and real estate, working capital, and certain types of refinancing (ineligible purposes of this program include any business that derives more than 10 percent of its annual gross revenue from gaming activities). Unlike SBA programs, a business does not have to meet “small” size designations to qualify. Generally, the maximum aggregate amount made available to a borrower is \$25 million, although the maximum amount for rural cooperatives processing value-added agricultural commodities is \$40 million. USDA will guarantee up to 90 percent of the amount of a loan under \$2 million, 80 percent of a loan between \$2 million and \$5 million, 70 percent of a loan over \$5 million, and 60 percent of a loan over \$10 million.

### ***SBA 7(a) Program***

The SBA 7(a) loan program provides commercial loan guarantees for general business purposes. Loan proceeds may be used for working capital, machinery and equipment, furniture and fixtures, land and buildings (including purchase, renovation, and new construction), leasehold improvements, and, under certain conditions, debt refinancing. Loan terms are up to 10 years for working capital and, generally, up to 25 years for fixed assets. The SBA offers multiple variations of the basic 7(a) loan program to accommodate specific needs.<sup>24</sup>

Commercial loans to tribally owned businesses may be eligible to receive guarantees under the 7(a) program if they meet the SBA requirements regarding size, nature of the business, use of proceeds, character, and lack of available credit elsewhere.<sup>25</sup> Tribes may be required to guarantee the loan. Procedures for processing loan applications for Indian borrowers are the same as for any other SBA loan.

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<sup>22</sup> The BIA's regulations for each of these programs may be found at 25 CFR 103. These regulations can be accessed at: <http://www.gpoaccess.gov/cfr/index.html>.

<sup>23</sup> The regulations for the USDA B&I program may be found at <http://www.rurdev.usda.gov/>.

<sup>24</sup> The regulations, 13 CFR 120, may be found at <http://www.sba.gov/financing/fr7aloan.html>.

<sup>25</sup> SBA regulations specifically deem businesses that derive more than one-third of their gross annual revenue from “legal gambling activities” ineligible for SBA business loans.



## **Working with tribal businesses**

Tribal sovereign immunity (discussed in Section IV) has implications for the corporate or business structures that tribal governments create to undertake development ventures. Although tribal governments enjoy sovereign immunity, depending on their organizational structure, not all of the business entities formed by the tribe may possess this immunity. Moreover, given the advisability for bankers to separate tribal governments from the actual borrowing entities in Indian Country, tribes and banks have established various methods by which tribal economic activities are insulated from governmental functions and, generally, immunity issues. Three of the most often used methods are described as follows.

### ***Establish a Section 17 corporation***

Pursuant to Section 17 of the Indian Reorganization Act of 1934 (IRA),<sup>26</sup> a tribe may establish a “Section 17 corporation” to carry out its tribal business activities and responsibilities. Under a Section 17 corporate umbrella, the tribe becomes a separate legal entity from the governmental entity, essentially formed for economic purposes. There are other corporate structures that tribes can establish in lieu of Section 17 corporations, such as wholly owned, tribally chartered enterprises.

### ***Establish a state-chartered corporation***

Some tribes have organized state-chartered corporations (as well as limited liability companies) with the intent that the assets of those entities are not immune from suit, since they are incorporated pursuant to state, not tribal, laws.<sup>27</sup>

### ***Tribal council appointments***

Rather than having the tribal council act as decision-makers for tribal businesses, tribes more typically permit their tribal councils to appoint members of the board of directors of the tribal corporation(s) or tribal enterprise(s).<sup>28</sup> Bankers and tribal representatives have commented that this strategy has proven to be workable and effective. Under this scenario, the tribal council can remain informed about the activities of the tribal enterprise, but is not burdened by involvement in the entity’s management.

## **IV. What Are the Key Risks and Regulatory Issues Associated with Commercial Lending in Indian Country?**

Native and non-Native parties must address a complex interrelationship of legal, regulatory, cultural, governmental, and operational issues when lending in Indian Country.<sup>29</sup> In this section, we describe the primary risks and barriers that have inhibited bank financing and identify how some banks have seized opportunities to partner with tribes to move economic development activities forward. Additionally, we report on situation-specific responses to these issues.

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<sup>26</sup> 25 USC 477. Tribes may establish federally chartered corporations under this Act. These corporations are owned by the respective tribes and incorporated under tribal laws.

<sup>27</sup> Generally, tribal immunity does not pass through to state-chartered corporations, although that question has not been settled. Non-Native parties should exercise due diligence in making this assessment.

<sup>28</sup> Walter Hillabrant et al., op. cit.

