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CALIFORNIA COMMUNITY ECONOMIC DEVELOPMENT ASSOCIATION

COMMUNITY DEVELOPMENT CREDIT UNIONS

Community Economic Development Manual

Disclaimer

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COMMUNITY DEVELOPMENT CREDIT UNIONS

Use of this Guide

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

1. Organizations wanting to learn about Credit Unions
2. Organizations creating alternative lending and investment programs
3. Organizations seeking services and capital from loan funds

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

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

Organizations interested in expanding access to capital for underserved communities have focused on various forms of loan and investment funds. This guide will focus on Credit Unions. Credit Unions provide specialized forms of credit, but can also capture local savings from individuals and business entities. The ability to keep community assets (through deposits) within the community makes credit unions a very important tool for community development. Credit unions are regulated and must maintain certain capital levels bit they do have lower requirement thresholds as compared to thrift and loans and banks. Credit unions offer an expanded menu of credit and banking services for communities and residents.

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

Community Development Financial Institutions (CDFIs) is becoming the standard nomenclature categorizing all community development lending and investment entities (albeit not all such entities have obtained the official US Treasury designation, most have and will apply for the CDFI designation because it represents a recognizable industry standard). The Opportunity Finance Network is the association representing all types of lending institutions and has broadly categorized all lending institutions as CDFIs and subcategorized lending and investment institutions as follows:[1]

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

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

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

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

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

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

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

Credit unions play an integral role in support of a community's economic development strategy. These financial institutions can import and retain capital through deposits and can re-circulate capital in underserved markets. These funds can be used for business finance (start up, micro, non-profit, small and business expansion), real estate development finance (affordable housing, commercial and office, community facilities and industrial) and personal finance (auto, home or personal). Capital enhances economic stability while creating jobs and opportunities for community residents. Creation of personal and community assets is a keystone in building and strengthening communities. Credit unions also bring communities a higher level of technical expertise in business and finance, increasing the potential for sustained community stability and growth.

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

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

For the Organization:

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

For the community:

1. Increases access to capital
2. Increased access-related resources such as training and technical assistance in the areas of finance and business development
3. Creates personal and community assets

4. Enhances the local economy by supporting important segments of the economic infrastructure including business, residential and industrial sectors
5. Can collect deposits that will keep capital re-circulating through the local economy.
6. Provides needed banking services at generally lower costs as compared to other financial institutions (including banks and especially check cashing outlets).

Successful lending efforts (and ancillary financial programs) results in economically stronger communities, stronger workforces, more informed and capable businesses and tenants, and ultimately a stronger and more inclusive economy. The added ability to collect deposits from the community helps to keep capital re-circulating within the community.

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

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

   In financial institutions and in larger funds, loans in portfolio are rated. Those with greater risk or in various stages of distress (late payments) will have a higher percentage set aside for potential loan losses.
7. Feasibility: Income needs to exceed expenses. The larger the lending pool (and level of funding you have out to borrowers) the greater your potential returns are. Similarly, smaller sized funds have a more difficult time generating income to cover expenses. Smaller loans have greater relative operating costs because handling and processing costs for each transaction is about the same whether the loan is for $500 or $5,000,000.

Start-up or Expansion

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

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

Start-up Credit Union: Starting a credit uion is very difficult due to costs. Funding is needed for business operations and for the loan fund. Capital requirements must be met to become a credit union and the detailed application process usually requires assistance from a consultant.

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

Strategy 1: New Entity (If your plans call for the creation of a new entity). A significant amount of funding and predevelopment work is needed for developing the business plan, marketing and management plans and to work through the approval process

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

    Determination of the scope, size, and direction of your loan fund should provide a good indication of feasibility. Sources of initial capital are secured through foundation and corporate grants and, in some instances, from local government programs, especially if there is a targeted market with tremendous needs.

