CDFI/COMMUNITY REINVESTMENT ACT (CRA)

Summary

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS and COMMUNITY REINVESTMENT ACT REFORM

President Clinton is commited 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, and his March 10 announcement of a deregulatory initiative 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 campaign, then-candidate Clinton offered three approaches to help empower people and businesses in underserved areas to join the economic mainstream: community development banks, reforming Community Reinvestment Act enforcement, and micro-enterprise loan funds. Today the President announces two initiatives to begin implementing those commitments. Building a network of community development banks and financial institutions (CDFIs), including micro-enterprise loan funds, and moving to a performance-based Community Reinvestment Act (CRA) system that will focus on results rather than process and paperwork will catalyze both communities and the mainstream banking sector to invest in people and businesses in low- and moderate-income neighborhoods.

These new approaches use the private sector to help communities grow from the bottom up -- with more opportunity, not more bureaucracy.

1. **GROWING THE CD BANK INDUSTRY:** The President's proposal calls for a Community Development Banking and Financial Institutions Fund that will invest in a national network of CD Banks and CDFIs 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 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. With $382 million over 4 years, and a maximum of between $2 and $5 million awarded per application, the President will meet his pledge of creating a network of 100 CD Banks and CDFIs.

2. **REQUIRING PERFORMANCE NOT PAPERWORK FROM BANKS:** Low- and moderate-income communities and people will never have full economic opportunity without the involvement and investment of major banks. The Community Reinvestment Act of 1977 requires banks and thrifts to meet the credit needs of the entire community in which they do business. Yet, the current system has focused too much on documentation and not enough on lending performance. The President has requested the four bank regulators, by January 1, 1994, to issue new regulations for CRA enforcement that will grade performance based upon actual lending and banking services to low- and moderate-income people.

PROBLEMS FACED BY CREDIT-DEPRIVED RURAL AND URBAN COMMUNITIES

INADEQUATE BASIC BANKING SERVICES. Millions of poor Americans have no access to nor relationship with a bank. Without easy access to a checking or savings account, they are forced to deal with cash-checking operations that charge an exorbitant fee for a simple service. Between 1977 and 1989, the number of banks in low-income areas shrank by 10% relative to high-income areas; thrift institutions in low-income and in mostly minority areas shrank by nearly one-third relative to population; and the number of loan and mortgage companies in low-income areas shrank by nearly half. At the same time the numbers of these mainstream financial institutions grew by 10 to 20% in more affluent areas while the number of check-cashing companies in low-income areas more than tripled (going from .22 per 10,000 people in low-income areas in 1977 to .73 in 1989).

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. A recent Federal Reserve Board study has shown that banks are the most important source for nearly every financial product for small- and medium- sized business. A recent National Small Business United Survey found that banks are the primary source of long-term capital for small businesses and the primary source of start-up capital aside from personal capital. Yet, a Woodstock Institute Study of the Chicago banking market found that large banks and banks located in the downtown area were more likely to lend in the suburbs and downtown area, while banks located in neighborhoods were more likely to lend in those neighborhoods.

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 ACCESS TO TECHNICAL INFORMATION AMONG BORROWERS. Small businesses, particularly those in distressed areas where commercial lenders are absent, often find no place to turn for essential counseling and information in the basics of small business management, including accounting, borrowing, managing and repaying money.

DISCRIMINATION AND REDLINING. The Home Mortgage Disclosure Act (HMDA) data for 1990 showed substantially higher loan denial rates for minorities than for white applicants. A 1992 Federal Reserve Bank of Boston study found that black and Hispanic applicants in Boston were 60% more likely to be turned down than white applicants with similar financial, employment, and neighborhood characteristics. A recent General Accounting Office study revealed that the number of mortgage loans purchased by Fannie Mae and Freddie Mac per homeowner declines as the percentage of minorities in the neighborhood increases. Anecdotal and other evidence suggests that the situation is even worse for commercial and consumer loans. A recent Woodstock Institute study of business lending in the Chicago area found that two-thirds of all commercial loan dollars went to the more prosperous suburbs and that commercial loan dollars that remained in the city were highly concentrated in or near the central business district.

