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Capital for Communities—
Opportunities for People™

May 7, 2010

Scott Berman
Acting Chief Operating Officer
Community Development Financial Institutions Fund
U.S. Department of the Treasury
601 Thirteenth Street, NW, Suite 200 South
Washington, DC 20005

ATTN: Request for Public Comment on the Community Development Financial Institutions Fund and Award Programs

Dear Mr. Berman:

On behalf of Community Reinvestment Fund, USA, I am pleased to provide comments on issues regarding the Community Development Financial Institutions ("CDFI") Fund and its award programs in response to the Request for Public Comment published in the Federal Register on March 8, 2010. CRF was among the early advocates for the creation of the CDFI Fund and we have been a loyal and active supporter since its inception. Over its 15 year history, the Fund has established and implemented an exceptional array of programs and policy initiatives with which CRF is actively engaged. We are committed to the success of this Agency and appreciate the opportunity to share our views and recommendations for improving the Fund's statutory requirements and its programs. In addition, we recommend that the CDFI Fund explore and undertake new approaches to carrying out its mission.

BACKGROUND

Community Reinvestment Fund, USA ("CRF") is the nation's leader in accessing the capital markets to provide liquidity to support community development financing activities. As a national nonprofit financial intermediary and certified Community Development Financial Institution, we provide new loan capital for community-based development lenders by operating a secondary market for their loans. CRF purchases performing small business, economic development, affordable housing and community facility loans from private nonprofits, such as CDFIs, governmental and quasi-public lending agencies. We pool these loan obligations and transform them into securities through the process of securitization. These securities are then sold to banks, thrifts, insurance companies, pension funds and other qualified institutional investors.

CRF pioneered the development of asset-backed community development securities to help community-based lenders tap capital markets resources. In 2004, CRF began issuing rated debt offerings – one secured by a pool of affordable housing loans totaling $84.7 million with the highest class of certificates in this offering receiving a "AAA" rating from Standard & Poor's; and the second offering was collateralized by small business loans totaling $51 million

- including $46 million in asset-backed securities, of which 57% received a "AAA" rating from Standard & Poor's. Since then, CRF has issued additional rated debt offerings that have brought more than $100 million in capital primarily to low-income communities.

The CDFI Fund's New Market Tax Credit ("NMTC") program has complemented our debt securitization products. CRF has created an "advanced commitment product" for CDFIs and other community-based lenders engaged in small business financing. We played an instrumental role in creating and shaping the design of the NMTC program. These efforts enabled us to develop our own highly successful and unique tax credit financing product using our "advanced commitment" template that delivers much needed loan capital to small business and nonprofit borrowers in low-income communities. CRF's affiliate, National New Markets Tax Credit Fund ("NNMTCF"), is one of the country's largest Allocatees, receiving NMTC award allocations totaling $597.5 million as well as investing $52.5 million in allocations on behalf of other Allocatees. To date, we have funded more than 350 NMTC loans totaling $476.1 million in 187 cities in 34 states.

Since its inception, CRF and its affiliates have delivered nearly $1.2 billion in capital—primarily to small businesses—located in more than 750 communities across the country. In turn, this capital has leveraged an additional $1.1 billion in other resources. In partnership with 154 local lending partners, we have funded a total of 2,280 loans in 46 states and the District of Columbia. CRF, working through its local lending partners, has directly assisted more than 210,000 families, including financing 16,317 affordable homes, supporting small businesses creating or retaining almost 40,567 jobs and funding community facilities that serve 152,574 individuals.

THE CURRENT STATE OF THE CDFI INDUSTRY AND THE NEED FOR LIQUDITY

However, much has changed in the financial markets since CRF issued its last asset-backed securities, and our vantage point as a national intermediary working with many local organizations may give us a different perspective on the role of the CDFI Fund and its statute going forward. Therefore, before commenting on specific questions or issues raised by the CDFI Fund in its request for comment, we would like to offer general comments on the state of the CDFI industry and the need for liquidity, as it pertains to nondepository loan funds.