<sup>29</sup> During our interviews, it was determined that some tribes have expanded their economic development activities to off-reservation enterprises. These ventures were highly successful in attracting bank financing in that the typical collateral requirements, such as obtaining fee simple mortgage liens, and other customary legal circumstances were operable.

## ***Sovereign immunity***

Federally recognized tribes are sovereign entities, analogous to national governments, with many of the rights and attributes of an entity, such as a foreign nation. The legal status of tribes provides them with considerable economic benefits, including the ability to levy taxes and establish a business environment that can be conducive to development by outside investors and lenders.<sup>30</sup>

Tribes have immunity from private lawsuits and, ordinarily, may not be sued in tribal, state, or federal courts absent an “effective” or “unequivocally expressed” waiver or consent by means of a “sue or be sued clause” contained in relevant legal documents. Many Indian tribes, however, are not comfortable providing a complete waiver of their sovereign immunity.

As a “workaround” to address concerns by both banks and tribes regarding tribal immunity, banks have negotiated limited waivers of sovereign immunity in their transactions with tribal governments and tribal corporations that are restricted to a specific transaction, with assets expressly pledged or made available to satisfy any claims that may arise from the transaction.<sup>31</sup> Alternatively, the transaction may be carried out through a legally distinct tribal business entity with either no sovereign immunity or limited immunity vested by the tribe. In the current business climate in Indian Country, an increasing number of tribes are willing to provide limited waivers of immunity in their commercial transactions with lenders and other non-Native parties, or to conduct the transaction through a distinct tribal business entity.

## ***Collateral***

The relationship between the United States government and tribal governments, and the U.S. government and individual Indians, is referred to as a “trust responsibility” for Indian assets. Indian trust assets include lands, natural resources, money, or other assets held by the federal government on behalf of tribes and members of tribes.<sup>32</sup> The designated trustee agency is the BIA, which is part of the U.S. Department of the Interior. Tribes and members of tribes hold beneficial ownership interest in those assets.

Tribal trust lands generally may not be sold, taxed, or encumbered,<sup>33</sup> making the perfection of a bank’s mortgage lien(s) on real property challenging. However, with the approval of the BIA, the tribe can lease the trust lands to a tribal entity, tribal member(s), or a non-tribal party.<sup>34</sup> The lessee then may grant a leasehold mortgage interest that, in the event of a default, gives the lender control over the pledged land for the balance of the term of the lease. Thus, leasehold interests, with BIA approval and tribal consent, can be encumbered, assigned, and used as collateral for the financing of the transaction.<sup>35</sup>

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<sup>30</sup> Income-producing tribal governments are not subject to taxation, pursuant to Revenue Ruling 67-284 issued by the U.S. Internal Revenue Service. Since tribes can control the tax and regulatory structure of commercial relationships with non-members, the favorable tax consequences of tribal sovereignty may pass through to the non-Native businesses that locate in Indian Country, and could represent an important incentive for entrepreneurs. Refer to <http://www.irs.gov/govt/tribes/> article for FAQs on the tax status of Indian tribes.

<sup>31</sup> Mark A. Jarboe, *op. cit.*

<sup>32</sup> U.S. Department of the Interior, Order No. 3215, April 28, 2000.

<sup>33</sup> 25 USC 177.

<sup>34</sup> Under federal regulation, such leases are generally limited to a term of 25 years with a renewal option of an additional 25 years; however, on certain reservations, the leases may have terms up to 99 years. 25 USC 415.

<sup>35</sup> Mark D. Ohre, *Business Law Today*, Vol. 10, No. 4, March/April 2001; refer to <http://www.abanet.org/buslaw/blt/>.

Many bankers have had positive experiences in negotiating leases with tribal entities and taking leasehold mortgage interests as collateral.<sup>36</sup> Bankers also have “worked around” the issue of securing loans on trust lands by using collateralized deposits from sources, such as tribal reserve funds and certificates of deposit.

### ***Lack of standard commercial practices and commercial codes***

One of the most frequently mentioned impediments to perfecting liens against non-fixed assets in reservation-based communities is insufficient or non-existent written tribal commercial laws and regulations, including commercial codes.

In many instances, there are inconsistencies among tribal laws and regulations regarding these secured transactions, resulting from the lack of formalized commercial practices and standardized documentation. Consequently, there is lender uncertainty about the enforceability of security agreements, particularly regarding certificates of deposit and personal property collateral.