SHORTAGE OF CREDIT AND CAPITAL. The unmet demand for credit and capital in poor communities is therefore substantial. The Treasury Department estimates that the unmet credit needs in low-income American communities are on the order of $15 billion. In too many low- and moderate-income neighborhoods, loans are unavailable for even the most credit-worthy housing and business purposes. Economic revitalization cannot take root in these communities where good risks and sound businesses cannot get loans.

HIGHLIGHTS OF CDFI PROPOSAL

CREATION OF FUND/GOVERNANCE. A Fund will be created to provide assistance to community development financial institutions (CDFIs). A corporate board of directors to establish policy will include the Secretaries of HUD, Treasury, Commerce, Agriculture, and the Administrator of the Small Business Administration and individuals appointed by the President who collectively represent community groups and have expertise in community development lending and commercial banking. A CEO appointed by the board will manage the Fund.

FUND A FULL RANGE OF CDFIs. All types of existing and new CDFIs will be eligible for assistance, e.g., Community Development Banks, Community Development Credit Unions, Revolving Loan Funds, Micro-Loan Funds, Minority-Owned Banks, and Community Development Corporations. No set aside of funds is allotted for any one type of CDFI.

MISSION. To be eligible for assistance, a CDFI must have a primary mission of lending to and developing an underserved target area or population that is low income or disadvantaged. All CDFIs must present a strategic plan in their application which clearly states how they will meet the economic development needs of their targeted communities.

NON-FEDERAL MATCH. A minimum of 1 to 1 match for investment in insured depository CDFIs will be required. For investment in other CDFIs, a match will be required but the amount is left the discretion of the Fund. Technical assistance to any CDFI from the Fund will not require a match.

TYPES OF ASSISTANCE. The types of assistance provided by the Fund will include capital and technical and training assistance, with the specific allocations of types of assistance left to the discretion of the Fund.

CRITERIA FOR RECEIVING ASSISTANCE. Three key criteria for receiving assistance from the Fund are: (1) **Community Representation** -- the extent of community involvement in the CDFI; (2) **Community Lending** -- the extent of community financing and lending that will result from federal support; (3) **Promotion of Self-sustaining Institutions** -- the likelihood of becoming self-sustaining.

LIMITS ON ASSISTANCE. Each insured depository CDFI can receive a maximum of $5 million in assistance, while assistance to other types of CDFIs will be capped at $2 million per application.

FUNDING. The initiative will be funded at $382 million over four years or such greater sums as may be appropriated, which will enable the President to meet his goal of creating a network of 100 or more CD Banks and CDFIs. In addition, the Fund will be authorized to incorporate private entities that can receive contributions and investments from the private sector to support CDFIs. All private funds will be entirely off of the federal budget.

SAFETY AND SOUNDNESS. All insured depository CDFIs are subject to the laws and regulations set forth by Congress and the banking regulators. No separate system of regulation or banking will be created.

CLEARINGHOUSE. The Fund will establish an information and service network in order to help CDFIs provide community and economic development assistance.

ESTIMATED IMPACT. Accounting for the leveraging capability of CDFIs, Treasury conservatively estimates that between $2 and $2.5 billion in new credit will be made available for low- and moderate- income communities and the initiative will create between 40,000 and 80,000 new jobs.

THE COMMUNITY DEVELOPMENT BANKING INDUSTRY

Many enterprising communities have come up with their own ways to fill the void in community development and banking services and serve as a catalyst for the economic revitalization of the communities they serve. A variety of promising alternatives are under way around the country.

COMMUNITY DEVELOPMENT BANKS (CDBs) are federally insured and regulated depository institutions that exist specifically to provide capital to rebuild lower-income communities. South Shore Bank in Chicago, Elk Horn 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 community development bank holding companies have emerged over the last twenty years.