When the financial markets collapsed in 2008, CDFIs, including CRF, found themselves caught up in a crisis over which they had little control, but which dramatically affected their ability to access funds for their lending activities. Much to its credit, the CDFI Fund was quick to respond with an emergency award program supported with stimulus money. The resources distributed to CDFIs under the American Recovery and Reinvestment Act of 2009 ("ARRA") have been a vital "lifeline" for the industry but they are limited by their very form. As equity, ARRA dollars clearly leveraged private sector funding and helped to keep CDFI lending spigots open. However, while the Fund's efforts are certainly laudable, the ARRA resources provided a "one-time" response to broader, more long-lasting credit constraints facing CDFIs.

What this industry desperately needs is an on-going, reliable mechanism tailored to the lending activities of its participants that enables them to manage their own liquidity needs—particularly in times of profound economic stress. The financial meltdown and the ensuing recession underscored and exacerbated a serious flaw in the collective CDFI model. While CRF continued to purchase loans early in the crisis, it also found that it could not continue purchasing loans at the scale necessary to meet the demands of its customers when the securitization markets froze up. While CRF maintained liquidity, it simply was not able to access former sources of liquidity to fill the breach.

As a result of our experiences in the credit Tsunami, we believe that the community development finance industry will not be sustainable, nor will it grow to scale without a means of efficiently and swiftly allocating liquidity to participants seeking to recapitalize their loan funds for their own balance sheet purposes or to meet borrower credit demand.

Unlike regulated banks, thrifts and credit unions, most CDFIs had no emergency liquidity infrastructure to which they could turn. The Federal Reserve implemented a complex series of programs alone and in concert with the Treasury Department to support financial institutions to ensure that credit continued to flow to businesses and consumers. In addition, traditional credit providers have a comprehensive infrastructure which they can tap to meet their liquidity needs, including borrowing windows at the Federal Reserve and the Federal Home Loan Banks, loan syndication and participation networks, formal and informal networks of correspondent lenders, bankers' banks and corporate credit unions, as well as access to bond markets, deposit insurance and deposit raising innovations (e.g. CDARS).

Except for a handful of CDFI liquidity providers, including CRF, and the CDFI Fund's award "window", there are few sources of liquidity for CDFIs. The Financial Assistance program is critical to industry because it serves as a source of equity – something which is necessary and vital for CDFIs but not, in our view, sufficient to maintain liquidity in the community development financing system. We believe that this is a structural issue for the industry, and not a commentary on the liquidity and balance sheet management strategies of any particular organizations. The industry has grown on a portfolio lending model whose capital structure relies primarily on equity raised from the CDFI Fund, foundations and others, together with short-term debt from banks, and foundations. This structure left many CDFIs unprepared to meet the challenges they faced in the wake of the economic crisis. We contend that had a robust liquidity infrastructure been in place for CDFIs, similar to that which exists for mainstream financial institutions, many would have been able to weather the recession and continued to lend in their communities.

So what does liquidity mean for CDFIs and what should policymakers, such as the CDFI Fund, put in place to prepare the industry to cope with current and future economic challenges? We see three issues in the CDFI capital structure.

First, as previously noted, in spite of CRF's presence in the marketplace, CDFIs do not have a sufficient market in which they can sell their illiquid loans. Despite the efforts of the Federal Housing Finance Agency staff, as directed by the Housing and Economic Recovery Act of 2008, to develop membership criteria for unregulated CDFIs wishing to join the Federal Home Loan Bank System, few such organizations will be able to meet the eligibility requirements.

CRF's track record over the past 20 years demonstrates that is it possible to create a performance driven business model that connects the community development finance industry to the capital markets. With the proper structure in place, CRF and other emerging liquidity providers could once again serve as a liquidity lynchpin for the CDFI industry but the Fund must take steps to help capitalize these organizations to operate at a larger scale.