A growing number of tribes are adopting commercial laws that mirror the Uniform Commercial Code (UCC). Absent a tribal UCC, parties doing business in Indian Country have developed alternatives to secured transactions with tribes, including selectively adopting limited components of state law, such as debt collection codes.<sup>37</sup>

### ***Tribal courts***

Researchers have observed that an essential element to attracting private sector investment in reservation-based business development is an independent tribal judicial system willing to uphold contracts, enforce effective business codes, resolve disputes, and, generally, separate tribal business matters from governmental decision-making by tribes.<sup>38</sup> Generally, a tribal court has jurisdiction over non-Indian parties that enter into commercial relationships with tribes or tribal entities through contracts, leases, or similar business arrangements.

While tribal courts generally have exclusive jurisdiction over a suit involving Native-Americans in Indian Country, such courts are not necessarily the only adjudicatory venues for transactions involving trust lands. Parties to an agreement can expressly agree to a limited waiver of sovereign immunity and specific dispute resolution provisions to permit adjudication in another forum (choice-of-venue or choice-of-forum provisions) or in accordance with a particular state or federal law (choice-of-law provisions).<sup>39</sup>

Alternatively, tribes and non-Native parties may agree to resolve contractual disputes through binding or non-binding arbitration, bypassing the court system completely, except for the enforcement of an arbitration award. This may be especially useful if non-Native parties insist

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<sup>36</sup> In one instance, a national banker negotiated master leases between the tribe and the tribal entity that extend up to the 99-year maximum allowable term, which created both legal and business benefits for that enterprise.

<sup>37</sup> Susan Woodrow and Tim Berg, “Model Tribal Secured Transactions Act and its Implementation Guide and Commentary,” presentation to the OCC Interagency Native American Financial Access Working Group, June 21, 2005. The harmonization of state transaction laws with tribal commercial codes may reduce lender/tribal concerns and the reluctance to enter into commercial transactions. It also may reduce transaction costs through shorter timetables and lower legal costs, which interviewees identified as significant. To this end, the National Conference of Commissioners of Uniform State Laws (NCCUSL), in conjunction with the Minneapolis Federal Reserve Bank, is currently launching a proposed Model Tribal Secured Transactions Act and companion implementation materials. Based primarily on revisions to Article 9 of the UCC, it may prove to be a helpful resource for different tribes to adopt in the near future and modify as appropriate. Refer to <http://www.nccusl.org>.

<sup>38</sup> Stephen Cornell and Joseph P. Kalt, op. cit., No. 2003-02.

<sup>39</sup> Gabriel S. Galanda, op. cit.

that tribes agree to adjudicate disputes in non-tribal courts. Choice-of-forum and choice-of-law matters are significant issues that should be settled before the beginning of a commercial transaction.<sup>40</sup>

## **V. Who is in the Business of Commercial Lending in Indian Country Today?**

There are a number of participants in today's commercial lending market in Indian Country. They include large regional banks, community banks, tribal entities, government and nonprofit agencies, and financial intermediaries, such as Native CDFIs and community development corporations (CDCs).

The larger banks operating in Indian Country typically have regional footprints in geographies that contain many reservation-based communities, or are closely proximate to tribal trust lands. As tribes have expanded the scope of their business and economic development activities, banks have adapted their financing activities. Although these banks have financed a number of gaming-related ventures, they are increasingly diversifying their lending and investments into non-gaming economic development projects as a major element of their business lines. These banks are developing comprehensive business models for building and managing a growing array of tribal development activity, including projects that capitalize on natural, physical, and cultural resources of tribes. Large banks noted that they are seeking opportunities to expand both within and outside of their footprints by making loans to individual tribal businesses and tribal enterprises.

Community banks also have tribal communities in their assessment areas, particularly in certain regions of the country, such as the west and southwest.<sup>41</sup> The community bankers who have expended resources necessary to develop expertise in responding to the cultural and legal challenges that confront lenders in Indian Country are particularly interested in expanding their lending in this area. These community bankers were more likely to use the federal loan guarantee programs discussed in Section III.

Tribal representatives described ways in which a tribal corporation partnered with its tribe's CDC to raise equity funds from foundations and other sources that, in turn, were used to help construct an industrial facility that created jobs for tribal members. Tribal funds frequently have been used to self-finance tribal enterprises and other economic development activities. Tribes also have pledged funds with lenders as secondary sources of debt repayment, via collateralized revenue streams from successful ventures, as well as using tribal reserve funds as collateralized deposits, in addition to, and in lieu of, guarantee programs.

Bankers and tribal representatives alike have participated in arrangements in which more experienced and/or more affluent tribes have willingly shared both their financial and intangible resources, such as the use of tribal commercial practices and financial education programs, to help other tribes undertake economic development activities. Nonprofit and for-profit partners are increasingly seeking investments in CDFIs and other intermediaries by tribes that have generated significant financial capacity, as well as looking to those tribes to provide funds for mechanisms such as loan and venture capital pools. Banks can work with tribes and tribal corporations to establish a range of financing vehicles.

