

Investing in Community Development and Other Emerging Domestic Markets

Federal Reserve Bank of Boston
AltruShare Securities
Southern New Hampshire University

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Saurabh Narain

snarain@ncif.org | 312-881-5826

Outline

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 - Vehicles for Leveraged Economic Development

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- **Increasing Asset Class of CDBIs**
 - NCIF Social Performance Metrics

- **National Community Investment Fund**

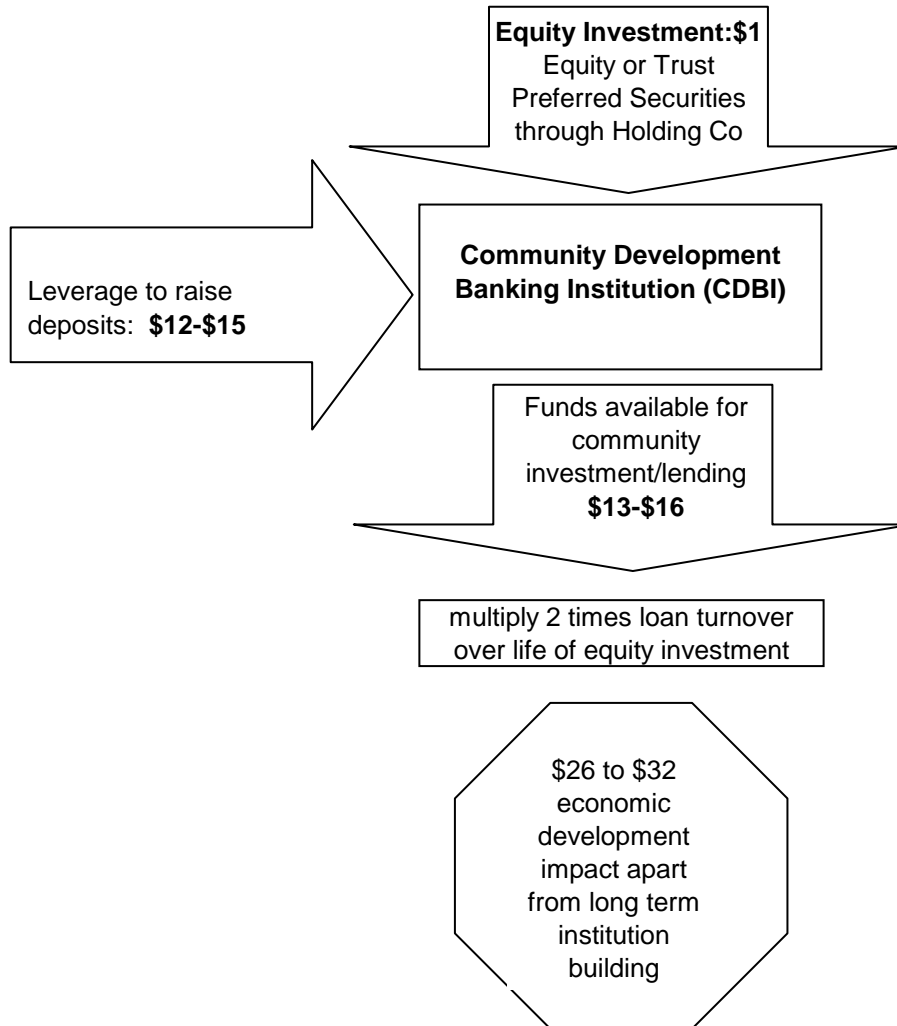
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Community Development Banking Institutions: Vehicles for Leveraged Economic Development

Community Development *Banking* Institutions

- Banks, thrifts and credit unions that have a double bottom-line mission i.e.
 - *insured financial institutions* that are
 - *sound financial performers* and have
 - *a mission of economic or social development, ex ante or ex post.*
- Some of these institutions are certified as “Community Development Financial Institutions” or CDFIs by the Department of Treasury (www.cdfifund.gov), while others are not; but continue their double bottom-line mission.
- NCIF collectively calls these institutions – Community Development ***Banking*** Institutions” or CDBIs

Why invest through CDBIs?