Second, the CDFI capital structure may be overly reliant on short- to medium-term debt, such as Program-Related Investments[1] ("PRIs"), which for the first time is posing refinance risk for many organizations. Another common debt product, Equity Equivalent Investments[2] ("EQ2s"), while more patient than PRIs have added liquidity risk to many CDFI balance sheets, because, while they have equity-like features, these instruments are actually debt obligations that must eventually be repaid. Historically, CDFIs have been able to renew these debt instruments when they came due and maintain liquidity over time. However, as CDFI loan portfolios have experienced rising delinquencies and charge offs, many have found that their capital cushion is no longer adequate to absorb loan losses, thus devouring the capital CDFIs expected to use to repay their debt obligations. To make matters worse, some PRI and EQ2 lenders have begun to call these obligations rather than to roll them over. As a result, many CDFIs may see balance sheet liquidity erode further. However, the pressing asset/liability mismatch facing many CDFIs could be partially offset if these organizations had a way to increase their liquidity through asset sales, loan participations or access to a short term borrowing window at the CDFI Fund. Without the ability to raise core deposits and or other resources, an increasing number of CDFIs could find themselves unable to repay their PRI and EQ2 debt. We therefore urge the CDFI Fund to look beyond the statute at ways to strengthen the capital structure of CDFIs through enhanced liquidity facilities and intermediaries such as CRF.

The third issue CDFIs face is the absence of a mechanism for redistributing liquidity among industry participants. Despite the challenging environment, CDFIs generally hold a portion of their assets as idle funds on their balance sheet. An institution may be forced to invest these funds in low yielding investments, such as cash and near-cash equivalents, in order to meet anticipated liquidity needs. This could result in the CDFI having a negative net interest margin where they are paying more for their funds than their liquid investments are yielding. At present, there is no way to allow CDFIs with short term liquidity surpluses to invest their funds at higher interest rates with other CDFIs that may have liquidity needs. In short, when one considers the liquidity of the entire system, rather than each CDFI on its own, the allocation of liquidity resources may be extremely inefficient. The Fund should review and support industry research on the issue of how to design and implement structures or mechanisms to address liquidity imbalances by more effectively allocating liquidity among CDFIs.

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[1] Program-Related Investments as used by CDFIs are generally full recourse, senior, unsecured loans issued by foundations and other socially motivated investors to CDFIs. They generally have terms of between five and seven years.
[2] Equitiy Equivalent Investments play the role of quasi-equity on the balance sheets of many CDFIs. EQ2s are unsecured, subordinate loans that generally have ten year maturities, but with the provision that lender must call the note generally five years before the loan is due. If the lender does not call the note the maturity is automatically extended annually.

The liquidity challenges confronting CDFIs raise important policy questions. At a time when CDFIs may be experiencing negative arbitrage as a result of constraints on their asset/liability management, should the federal government be making grants to other CDFIs that need cash? Are there ways to optimize or better deploy liquidity among CDFI industry participants using financial markets, and if so, how should it be done? We hope the CDFI Fund will keep these questions in mind as it shapes the programs and the requirements that will guide the CDFI industry in the future.

COMMENTS ON CDFI FUND AWARD PROGRAMS AND STATUTORY REQUIREMENTS

The CDFI Fund seeks comments on an extensive list of issues related to its statutory requirements as well as its award programs to determine whether technical corrections or substantive revisions should be made to the authorizing statute. CRF has chosen to focus its comments on two areas; first we offer comments on various aspects of the CDFI Fund's award programs, including program definitions, the certification process, type of financial assistance provided, limitations or caps on the size of awards (annual and multi-year). Our second set of comments address the Liquidity Enhancement Program, a provision of the statute that has never received appropriations and therefore is not operational. As a national CDFI that provides liquidity to community-based lenders, CRF has a unique perspective on the CDFI industry's need for a consistent and reliable source of liquidity and the importance of operationalizing this program in the context of the current economic crisis. Please note we have structured our comments using the same section headings and followed the order reflected in the Request for Comment.

B. <u>Community Development Financial Institutions (CDFI) Awards</u>

1. <u>Definitions</u>

(d) The Federal Housing Finance Agency (FHFA) has issued its final rule regarding CDFI eligibility for membership in the Federal Home Loan Bank System. In its final rule, the FHFA provided several financial definitions (e.g., net asset ratio, operating liquidity ratio, gross revenues, operating expenses, restricted assets, unrestricted cash and cash equivalents). Should the CDFI Fund adopt any or all of these definitions?