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<sup>40</sup> Mark D. Ohre, *op. cit.*

<sup>41</sup> Several tribes have an ownership interest in community banks that offer credit products and services to tribal members and tribal economic development entities. For a general discussion of this subject, see OCC's "A Guide to Tribal Ownership of a National Bank" at <http://www.occ.treas.gov/corpbbook/tribal/tribalp.pdf>.

Banks that are just getting started in Native American commercial lending may tap various resources. The National Center for American Indian Enterprise Development (NCAIED), in cooperation with the Minority Business Development Agency (MBDA), operates a number of Native American Business Development Centers (NABDCs) at locations throughout the country. NABDCs offer management and technical assistance to tribes and members of tribes, particularly the promotion of mentor/protégé relationships. Information about the location of these centers is listed in the Resource Appendix.

## **VI. How Does the Cost/Pricing Structure Work?**

There are certain unique costs associated with commercial lending in Indian Country, primarily related to the relationship-building process among banks and tribes, tribal entities, and members of tribes.

Bankers advise that, although lending to sovereign nations on trust land assumes a certain amount of added risk, banks can effectively manage this risk by conducting a comprehensive evaluation that includes the creditworthiness of the tribe, a tribal and tribal enterprise management assessment, financial analysis of the project, and the collateral pledged by the tribe. The credit risk profile that the bank establishes for the tribe, tribal corporation, and the transaction will determine the loan rates and terms offered.

There are, however, a number of factors that impact the cost structure of transactions consummated in Indian Country.

### ***Marketing and outreach campaigns***

Typically, bankers expend substantial marketing, promotion, and outreach efforts in developing business prospects in Indian Country. Venues include conferences and conventions, such as the annual Reservation Economic Summit and American Indian Business Trade Fair, sponsored by NCAIED, exhibits, and many one-on-one consulting sessions.<sup>42</sup>

Bankers also recognize the need to have patience in communicating with tribal councils and tribal corporations or other business entities. This commitment of effort not only enables bankers to understand tribal laws and traditions more fully, but also helps inform the tribal parties about the bank's legal and business requirements. While the time spent in building trust and cultivating business relationships is invaluable, it may extend the timetables for completion and may increase the costs associated in financing the ventures.

### ***Specialized legal resources***

Many bankers conduct a legal risk assessment prior to undertaking a project in Indian Country. Having in-house or outside counsel with Indian commercial law experience is viewed as important to the success of the banks' transactions.

In a number of instances, banks developed standardized loan documentation packages that reflected the major legal considerations discussed previously, with the ability to adjust provisions to incorporate the transaction-specific terms and conditions negotiated. These documents and other products can serve as templates or models for future business negotiations with different tribes involving other commercial activities.

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<sup>42</sup> Business assistance is available for tribes and individual members both on and off the reservation, and includes financial and loan packaging, business plan preparation, and SBA 8(a) assistance. Refer to <http://www.ncaied.org/> for more information.

### ***Capacity- and resource-building strategies***

Tribal advocates emphasized the importance of creating partnerships, such as mentoring arrangements, which have been particularly valuable in the construction industry. Several bankers have developed customized training for tribes, members of tribes, and tribal entities, noting that even more experienced tribes often benefit from ongoing financial management assistance. In some cases, they have carried out these training and technical assistance programs in partnership with entities such as tribal nonprofit agencies and local Native CDFIs.<sup>43</sup> Native CDFIs are working with tribes to develop commercial strategies, including tribal codes, and to improve financial literacy as well as provide entrepreneurial skills.

Developing and implementing these programs entails the commitment of human and financial resources by Native and non-Native parties. Bankers and tribal representatives both noted that investments by lenders in these types of programs would enhance the long-term viability of the projects financed.

### ***Government guarantee programs***

As discussed in Section III, fees are imposed on lenders participating in the federal loan guarantee programs. These programs' regulations, however, permit banks to pass these costs on to the borrowers.

### ***Remote geographies***

The remote locations of reservation-based communities, coupled with the lack of physical infrastructure, including telecommunication facilities, can increase the costs of doing business in those geographies.

## **VII. What Barriers Have Constrained the Growth of Commercial Lending in Indian Country?**

A major constraint impeding the growth of commercial lending in Indian Country is the unfamiliarity of lenders with the unique characteristics and dynamics of the market. As described in Section IV, the sovereign status of tribes has substantial implications for jurisdiction, collateral, and arbitration practices that can impact negatively a bank's willingness to undertake economic development activities in Indian Country. Indian tribes and reservation-based communities exist and operate within a unique legal and governmental framework that can introduce a complicating factor into banks' need for predictably enforceable agreements. The tribes' sovereign status requires that banks and tribes work together to ensure that lenders can enforce contracts and resolve contract disputes that arise from commercial transactions through litigation, arbitration, or other methods of adjudication.