1. CDBIs provide outstanding leverage

- Assume: \$1 equity invest in a CDBI; this can be leveraged 12-15 times to raise deposits
- Assume average loan life of 5 years and equity holding period of 10 years
- This implies that \$1 of equity investment can create \$26 to \$32 of impact in low to moderate income communities.

2. Create institutions vs one-off projects

- As sustainable financial institutions, CDBIs provide credit and non-credit financial services and build partnerships for long term impact in distressed communities.

CDBIs – The Landscape

Category	#	Avg Assets (000)	Median Housing Focus	Median Return on Assets	Median Return on Equity
All Banks & Thrifts*	8,175	\$ 234,565	26.3%	0.89%	8.37%
Urban Banks	4,020	\$ 309,606	26.3%	0.69%	6.56%
Rural Banks	4,155	\$ 161,962	26.3%	1.04%	9.73%
CDFI Banks	57	\$ 198,710	24.3%	0.71%	7.26%
FDIC Minority Banks	193	\$ 237,946	19.2%	0.58%	5.53%
Primary Regulator**					
OCC Banks	1,519	\$ 254,525	24.4%	1.03%	9.57%
Federal Reserve Banks	820	\$ 263,372	24.5%	0.99%	9.63%
FDIC Banks	5,061	\$ 214,014	24.6%	0.90%	8.49%
OTS Banks	768	\$ 297,815	68.2%	0.45%	3.40%

* Only includes domestic banks & thrifts with below \$2 billion in assets

** does not include the seven branches of foreign chartered institutions

Of the 8,175 financial institutions, NCIF believes that there could be 200-300 financial institutions that are CDBIs worth supporting from a social mission perspective.

Note: these numbers do not include banks based in Puerto Rico, Guam and the Virgin Islands and only banks with an asset level below \$2 billion are included. *Housing Focus is defined as % of 1-4 residential and multi family real estate loans as a ratio of total loans.*

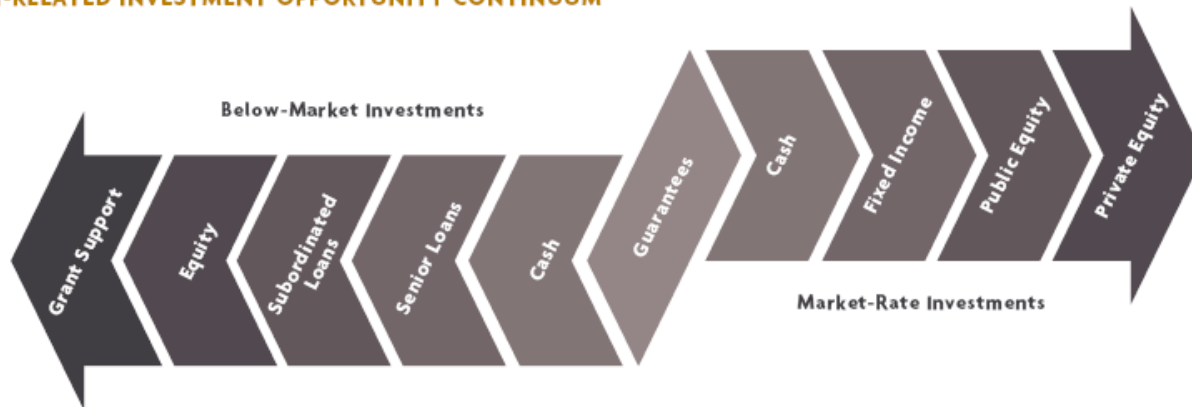
Investment Products

Investment Products

- **Equity and quasi-equity**
 - Publicly traded vs private equity
 - Convertible or non-convertible preferred stock
 - Trust preferred securities (debt at holding company)
- **Insured and uninsured deposits**
 - Market rate vs below-market rate