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

    Your organization must assess how the proposed program costs will benefit the overall economic development strategy of the community and organization while assessing impacts to individual CED projects and programs. The creation of a credit union offers substantial benefits to the community and its economic well being.
3. Pre-development Activities:
    A. Business Plan/Market Analysis: Conduct a market analysis and develop a business plan for the fund.
    B. Management Plan:

    1.) Fund Management: Included are the documents that define lending parameters, lending guidelines, requirements the application process.
    2.) Loan Management: Included are the loan management functions (loan approval process, closing, documentation, and loan management (billing/collections) process).
    3.) Portfolio Management: Guidelines and standards on risk management (loan loss tolerance, reserves and risk rating of loans).
4. Board: Creation of the Board of Directors is a very important step that builds the foundation for a successful credit union.
    A. Proper balance between mission (helping improve distressed communities) and risk (lending guidelines and requirements) is maintained by board representation.
    B. Fundraising: Fundraising is a critical need for loan funds and having representatives from entities that either funds/invests in loan funds or are in peer industries that can support credit union activities is critical.
    C. Management: Expertise in lending, business or law provides the necessary input and oversight of lending activities and overall success.
5. Loan Committee: The loan committee should in many ways mirror the balance of the board of directors but have focus on management issues. The committee must have members versed in understanding of the lending guidelines and policies of the credit union fund. Experienced lenders can typically be recruited from financial institutions that invest or lend into the fund.
6. Start Up Lending Activities
7. Application for credit union certification.

Strategy 2: Partnership: If there are other credit unions operating in your area (or nearby), you may want to consider partnerships that will leverage their expertise with your understanding of local needs. This strategy allows you to build capacity and expertise and maintain a goal of creating your own or operate a branch. Some of the strategies include:

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

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

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

As defined on the CDFI website, "a CDE is a domestic corporation or partnership that is an intermediary vehicle for the provision of loans, investments, or financial counseling in Low-Income Communities (LICs). Benefits of being certified as a CDE include being able to apply to the CDFI Fund to receive a New Markets Tax Credit (NMTC) allocation to offer its investors in exchange for equity investments in the CDE and/or its subsidiaries; or to receive loans or investments from other CDEs that have received NMTC allocations."[2]

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

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

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

[2] CDFI Fund Website, Op Cit

COMMUNITY DEVELOPMENT CREDIT UNIONS

The Opportunity Finance Network defines Community development credit unions (CDCUs):

> *"CDCUs promote ownership of assets and savings and provide affordable credit and retail financial services to low-income people, often with special outreach to minority communities. They are nonprofit financial cooperatives owned by their members. Credit unions are regulated by the National Credit Union Administration (NCUA), an independent federal agency, by state agencies, or both. In most institutions, deposits are also insured by NCUA."*[3]

In 1995 there were over 8,200 credit unions, of which over 5,000 are federally chartered and about 3.000 are state-chartered (federally insured). The remaining institutions are state chartered and privately insured. Today there are 7,292, with the decrease due to the declining economy.[4] These entities have a total membership of over 85 million people. 84% of the credit unions have under $100 million in assets with 12% having assets of $100-$500 million. 4% have assets over $500 million.[5] Since its peak in 1969 (when there were almost 24,000 credit unions), the number has declined and annual mergers remained steady at 2.5% to 3.5%.[6]

Credit unions originally were limited to a defined community or geographic area; employment within a given company or institution; or membership in a professional, ethnic, religious or social affiliation. In the early 1980's, it became evident that membership in credit unions dwindled as companies merged, industries changed and demographics shifted. As a result, the definition of membership expanded significantly to the chagrin of thrifts, saving and loans and banks. This is especially true since credit unions take deposits but are tax-exempt and exempt from the Community Reinvestment Act (CRA).

Community development credit unions (CDCUs) are distinguished from all other credit unions by focusing primarily on low-income people who work in low-income urban and rural communities. The goals of CDCUs are to bring capital to communities in need by providing affordable services (financial counseling and check cashing services) and building the asset base of low income individuals, families and ultimately the community. NCUA designates a low income CDCU if the majority of its members earn less than 80% of the national median household income. The term "community development" is a self defining term that describes its mission (and activities) focusing on community improvement.