COMMUNITY DEVELOPMENT CREDIT UNIONS (CDCUs) 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 CDBs, 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. Like Shore Bank, Self-Help is part of a larger holding company that includes independent, non-depository affiliates that provide venture capital, development loans, and technical assitance. There are over 100 CDCUs across the nation. One the newest was chartered in South Central Los Angeles last November.

COMMUNITY DEVELOPMENT CORPORATIONS (CDCs). Over 1000 CDCs 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.

COMMUNITY DEVELOPMENT LOAN FUNDS (CDLFs). Scores of CDLFs, 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.

COMMUNITY DEVELOPMENT INTERMEDIARIES. A number of state and local governments, community groups, and financial consortia provide specialized services that link communities, CDBs, and CDFIs 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.

COMMUNITY REINVESTMENT BY MAINSTREAM BANKS. Several mainstream commercial banks and thrifts have begun to increase their activities in distressed communties. 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.

SUCCESS STORIES: CD BANKS AND CDFIs MAKING A DIFFERENCE

HARLEM'S BEN & JERRY'S ICE CREAM FRANCHISE -- AN EMPLOYER TO THE HOMELESS: In 1982, Joseph Holland, a graduate of Harvard Law School, gave up a lucrative law practice to return to Harlem and help the homeless. He founded the Harlem Ark of Freedom, a non-profit community organization which operates a homeless shelter for men. In 1992, Holland wanted to start a business in Harlem -- an ice cream store -- but because big banks were wary, he could not secure capital for the start up costs. New York's Community Capital Bank of Brooklyn, a community development bank which provides development loans to new ventures that create jobs and affordable housing in underserved neighborhoods, stepped in an gave Holland's idea a chance. With the help of a $100,000 construction loan from Community Capital, Holland launched a partnership venture between Ben & Jerry's and the Harlem Ark of Freedom. The result is the first Ben & Jerry's franchise to be established in a low-income community. And most of its employees are homeless men. Located on West 125th street, in the heart of Harlem's commercial and cultural corridor, the 10-person ice cream shop employs 8 residents of the HARKHome shelter for men and it donates much of its profits to the shelter.

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.

HIGHLIGHTS OF COMMUNITY REINVESTMENT ACT REFORM

The Community Reinvestment Act (CRA), enacted in 1977, requires banks and thrifts to help meet the credit needs of the communities in which they do business. In recent years, this statute has come to play an increasingly important role in making credit opportunities available to underserved communities, both urban and rural, across America.

But despite its successes, the Community Reinvestment Act's true potential remains unrealized. Its implementation has focused too much on documentation and not enough on actual lending performance. Banks complain about excessive paperwork and inconsistent implementation of the law. Community groups complain that their communities remain unserved, and that CRA evaluations often fail to reflect actual community reinvestment activities.

By giving our banks and thrifts clearer guidance as to how the regulatory agencies will evaluate performance under the Community Reinvestment Act, we can reduce the need for meaningless documentation. By focusing that guidance on the provision of real investments and services, we can increase support to communities that need it.

Therefore, the President is requesting the banking regulators -- the Office of the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Reserve Board, the Federal Deposit Insurance Corporation -- to take the following actions:

- **Reform CRA Enforcement by January 1, 1994** -- In consultation with the banking industry, the thrift industry, congressional leaders, and community groups across the country, work together to reform CRA enforcement system by developing new regulations and procedures that replace paperwork and uncertainty with greater performance, clarity and objectivity;

- **Train a Corps of CRA Examiners** -- Develop a well-trained corps of regulators who specialize in CRA examiniations;

- **Implement More Effective Sanctions** -- Institute more effective sanctions against banks and thrifts with consistently poor performance;

- **Develop More Objective, Performance-Based CRA Assessment Standards** -- Reform CRA standards to focus on more objective, performance-based criteria that will minimize the compliance burden on financial institutions while stimulating improved CRA performance. These new standards might appropriately focus on three types of community reinvestment activities: (1) Lending to low- and moderate-income individuals and neighborhoods, small businesses, and small firms; (2) investments in low- and moderate-income neighborhoods; (3) provision of banking services to residents of low- and moderate-income neighborhoods.