CRF does not believe the CDFI Fund should adopt any or all of the financial definitions included in the FHFA's final rule outlining the CDFI eligibility critieria for membership in the Federal Home Loan Bank System for the following reasons. First, it is not clear from this question whether it is being suggested that the Fund should adopt the definition of these financial ratios or measures *as well as* the specific benchmarks or targets established in the FHFA's final rule. In our view, because CDFIs employ a wide range of business models some of these financial definitions are not appropriate for a given type of CDFI. Moreover, applying a single set of benchmarks or targets for these measures to all types of CDFIs is simply not suitable or useful. CDFIs and their social capital lenders tailor performance metrics and covenants to the risks and activities of the insititution rather than adopting a "one size fits all" approach.

2. Certification

(a) Is the criteria established for CDFI certification adequate to ensure that only highly qualified CDFIs obtain the certification? Should the CDFI Fund seek to only certify highly-qualified CDFIs?

In CRF's opinion, the CDFI certification process is designed to ensure that only applicants whose mission and activities are aligned with the Fund's definition of a CDFI are certified. Although the Fund has not defined what is meant by "highly qualified CDFIs", we believe qualification to be a CDFI involves a great deal more than its financial performance. In our view, the Fund's certification process is appropriately focused on mission and how a CDFI applicant is serving its Target Market. CDFIs develop unique and highly individualized approaches to delivering financial products and services. The purpose of the certification process is to determine whether an applicant meets the eligibility criteria as set forth in the statute and the regulations. How well a CDFI is performing in terms of its financial health, its community impact, or its business strategy is best evaluated in the context of the Fund's award review process.

(d) Should CDFIs be re-certified on a regular basis and, if so, how often?

We respectfully suggest that a self recertification procedure be implemented that would require all certified CDFIs to recertify themselves every three years, regardless of whether they have received an award from the Fund. Under the self recertification process, a CDFI would confirm that it maintains a primary mission of community development; that it still serves its designated Target Market(s); and that it is a going concern. As part of this process, CDFIs would be required to submit financial statements (audited if available) for the past three years. CDFIs experiencing a "material event" would trigger a more thorough recertification by the CDFI Fund. With such a process in place, the CDFI Fund could then conduct periodic recertification of all CDFIs on a rolling six year schedule.

(e) Presently, the CDFI Fund only requires a CDFI to notify it of material events when applying for an award. Should such notification be required from all certified CDFIs on a regular basis (e.g., every year; every three years)?

Yes, in our view, all certified CDFIs should be required to notify the Fund of material events regardless of whether they are applying for an award. We believe this notification should be incorporated into the three year self recertification process we have described above in section (d).

(f) Currently, CDFI certification review does not entail an assessment of an organization's underlying financial soundness. Should the CDFI Fund require any or all of the following financial documentation as a condition of certification?

(i) Net asset ratio to total assets of at least 20 percent, with net and total assets including restricted assets (net assets are calculated as the residual value of assets over liabilities);

(ii) Positive net income (gross revenues less total expenses) measured on a three-year rolling average;

(iii) Ratio of loan loss reserves to loans and leases 90 days or more delinquent (including loans sold with full recourse) of at least 30 percent, and loan loss reserves at a specified balance sheet account that reflects the amount reserved for loans expected to be uncollectible;

(iv) Operating liquidity ratio of at least 1.0 for the four most recent quarters and for one or both of the two preceding years (numerator of the ratio includes unrestricted cash and cash equivalents and the denominator of the ratio is the average quarterly operating expense).

CRF believes that the *certification* review should not entail an assessment of an organization's underlying financial soundness. Therefore, we would object to requiring applicants to meet any or all of the financial ratios or measures listed above. As we noted earlier, the financial performance of a CDFI is and should be evaluated in the context of an application for financial assistance from the CDFI Fund.

(h) Should the CDFI Fund require certified CDFIs to annually submit current information on financial viability and other data necessary to assess the financial condition and social performance of the CDFI industry?