Chartered by the NCUA or by state agencies that are responsible for credit unions, the deposits are insured up to $100,000 by the National Credit Union Share Insurance Fund. Most credit unions focused lending on smaller home improvement, auto and personal loans. This conservative approach enabled most to avoid the sub-prime and credit crisis. However, their focus on low

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[3] Opportunity Finance Network, Op. Cit.
[4] Tom, "Credit Unions are Increasing Membership and Deposits" , The MRI Blog, June, 2011, website www.marketratesinsight.com
[5] Kolakowshi, Mark, "Credit Unions, Financial Careers" about.com website: www.about.com
[6] Wilcox, James and Dopico Louis, "Credit Union Mergers: Efficiencies and Benefits" Federal Reserve Bank SF Economic Letter, September 12, 2011

income communities has made many susceptible to negative economic trends. Most have very modest operating budgets.

Characteristics of Low Income Credit Unions, Community Development Credit Unions and the Members They Serve: LICUs and, generally, CDCUs typically serve a membership primarily composed of low-income members. These credit unions face unique challenges serving members. The challenges are even more prevalent in small credit unions. Their members may face one or more of the following circumstances and characteristics:[7]

- Unsteady employment (often temporary jobs with long hours);
- Part-time employment with multiple jobs or side businesses;
- Unstable residency (often rent or live in public or subsidized housing);
- No health insurance;
- Lack of affordable child care;
- Receive supplemental security income or social security disability benefits;
- English as a second language;
- Low share account balances;
- Need for small dollar loans;
- Limited financial resources;
- Limited, negative, or no credit history; and,
- A need for labor-intensive services (e.g. money orders, financial education and/or counseling, check cashing).

Key elements for starting a credit union include:

1. Common Base: Determination of the membership. Can be based on:
    a. Occupation/Industry
    b. Association
    c. Community
    d. Income
2. 3,000 members: NCUA requires credit unions with fewer than 3,000 members show evidence of support. Institutions with fewer than 3,000 members may not be economically justified.
3. Capitalization: Determination of capitalization requires assessment of three basic categories:[8]
    a. Capital (equity) requirements Capital (equity) requirements: Credit unions cannot issue stock and must raise capital through retained earnings and receipt of grants
    b. Anticipated operating expenses: Operating expenses for a new credit union include:
        i. Members: How many will join, how soon and what will their average deposits be
        ii. How much interest will be paid to depositors
        iii. What products and services will be offered and what is their cost in relation to income
        iv. What operating systems will be necessary to serve the membership
        v. Employee positions, number and salaries
        vi. Location (rent, utilities and office expenses)
    c. Costs associated with preparing the charter application, crafting an appropriate business plan, and related projections and exhibits. Documentation and Application expenses include:

[7] NCUA, "Low Income Credit Unions" website: www.mycreditunion.gov
[8] Hall Associates Consulting, LLC, "How Much Does it Cost to Start a New Credit Union" website: www.hallassociatesllc.com

    i. Business plan
    ii. Pro forma financial projections
    iii. Organizational Bylaws
    iv. Proposed operation and governance policies and procedures
    v. Evidence of due diligence in selecting operating systems
4. Application Process: If the initial application is approved, NCUA issues a credit union charter and business operations should begin within 60 days

Credit Union Start-up Considerations:

1. Membership: The average credit union has about 12,475 members with an average deposit of over $8,900.[9] The average deposit for low income and community development credit unions is approximately 33% of this average.
2. Board of Directors: Elected from the membership, the board's primary responsibility is management and setting policy. The board also determines products and services.
3. Staff usually consists of one paid employee (credit union manager). The manager must play several roles (that may evolve into full time positions as the credit union becomes more successful). These roles include financial manager, organizer, teller, loan officer and marketing representative. It is important that this person have significant previous experience. Credit unions with assets up to $500,000 will have 0.6 FTE and those with assets greater than $500,000 average 3.2 FTE.
4. Basic Services: Services include basic banking services and credit to members. Members make deposits into share draft accounts (credit union equivalent of checking accounts) and share accounts (savings accounts). Loan products vary and are based on community needs and the goals and objectives of the credit union.[10]
5. Projects include consumer loans (home/auto), debt consolidation loans and home improvement loans. Some may provide small business loans (usually under $50,000).
6. Asset Size: The average asset size of a credit union was $93 million in 2007. Bank asset average was $1.53 billion.[11] At the same time, low-income credit union's average asset size was just under $4.5 million and most ranged from $400,000 to $5 million.
7. NCUA's regulations specify that a credit union cannot receive more than 20% of its deposits from non-members, however low income credit unions are not subject to this regulation. The 20% threshold can be waived for institutions by a NCUA Regional Director.
8. Through their Community Development Revolving Loan Fund, NCUA provides technical assistance grants ($6,500) to help low-income credit unions provide financial services to their members and to make the operations more efficient,. See NCUA website at: www.ncua.gov
9. NCUA provides several grant programs that may change year to year depending on funding. 2011 grant programs include
    a. Financial Education and Financial Literacy Initiative
    b. Building Internal Capacity Initiative
    c. Partnership and Outreach Initiative
    d. Student Internship and Job Creation Initiatives
    e. Staff, Official and Board Member Training Initiative

