Create A Nationwide Network of Community Development Banks

President Clinton is committed to making more credit available to unleash the private sector and create jobs in all American communities. His push for real deficit reduction that will lower interest rates, his championing of tax incentives like increased expensing that reward small business investment, his signing of regulatory improvement legislation to reduce the credit crunch felt by small businesses are all a part of that commitment. Yet more is needed to ensure that this commitment reaches communities where credit deprivation is particularly acute.

Across the country, many rural and urban communities are starved for affordable credit, capital, and basic banking services. Millions of Americans in low- and moderate-income neighborhoods have no bank where they can cash a check, borrow money to buy a home, or get a small loan to start a business or keep one going.

During the 1992 Presidential campaign, then-candidate Bill Clinton promised to create a national network of community development banks to provide access to capital, credit, and basic banking services in low and moderate income communities. Two of the models for these institutions was the South Shore Bank of Chicago and the Grameen Bank of Bangladesh. This new democrat approach to economic development uses the private sector to help communities grow from the bottom up -- with more opportunity, not more bureaucracy.

By the Summer of 1994, within two years of entering office, the legislation to create a network of community development banks and financial institutions to spur entrepreneurship, assist small and microbusinesses to low- and moderate-income communities became law and is well on its way to being implemented. Passage of the "Community Development Banking and Financial Institutions Act of 1994" (CDBFI Act) fulfills the President's campaign commitment to support the creation of a network of community development banks to steer private capital to distressed communities and to empower low-income entrepreneurs to create jobs and start new businesses. Along with reform of the Community Reinvestment Act (CRA) and the Empowerment Zone/Enterprise Community Initiative, the CDBFI Act serves as the foundation for your economic development strategy for low-income communities.

The Problem

Low-income communities face several chronic banking problems:

- Inadequate Basic Banking Services -- Millions of poor Americans have no access to nor relationship with a bank. They live in neighborhoods with no ATM machines, no drive-through windows, no checking or savings accounts. Instead, they are forced to deal with cash-checking operations that charge an exorbitant fee for a simple service.

- No Loans for Small Borrowers -- Most commercial lenders shun low-income communities because small loans have higher transaction costs and lower profit margins, and require more labor and attention, if not more risk.

- Lack of Expertise Among Lenders -- Lending in distressed communities, particularly for small business, can be complicated. It can require specialized underwriting expertise and knowledge, credit products, subsidies, and secondary markets.

- Lack of Expertise Among Borrowers -- Small businesses, particularly those in distressed areas, often lack access to counseling in the basics of small business management, including accounting, borrowing, managing and repaying money. When commercial lenders abandon these communities, there is often no place to turn for essential capital, credit or information.

- Discrimination -- Home Mortgage Disclosure Act (HMDA) data suggest that, deliberately or not, home mortgage lenders deny loans to middle- and upper-income minority borrowers more often than to moderate- and lower-income whites. Anecdotal evidence suggests that the situation is even worse for commercial and consumer loans.

- Shortage of Credit and Capital -- The unmet demand for credit and capital in poor communities is therefore substantial. In too many low- and moderate-income neighborhoods, loans are unavailable for even the most credit-worthy housing and business purposes. A recent study found $360 million in unmet demand for credit-worthy small business loans in the City of Oakland alone. In New York City's distressed communities, several billion dollars in demand for housing loans that would qualify for federal insurance went begging. Economic revitalization cannot take root in these communities where good risks and sound businesses cannot get loans.

History of the Community Development Banking and Financial Institutions Industry

Many enterprising communities have come up with their own ways to fill the void in community development and banking services. A variety of promising alternatives are under way around the country, including community development banks, credit unions, corporations, and loan funds; loan consortia and other community development intermediaries; and community reinvestment by mainstream commercial banks.

1. **Community Development Banks (CD Banks)**: South Shore Bank in Chicago, Elkhorn Bank and Trust in Arkansas, and Community Capital Bank in Brooklyn offer a comprehensive range of assistance to the communities they serve. Through for-profit and non-profit affiliates, they provide basic deposit, saving, checking, and consumer and mortgage lending services; venture capital (for small business; microenterprise loans; and technical assistance. They also develop rental and cooperative housing for low-income residents and commercial real estate for small businesses. Three such integrated, full-service financial community development bank holding companies have emerged over the last twenty years.