### ***Tribal governmental infrastructure: managing political risk***

Bankers and tribal representatives both stressed the importance of a stable tribal governmental infrastructure. Political uncertainty can be a significant impediment to implementing viable economic development activities. Bankers emphasized that all parties to a tribal commercial transaction must understand the governmental organization of the tribe in question.

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<sup>43</sup> Introduced by the CDFI Fund in 2004, the Native American CDFI Assistance Program (NACA) Program provides eligible Native CDFIs with loans or grants through a competitive application process to support their financing activities. Examples of these activities include investments in tribal business ventures and small businesses owned by tribal members, and financial literacy development and entrepreneurship training. To date, 22 organizations have received awards from the CDFI Fund. Refer to <http://www.cdfifund.gov>.

### ***Capacity of tribes and tribal entities***

The ongoing need to create long-term capacity-building strategies, including the development of business skills and entrepreneurial literacy, is a key, long-term challenge for enhanced commercial lending in Indian Country. Bankers and tribal representatives frequently cited the need to provide loan packaging services and technical assistance in the business management and financial operations of funded transactions, even when dealing with tribes having considerable development experience.

### ***Lack of awareness of risk mitigation programs***

Lenders also may not be conversant with the programs available to mitigate risks when undertaking commercial activity in Indian Country. Summarized in Section III are several of the most frequently used federal programs, which are used on a transaction-specific basis, even by larger banks with extensive commercial loan volumes in Indian Country.

Commercial transactions in Indian Country have some similarity to economic development efforts in other traditionally underserved markets, such as inner-city neighborhoods. These markets are characterized by the need for, and the use of, layered subsidies. Similarly, they require the time, patience, and commitment of bankers to develop workable strategies to address the risks and challenges of those markets.

## **VIII. Conclusion**

Commercial lending in Indian Country presents challenges, but the market has evolved and bankers have responded positively to these challenges. A number of banks and tribes are comfortable using different business and legal mechanisms to address some of the long-standing barriers to lending in Indian Country. Government guarantee programs also accommodate these legal nuances and provide assistance when banks decide to access this market.

Market opportunities do exist, illustrated by the relatively high growth of Native-owned businesses, as compared to all U.S. firms, in recent years. There is a growing appetite for business and commercial lending on tribal trust lands. As this report describes, some banks have aggressively pursued these opportunities by implementing a variety of business strategies to meet the needs of this expanding market.



## Resource Appendix

**Native American Banking Resource Directory at:**

<http://www.occ.treas.gov/cdd/resource.htm>

**The National Congress of American Indians at:**

<http://www.ncai.org>

**Harvard Project on American Indian Economic Development at:**

<http://www.ksg.harvard.edu/hpaied/>

**First Nations Oweesta Corporation at:**

<http://www.oweesta.org/>

**The CDFI Fund at:**

<http://www.cdfifund.gov>

**U.S. Small Business Administration at:**

<http://www.sba.gov/financing/special/native.html>

**U.S. Department of Agriculture, Business and Industry Program at:**

<http://www.rurdev.usda.gov/>

**National Center for American Indian Enterprise Development at:**

<http://www.ncaied.org/>

**The National Tribal Justice Resource Center at:**

<http://www.ntjrc.org/>

**Federal Reserve Bank of Minneapolis at:**

[http://minneapolisfed.org/community/pubs/secured\\_transactions.pdf](http://minneapolisfed.org/community/pubs/secured_transactions.pdf)

**Federal Reserve Bank of San Francisco / Bureau of Indian Affairs Loan Guaranty Program Guidelines at:**

<http://www.frbsf.org/community/native/bia.html>

**Minority Business Development Agency /Native American Business Development Centers at:**

[http://www.mbda.gov/?section\\_id=1&bucket\\_id=151&content\\_id=2264](http://www.mbda.gov/?section_id=1&bucket_id=151&content_id=2264)

Stephanie Caputo was the primary author of this report. Also contributing were William Reeves, Matt Quigley, and Barry Wides. *Community Developments Insights* reports differ from OCC advisory letters, bulletins, and regulations in that they do not reflect agency policy and should not be considered as definitive regulatory or supervisory guidance. Some of the information used in the preparation of this paper was obtained from publicly available sources that are considered reliable. However, the use of this information does not constitute an endorsement of its accuracy by the Office of the Comptroller of the Currency.