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[9] Tom, MRI Blog, Op. Cit
[10] Shorebank Advisory Services, "Bank of America CDFI Program, Community Development Credit Unions", May 1996, pages 6-4 through 6-6
[11] "Comparing Credit Unions and Banks" website www.becu.org

f. Volunteer Income Tax Assistance
g. Urgent Needs Grant

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS (CDFIs)

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

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

The mission of the Community Development Financial Institutions Fund is to "expand the capacity of financial institutions to provide credit, capital and financial services to underserved populations and communities in the United States"[12] The CDFI Fund has several programs that enhances access to capital. Upon receiving certification, CDFI's are eligible to compete for technical assistance grants, capital grants, New Markets Tax Credits as well as other targeted incentive programs.

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

CDFI PROGRAM BENEFITS

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

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

Both certified and non-certified CDFIs are eligible to apply for TA awards. However, non-certified organizations must be able to become certified within two years after receiving a TA award. The TA

[12] Community Development Financial Institutions Fund "CDFI Certification Application", Department of Treasury, June 2007, pg 4

awards will cover expenses needed to build the capacity of organizations to become eligible for CDFI designation.

2011 CDFI Award Categories:
1. Financial Assistance: Certified CDFIs may receive awards in the form of grants, loans, equity investments, deposits and insured credit union shares
2. Technical Assistance: Non-certified CDFI's may apply for TA (not both) to build organizational capacity. If you have not been certified, TA could help you get certified. These funds do not require matching funds.
3. Healthy Foods Financing Initiative: Awards to CDFIs to address the need for healthy foods in their markets (USDA and HHS support)

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

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

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

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

OTHER NOTES:

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

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

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

SOURCES OF FUNDS:

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

            For example, funds are available for loans to businesses that handle exports to foreign countries, businesses that operate in rural areas, and for other very specific purposes:
            1. Special Purpose Loans: Businesses impacted by North American Free Trade Agreement, support for Employee Stock Ownership Plans and pollution control.
            2. Export Loan Programs
            3. Rural Business Loans
            4. Advantage Loan Initiative: Focus on underserved communities.
            5. Community Advantage Approved Lenders: Pre-approved organizations.
            6. Express & Pilot Programs: Streamlined expedited loan procedures for specific target borrowers.
        v. The 504 Loan Program provides approved small businesses with long-term, fixed-rate financing used to acquire fixed assets for expansion or modernization. 504 loans are made available through Certified Development Companies (CDCs) which are SBA's community based partners for providing 504 Loans. 504 Loans are typically structured with SBA providing 40% of the total project costs, a participating lender covering up to 50% of the total project costs, and the borrower contributing10% of the project costs. In special circumstances, a borrower may be required to contribute up to 20% of the total project costs
    b. Department of Treasury: CDFI Fund
        i. CDFI Certification: Certification Program for loan funds to become eligible to apply for CDFI programs
        ii. Technical Assistance: Grants allow certified CDFIs and established entities seeking to become certified to build their capacity to provide affordable financial products and services to low-income communities and families. Grants may be used for a wide range of purposes including equipment, materials, or supplies; for consulting or contracting services; to pay the salaries and benefits

of certain personnel; and/or to train staff or board members. The CDFI Fund makes awards of up to $100,000

iii. Financial Assistance: Awards of up to $2 million are made to certified CDFIs under the FA component of the CDFI Program. A CDFI may use the award for financing capital, loan loss reserves, capital reserves, or operations. FA awards are made in the form of equity investments, loans, deposits, or grants, and the CDFI is required to match its FA award dollar-for-dollar with non-federal funds of the same type as the award itself.