Within the F. B. Heron Foundation Framework

MISSION-RELATED INVESTMENT OPPORTUNITY CONTINUUM



Equity and Quasi-Equity

- **Target CDBIs: Privately held or thinly traded, growing CDBIs**
- **Target investment amount**
 - Up to 9.9% of the total outstanding shares without bank holding company implications. No restrictions on non-voting stock or non-convertible preferred stock
 - Investments range from \$250,000 to \$3,000,000 per institution
- **Target holding period: 5-7 years**
- **Exit Strategy**
 - Initial public offerings
 - Strategic sales to other investors
 - Merger or acquisition
 - Trust preferred securities: average life of 7-10 years though they can be sold in the market
- **Risks**
 - Exit strategy – medium. Investees work with investors to generate exits, but not easy
 - Risk of default – low. Investees are highly regulated depositories
 - Geographic and ethnic diversification can be achieved to minimize portfolio volatility

Equity and Quasi-Equity

- Targeted return: 12%-15% per annum, after management fees
 - Dividend yield
 - Common stock – 0-2% p.a.
 - Non-convertible preferred stock: 8-10% p.a.
 - Convertible preferred stock: 2-5% p.a. with a negotiated conversion price
 - Capital gains in common stock
 - Intrinsic appreciation due to annual accretion in book value
 - Median ROE for CDFIs is 7.26% in 2007.
 - Change in the multiple to book between acquisition and sale of shares
 - Average multiple to book for all listed banks has ranged from 1.31x to 1.91x. Assuming that the book value multiple increases from 1.0x to 2.0x this results in an annualized IRR of 14.52% per annum.
 - Return is significantly higher for banks operating in very high growth geographic (Texas, California) or ethnic (Hispanic, Asian) markets.

Deposits

- **Target CDBIs: Private or public CDBIs with a demonstrated mission of community development.**
- **Targeted investment amount**
 - Between \$100,000 and \$50,000,000, using CDARS
- **Targeted holding period – as a liquidity management tool**
 - 1 month through 5 years
- **Risk to investment**
 - Exit strategy – low, deposits mature on due dates
 - Risk of default – low, given FDIC insurance
- **Targeted returns**
 - Market rates depend on tenor

Key Financial Data

Financial Data for Banks with less than \$2 Billion in Assets

	Minority Banks	CDFI Banks	All Banks
Number	193	57	8,175
Total Assets (000)	\$ 45,923,600	\$ 11,326,482	\$ 1,917,568,692
Average Assets (000)	\$ 237,946	\$ 198,710	\$ 234,565
Total Loans (000)	\$ 33,325,526	\$ 7,615,088	\$ 1,340,370,933
Total Deposits (000)	\$ 36,223,480	\$ 9,295,389	\$ 1,503,651,048
Total Equity (000)	\$ 4,846,725	\$ 1,021,953	\$ 211,557,052
Medians			
Net Interest Margin	4.14%	4.30%	3.93%
Efficiency Ratio	78.88%	77.83%	69.01%
Return on Assets	0.58%	0.71%	0.89%
Return on Equity	5.53%	7.26%	8.37%
Loan to Deposits	92.00%	81.92%	89.14%
Non Current Assets/Gross Loans	0.72%	2.34%	0.62%
Net Chargeoffs/Net Loans	0.05%	0.16%	0.08%

Financial data as of 12/31/2007

Increasing Asset Class of CDBIs: NCIF Social Performance Metrics

NCIF Social Performance Metrics

Five key metrics using publicly available HMDA, FDIC data

Primary Metrics

1. Development Lending Intensity (DLI – HMDA)
 - $DLI (HMDA) = \% \text{ of HMDA loan originations and purchases in investment areas – (IA) / total HMDA loans originated and purchased}$
2. Development Deposit Intensity (DDI)
 - $DDI = \% \text{ of branches in CDFI investment areas / total branches}$

Additional Metrics

1. Adjusted Development Lending Intensity (DLI - HMDA)
 - $Adjusted\ DLI\ (HMDA) = DLI \text{ minus percentage of 'high rate' loans; High rate loans} = 3\% \text{ over index, per HMDA}$
2. DLI-Equity: % of HMDA loans originated in investment areas/total equity of the bank
3. DLI – Low Income People: % of HMDA loans to low income people

NCIF has information on all metrics starting 1996 and also on highly distressed census tracts.