2. **Community Development Financial Institutions (CDFI's)**: A variety of other community-based organizations have found their own financial service niche:

    - Community Development Credit Unions (CDCU's) are regulated financial cooperatives owned and operated by lower-income persons to serve the deposit, check-cashing, and small consumer loan needs of their members. A growing number of CDCUs are making development loans for small business expansion and start-up. Like CD Banks, CDCUs can offer federal deposit insurance up to $100,000. The largest CDCU is the Self-Help Credit Union in North Carolina. With more than $40 million in assets, it is second only in size to South Shore Bank among community lending institutions. Self-Help is part of a larger holding company that includes independent, non-depository credit and support mechanisms. There are over 100 CDCUs across the nation, and one the newest was chartered in South Central Los Angeles last November.

- Over 1000 Community Development Corporations (CDC's) have been created by civic and community groups, local or state development authorities, and banks to provide small business or micro-enterprise lending, large community development projects, or affordable housing. Their sources of capital and loans include other banks, federal small business and housing programs, local corporations and foundations, and major national assistance corporations such as LISC or Enterprise.

- Scores of specialized Community Development Loan Funds (CDLF's), both for-profit and non-profit, aggregate capital and contributions from socially conscious banks, investors, and foundations to provide equity, bridge loans, or below-market financing for affordable housing, revitalization of retail stores, or small businesses in distressed communities.

3. **Community Development Intermediaries (CDI's):** A number of state and local governments, community groups, and financial consortia provide specialized services that link communities, CDB's, and CDFI's to mainstream banking, credit, capital, and government insurance and subsidy programs and secondary markets. These intermediaries underwrite, guarantee, or repackage loans to credit-worthy businesses and individuals in distressed areas.

4. **Community Reinvestment by Mainstream Banks**: Either in response to pressure from community groups to meet their obligations under the Community Reinvestment Act or out of their own self-interest to learn how to better serve underserved markets, many mainstream commercial banks and thrifts have begun to provide essential financial services to distressed communities. Some have formed loan consortia, loan loss reserve funds, and community lending networks; others provide capital, loans, or contributions to the community development institutions described above. A few Bank Holding Companies (BHC's) have recently created and capitalized Community Development Banking subsidiaries to serve the financial needs of distressed communities.

The President's Community Development Banking and Financial Institutions Act

The Administration has requested $500 million and the legislation authorizes $382 million or such higher sums as necessary over four years. These funds will be used to support a network of new and existing Community Development Banks and Financial Institutions (CDBFI) across the country. These institutions will be based in low- to moderate-income communities. CDBFIs specialize in providing to underserved communities basic banking services, credit, and capital. A new agency, the CDBFI Fund will be created to provide equity capital, grants, loans, technical and training assistance to CDBFIs that qualify for funding. When fully leveraged, this new program will create over $3 billion in new investments in low and moderate income communities. The Federal government's investment will be leveraged with private resources.

The legislation passed by Congress would establish a Community Development Financial Institutions Fund ("Fund") that will invest in community development banks and and other community development financial institutions (CDFI) which have a primary mission of community development, lending, equity investment, and loan counseling services in distressed, underserved communities. The Fund will promote the CDFI industry by serving as an information clearinghouse and provide assistance to CDFIs in the form of capital, grants, deposits, or technical services. Capital assistance will serve only as seed capital that must be matched with private funds. All types of new and existing CDFIs will be eligible for assistance, including community development banks and credit unions, micro-enterprise and revolving loan funds, minority-owned banks and community development corporations. Your budget requests funding of $500 million over four years for this program. Congress has appropriated $125 million for FY95.

The Fund will be run by an Administrator, to be appointed by the President, with Senate confirmation. In addition, there will be a 15 member Advisory Board consisting of representatives of the departments of Agriculture, Treasury, Commerce, Interior, HUD, and SBA, plus 9 members of the public appointed by you.

The bill also authorizes a new deposit insurance assessment credit program, built largely on the Congressman Flake's Bank Enterprise Act, to award credit to traditional lenders and CDFIs based on increases in qualifying lending and services in economically distressed communities and equity investments in CDFIs.