iv. Other Programs: Other CDFI Fund programs include:

1. Bank Enterprise Award (BEA): This program provides financial incentives to institutions to expand investments in CDFIs and to increase lending, investment, and service activities within economically distressed communities over a specific time period.
2. Capital Magnet Fund (CMF): provide competitively awarded grants to CDFIs and qualified nonprofit housing organizations. CMF awards can be used to finance affordable housing activities as well as related economic development activities and community service facilities. Awardees will be able to utilize financing tools such as loan loss reserves, loan funds, risk-sharing loans, and loan guarantees to produce eligible activities whose aggregate costs are at least ten times the size of the award amount.
3. Financial Education and Counseling (FEC): Through the FEC Pilot Program, the CDFI Fund provides grants to eligible organizations to enable them to provide a range of financial education and counseling services to prospective homebuyers
4. New Markets Tax Credits: The NMTC Program attracts investment capital to low-income communities by permitting individual and corporate investors to receive a tax credit against their Federal income tax return. This is in exchange for making equity investments in businesses and commercial projects that creates jobs in low income communities. *NOTE: The NMTC program has become a very important tool for Community Economic Development. Please review the separate Guide on New Markets Tax Credits for more details.*
5. Native American CDFI Assistance Program (NACA): Focused program supporting activities for Native American communities
6. Certification for Community Development Entities (CDE): Benefits of being certified as a CDE include being able to apply to the CDFI Fund to receive a New Markets Tax Credit (NMTC) allocation.

c. United States Department of Agriculture:

i. Rural Microenterepreneur Assistance Program (RMAP): Maximum loan: $500,000. Low interest, 20 year loans with 2-year deferral of payments, to capitalize a revolving microloan fund. The microlender must establish & maintain a 5% loss reserve from their own funds. Loan proceeds are to be used for relending as fixed rate microloans (≤ $50,000) to rural microentrepreneurs.

ii. RMAP Technical Assistance Grants: ($100,000 maximum size) to allow a microlender to provide technical assistance to their microloan borrowers. They can pay administrative expenses of the microlender, but not more than 10% of the grant. Maximum TA grant award is ≤ 25% of microlender's RMAP loan portfolio.

iii. RMAP Enhancement Grants ($25,000 maximum size) to allow a microlender to increase its capacity to serve rural microenterprises. Enhancement grant awards are *not* tied to the operation of an established RMAP loan fund. RMAP grants cannot provide more than 75% of the cost of the project.

d. Health and Human Services, Office of Community Services, Community Economic Development: Community Economic Development Grants: discretionary grant funds to Community Development Corporations (CDC) for well-planned, financially viable, and innovative projects to enhance job creation and business development for low-income individuals. Up to $800,000 is available for projects that include revolving loan funds, real estate development and business start up and expansion.

e. Department of Housing and Urban Development:

i. Community Development Block Grants (CDBG): Microloan funding is an eligible activity under the CDBG progam. Use of funds is determined by citizens input into the CDBG process by the participating jurisdiction (local or state government). Many jurisdictions have allocated funds for MDO support and all types of small business activities.

ii. Community Service Block Grants (CSBG): Loan funds are also supported though CSBG funding through eligible state and local jurisdictions. Most of the local jurisdictions are community action agencies or a local government affiliate that determines use of CSBG funds.

2. Foundations and Private Sector:

a. Grants: Foundations have been a strong supporter of microenterprise lending and development. Most of the support is conducted on a relationship basis.

b. Investments: To a great degree, banks and financial institutions have made equity type investments into loan funds, primarily CDFIs. They have also actively provided deposits in credit unions. Program Related Investments have been made by larger national foundations in the past and focused on specific industry support. The California Endowment has recently made a substantial investment into a fund to support the development of markets in “food deserts” as part of national “healthy food” initiatives. The fund is in partnership with the NCB Bank (previously known as the National Coop Bank).