Note: CDFI Fund Investment Area or IA are census tracts that meet any of the following three criteria: poverty rates greater than 20%, unemployment rate greater than 1.5 times the national average or median household income not exceeding 80% of the benchmark median household income.

NCIF Social Performance Metrics

Development Lending Intensity (DLI)	Quadrant 2: High DLI + Low DDI: Lots of lending in LMI areas but not too many branches -- EXAMINE	Quadrant 1: High DDI + High DLI: Demonstrates a very high focus in LMI areas - STRONG SUPPORT
	Quadrant 4: Low DLI and Low DDI - FOR LATER	Quadrant 3: Low DLI + High DDI: Since many branches in LMI areas there could be a social orientation -- EXAMINE
Development Deposit Intensity (DDI)		

There are between 360 (Quadrant 1) and 1,301 banks (Quadrants (1), (2) and (3)) that could qualify as having a double bottom-line mission.

Example

Depositor

Wants to place \$3 million in deposits into certified CDFIs, located anywhere in the country, that are profitable and highly active in low income communities. The depositor is only interested in institutions with an ROA over 0.20%, DLI-HMDA above 60% and DDI greater than 70%.

Screens applied

- CDBI must be a certified CDFI
- ROA must be higher than 0.20%
- Development Lending Intensity (DLI-HMDA) > 60%
- Development Deposit Intensity (DDI) > 70%

Example – Results

#	Institution	State	Assets (000)	Return on Assets	Housing Focus	DLI-HMDA	DDI
1	Citizens Savings Bank and Trust Company	TN	\$ 78,192	0.48%	7.5%	100.0%	100%
2	City First Bank of D.C., National Association	DC	\$ 150,123	0.28%	27.1%	95.7%	100%
3	OneUnited Bank	MA	\$ 653,374	0.66%	87.0%	85.4%	75%
4	ShoreBank	IL	\$ 2,205,770	0.53%	42.5%	85.1%	85%
5	Legacy Bank	WI	\$ 185,189	0.78%	34.6%	83.4%	100%
6	North Milwaukee State Bank	WI	\$ 81,126	0.69%	26.0%	78.1%	100%
7	Carver Federal Savings Bank	NY	\$ 784,226	0.84%	32.3%	74.3%	71%
8	Seaway National Bank of Chicago	IL	\$ 346,661	0.94%	44.1%	70.9%	100%
9	Industrial Bank, National Association	MD	\$ 333,750	0.49%	37.8%	66.8%	75%
10	Pacific Global Bank	IL	\$ 150,839	0.70%	66.2%	66.3%	100%
11	First American International Bank	NY	\$ 534,981	0.23%	13.1%	63.0%	100%
12	University National Bank	MN	\$ 117,530	0.76%	26.5%	62.3%	100%

- 12 out of 58 CDFI Banks receive investment.
- Each institution receives \$250,000.
- 4 banks have a Housing Focus greater than 40%.

National Community Investment Fund

National Community Investment Fund

- **Only mission oriented private equity fund focused on CDBIs**
 - **NCIF mission: NCIF invests private capital in, and facilitates knowledge transfer to, depository institutions that increase access to financial services in underserved communities.**
- **Significant investment track record; fund established in 1996**
 - **Cumulatively invested \$24.9 million in 37 institutions in equities/debt**
 - **73% of institutions are minority-focused, 68% of dollars are in minority-owned institutions.**
 - **81.1% of institutions in urban markets**
 - **\$3 billion in more than 74,000 development loans; CDFIs leverage capital 12-20 times.**
- **Thought leadership**
 - **NCIF Social Performance Metrics that are being adopted by investors and CDBIs**
- **Advised by ShoreBank Corporation – oldest CDFI with over \$2.2 billion assets**

Contacts

Saurabh Narain
Chief Fund Advisor
National Community Investment Fund
2230 South Michigan Avenue # 200
Chicago, IL 60616
Tel: (312) 881 5826
Email: snarain@ncif.org