Impact of the Law

Currently, the community development financial institution (CDFI) industry is capitalized with approximately $700 million and has extended more than $2 billion in loans. The $500 million CDBFI Act will greatly expand the capacity of the CDFI industry and will:

- **Create approximately $5 billion in new credit for economically distressed communities**

- **Provide financial and technical support for as many as 75 new insured community development banks** -- The combination of the equity investment and technical assistance grants by the CDFI Fund and the matching investment by traditional lenders yields a total investment of $346 million in insured CDFIs (Community Development Banks and Credit Unions). Assuming $4 to $5 million required to capitalize a new institution, this investment could create as many as 75 new insured CDFIs.

- **Support as many as 916 new well-capitalized community development corporations and over 4,000 community development loan funds** -- There are two sources of investment in these institutions, from the CDFI Fund and from traditional lenders. The

CDFI Fund divides its uninsured CDFI investment (with traditional lender match) among larger community supported CDCs (start-up capital needs of about $500,000); smaller CDCs (start-up capital needs of about $100,000); and CDLFs (start-up capital needs of perhaps $25,000 in seed money). Traditional lenders invest in larger bank-supported CDCs (start-up capital needs of about $2 million), smaller CDCs (start-up needs of about $750,000) and CDLFs (seed money needs of about $25,000). Applying these assumptions to the assumed investment totals suggests the investment in uninsured institutions could yield as many as 916 CDCs, with seed money for more than 4,000 loan funds.

- **Support nearly 40,000 in new loans to individuals and small businesses** -- Under the leveraging assumptions, the investment in insured CDFIs allows them to extend additional credit of $3.08 billion. With loan sizes ranging from $25,000 to $1 million and an average loan size of about $200,000-$300,000, based on data from HUD Profiles, insured CDFIs will make nearly **10,300** new loans. The investment in uninsured institutions by the CDFI Fund and by traditional lenders allows them to extend additional credit of about $600 million. Assume, as indicated in HUD Profiles that community-supported CDCs make loans averaging about $25,000 bank-supported CDCs make loans averaging about $150,000, and CDLFs make loans averaging about $40,00. Then the investment in uninsured institutions could yield as many as **10,700** new CDC loans and **3,700** new CDLF loans. Combined with the **15,000** new loans expected to be generated through the Flake Assessment Credit Program, Treasury estimates 39,700 new loans supported under the CDBFI Act.

- **Result in 150,000 new full-time jobs in low-income communities** -- An increase in the credit availability is assumed to support new full-time jobs at the average rate of approximately $30,000 in salary and benefits for one year. Thus, a $5 billion increase could mean 150,000 new jobs (each lasting one year).

Case Studies

RURAL EASTERN NORTH CAROLINA'S WOSCO -- A WORKER OWNED SEWING COMPANY: The Workers Owned Sewing Company (WOSCO) is located in Bertie County, a low-income rural area in Eastern North Carolina. When the company started, its business came primarily from contracts with other apparel companies for their overflow work. This type of business proved sporadic, unpredictable, and highly competitive, operating on very thin margins. In 1985, WOSCO was in trouble. In order to survive the company needed grow and by-pass middlemen to bid directly to retailers. But they needed credit for necessary materials and supplies. A small, local bank had helped WOSCO manage its business with a $10,000 line of credit. This small line of credit was cut off, however, when a large regional bank acquired the local bank. WOSCO's President, Tim Bazemore, turned to the Center for Community Self-Help. Self-Help's credit union and ventures fund gave WOSCO a $50,000 loan and assistance in marketing, financial management and business planning. Today, WOSCO's 80 working women are all proud owners of the second largest private employer in Bertie county. WOSCO has secured contracts with Sears and K-Mart and sales are increasing. Each year the company has been able to distribute profits back to its owner-workers.

BEVERLY ROSS IN MINERAL SPRINGS OHIO -- A MICRO-LOAN SUCCESS STORY: Beverly Ross, a single parent, is a sole owner of Lakeview Stables in Mineral Springs, Ohio, a popular tourist area in Tuscarawa County. Beverly worked for Lakeview Stables to support her family before luck and hard work made it possible for her to purchase the stables. After a year of operation, she realized she had undercapitalized her venture and had to turn customers away because she didn't have enough horses or equipment to serve them. Because of a divorce, she did not have a stable credit history and literally no financing options. She turned to a Microloan program sponsored by the Athens Small Business Center. There, she received intensive help in completing a business plan and loan package. She was given a \$5780 loan to purchase equipment and horses and to provide working capital for operation. The loan was made just in time for this year's summer trade -- an business is booming.