DEVELOPMENT TIPS:

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

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

   d. Your lending guidelines and approvals also impact your success…the greater risks your fund incurs; the greater the potential is for losses.
   e. The expenses for marketing, processing and managing a small loan are the same as expenses for a larger loan.
   f. Partnering and sharing of loan management and portfolio management functions are an excellent means of managing and reducing expenses.
   g. If you already have loan processing and management experience, you may want to market this capacity and generate additional income by managing funds for partner organizations.

8. Additional Capital: The CDFI Financial Assistance Award is a grant that can start your lending program, but you should look at it as an opportunity to locate additional matching funds to expand your loan pool.

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

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

   Engagement and discussions with the banking regulators; Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of Currency (OCC) and Federal Reserve Bank (FRB) regarding your fund are a very important activity. These institutions can be an important resource for knowing who might be interested in supporting lending activities or are interested in your community. They are also great resources for convening meetings with financial leaders to generate interest in your fund.
9. Credit Unions: The application process for credit union certification by the National Credit Union Administration or by designated state authorities is extensive and requires a significant amount of pre-development expenses for the business, marketing, management and operation plans. The businesses finance pro-forma will require significant details that include fund management income and expense projections. Additionally, significant startup capital is needed for operations and equity.

Final Note:

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

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

***APPENDIX A - FOR MORE INFORMATION**: Resources Websites:*

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

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

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

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

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

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

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

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

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

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

National Credit Union Administration (NCUA): (www.ncua.org) "NCUA is the United States independent federal agency that supervises and charters federal credit unions. NCUA also insures savings in federal and most state-chartered credit unions across the country through the National Credit Union Share Insurance Fund (NCUSIF), a federal fund backed by the full faith and credit of the United States government."

NCUA provides up to date information on credit unions and reports to assist all credit unions in start up and operations.

FOR MORE INFORMATION: *Organizational Examples*

Valley Economic Development Corporation / Pacoima Development Federal Credit Union

(web www.vedc.org and www.pacoimadcu.org)

"To create and sustain jobs and businesses in our communities by providing high-quality economic development services.

VEDC has consistently provided services to small and medium sized business owners, entrepreneurs and members of the communities it serves. VEDC has grown to become the largest non-profit business development corporation in the metropolitan Los Angeles area." It operates and facilitates several programs & projects such as

- SBA Women's Business Center
- San Fernando Valley Financial Development Corporation
- Pacoima Development Federal Credit Union
- Los Angeles Business Source Center

"VEDC knew that the Pacoima market was underserved in financial services. There were only two banks in Pacoima to service 90,000 local residents. Therefore, VEDC became interested in creating its own bank. In late 2000, VEDC and Los Angeles Urban Funders conducted a feasibility study for creating a community development bank in Pacoima. The findings were published in "Assessing Need for a Community Development Bank in Pacoima" in October of 2000. The study provided details about the demographics of Pacoima residents and its business community, as well as an outline of a community development bank strategy.

In 2001, VEDC retained Shorebank Advisory Services (SAS) to continue this feasibility study work. After its site visit, SAS presented several different options for VEDC to consider: create a *de novo* (start-up) community development bank; engage in a partnership with a large commercial bank to bring a bank presence into Pacoima; create a bank consortium to raise capital for area businesses, and/or charter a credit union. Based upon these options, VEDC supported the establishment of only the second commercial bank in Pacoima in 50 years, a Wells Fargo Bank Branch.

VEDC, then, proceeded with the chartering of a Credit Union on a federal level that would serve these underserved communities and utilize the provisions of the Federal Credit Union Act and its regulations that permit a federal chartered credit union to be designated as low income."

B.O.N.D. Community Development FCU (Atlanta, GA):

(See: http://www.bondcu.com/site/bond/AboutBONDCFCU.asp)

Concurrently, the Bass Organization for Neighborhood Development (B.O.N.D.) was organized to help five in-town neighborhoods take back their community. These neighborhoods were Little 5 Points, Inman Park (Atlanta's first suburb built after the Civil War, with some of Georgia's most beautiful Victorian and antebellum-style mansions), Poncey-Highlands, Candler Park, and Lake Claire. All these neighborhoods were considered low-income communities, consisting mainly of multi-family rental dwellings.

The community believed that only through property ownership would the average individual wield any power and escape poverty. Only through buying homes, residing in them, and fighting for them could the people be empowered and the road construction stopped. Everyone should have been given the opportunity to own a home, but due to "red-lining," there was no such opportunity for the residents of this area.

Financial institutions located in and around these neighborhoods would gladly take deposits, but would not reinvest back into the community. A financial institution was necessary to follow the philosophy of the local people, to reinvest back into the community, and to provide services and financial counseling to improve "the plight of the residents."

After a long two-year struggle with the National Credit Union Administration (NCUA), this was reluctant to charter a credit union with the expressed intent to provide real estate lending. The MCC then provided the initial funding of $2,500 to start-up the credit union on a shoestring budget.

Dividends were commenced at a full quarter percent over the closest competitor, C&S Bank, and deposits began to grow. But by the fourth quarter of the first year of operation, there were not enough funds in reserves to pay dividends. This was the point where the credit union proved itself to the community! The board devised a plan for increasing reserves in order to pay the dividends as they had been declared. They would take the available funds in reserves, borrow a resident's large truck, and pick peaches on a farm south of Atlanta. The plan was to bring these peaches back to Atlanta and by selling them on the street, raise the $210 needed to pay dividends.

B.O.N.D. Community FCU requested and received low-income status. By the end of 1974, the credit union deposits of $101,390 and had booked 162 loans totaling over $165,000, most of which were real estate. The credit union experienced great capital growth and low loan loss. This trend caused NCUA some concern. They felt that we were not charging off enough loans and our delinquency rate was too small. This is still a trend today at B.O.N.D. Community FCU and continues to cause NCUA concern even after so many years. NCUA once again tried to convince the Board of directors to take greater credit risks. The Board once again reminded NCUA that our primary purpose was and is to assure homeownership as a base for our community.

Over the years, our field of membership has expanded. The first of these expansions was when membership was opened to people working at the businesses located within the community boundaries. This change significantly expanded the neighborhood's use of the credit union. Our average share deposit grew 55% over the next three years.

The credit union added new neighborhoods to our original group. Currently, B.O.N.D. Community FCU serves over 5,000 members, and as of December 2008, assets exceeded $34 million dollars. B.O.N.D. Community FCU has loaned over $143 million dollars to residents who have renovated hundreds of in-town homes.

In 2010, the credit union obtained its CDFI certification, adding substantial resources and funding to increase its lending activities.

El Paso Credit Union Affordable Housing, LLC (El Paso, TX)

(see: http://epcuah.com/history.htm)

The El Paso Affordable Housing Credit Union Service Organization (CUSO) was formed in 2001 by 8 El Paso credit unions; GECU, First Light FCU, West Texas CU, El Paso Area Teachers FCU, One Source FCU, El Paso Employees FCU, Mountain Star FCU, and Golden Key FCU as a credit union initiative to improve the economic, social well being, and the quality of life, of members in the community through financial literacy, savings and providing access to low cost capital. El Paso AHCUSO services include: financial education, housing counseling, credit counseling, foreclosure prevention assistance, pre- and post-homeownership education, and information on predatory lender practices, and through its sister organization, El Paso Credit Union Affordable Housing, LLC, provides accessible low-cost program mortgage loans, in partnership with the Housing Authority, HUD, El Paso Empowerment Zone, the City of El Paso, and others. AHCUSO works closely with other credit unions to develop low cost financial products that will provide low to moderate income families with options to high-cost or predatory loans and wire remittances and are accessible to financially underserved markets.

The AHCUSO target market is approximately 90% Latino and is the very low to moderate income families within the County of El Paso, Texas, which includes the City of El Paso , City of Socorro , Horizon City , City of Anthony , Fabens, Tornillo, San Elizario and outlying Colonias. These are unincorporated settlements that lack basic water and sewer systems, paved roads, safe and sanitary housing. Texas has the largest number of colonias and the greatest colonia population, which is predominantly Hispanic. Of the proximately 1,500 colonias in the U.S side of the border, 97 percent are in Texas (Sharp, 1998). Our community is home to approximately 140,000 people living in 78 colonias (Profiles of Colonias, THDCA 1998). Most families living in the colonias do not have easy access to any financial institutions or traditional financial services, or access to low cost capital for home loans or consumer loans.