In order to respond to this question, the CDFI Fund needs to define the term "financial viability" as well as the type of data it would use to assess the financial condition and social performance of the CDFI industry. While it would certainly be useful to know how the industry is performing, we see significant challenges to defining and measuring "financial viability" across all types of CDFIs employing a broad range of business strategies. We also believe it is essential to preserve the flexibility CDFIs have to provide financing that mainstream financial institutions are unable or unwilling to offer. Thus it would be important to know what data the Fund would require CDFIs to submit and how such data would be used.

Additional Comments

In addition to the questions raised by the Fund in this section, CRF would like to highlight an important hurdle related to the accountability test that specifically affects national intermediaries seeking to be certified. In general, meeting the accountability test for a national Target Market is daunting as it is difficult to demonstrate how an organization's governing or advisory board can represent the interests of borrowers across the country. Applicants designating a national Target Market comprised of Low Income or Other Targeted Populations have been able to achieve accountability by building a board that includes representatives from national organizations that serve low income or other target populations. However, it is virtually impossible to designate a national Target Market comprised of eligible Investment Areas in order to be certified as a national CDFI intermediary offering small business financing. This is due, in part, to the challenges of the CDFI Fund's mapping system which compels applicants to designate a number of separate Investment Areas and in turn require their own individual accountability mechanisms, such as Advisory Boards. The result is that national CDFI applicants must establish numerous boards to meet the accountability requirement adding additional complexity and unnecessary burden for the organization. The Fund should consider adopting the approach used in the CDE certification process whereby applicants can meet the accountability requirement for a "national service area" by appointing representatives of "nationwide non-profit community development organizations".

5. Financial Assistance

(a) As implemented through its Notices of Funds Availability (NOFA), which are issued for each funding round, the CDFI Fund has structured two categories for financial assistance applicants: "Core" and "Small and Emerging CDFI Assistance" (SECA) for applicants that were recently established or that have smaller assets compared to institutional type. Despite these two award categories, many CDFIs have grown and expanded their reach in recent years. Is there a point at which a CDFI should be considered to have "graduated" from and no longer be eligible for CDFI awards? If so, what should be the criteria (e.g., successful award history, asset size, national reach, etc.)?

CRF does not believe that CDFIs of a certain size or activity level should "graduate" and become ineligible to apply for CDFI awards. The current financial crisis has clarified the need for equity among CDFIs of all types and sizes in order to sustain and grow their financing activities in low wealth communities. CDFIs must to have access to a *reliable* source of equity and the Fund plays this critical role. As private sector sources of equity capital, such as foundation grants and retained earnings, have declined it is all the more necessary that the CDFI Fund remains open to *all certified organizations* regardless of size or award history. CDFI Fund must continue to support successful community development financing models with critical equity resources without regard for the age, size or past awards received by a CDFI.

(b) If a CDFI were to "graduate" from CDFI award eligibility, should another program be developed for such an institution; if so, what type of financial assistance should those institutions receive?

As noted above, we don't subscribe to the notion that CDFIs should "graduate" and no longer be eligible for Fund awards. Furthermore, with CDFI Fund programs routinely oversubscribed, it is difficult to conceive of creating a separate program given limited resources to which "graduate" institutions would apply.

(c) Under the CDFI Fund's authorizing statute, the CDFI Fund has the authority to make long-term, low-interest loans to CDFIs, dependent on matching funds. Is there a need for a loan product in addition to the CDFI financial and technical assistance awards and its lending authority? If so, please describe the product, e.g., terms and conditions, matching funds requirement, etc. Should funds be diverted from the CDFI awards to establish a loan pool?

In our view, the need for a loan product in addition to CDFI financial and technical assistance awards needs to weighed in light of the other pressing industry needs. As we noted above earlier, the entire field may be overleveraged in the context of the new financial marketplace. The form of capital CDFIs most desperately need is true *equity*. CDFIs use their equity capital to attract the social capital or low interest debt they use for making loans and investments. With private sector equity sources severely constrained, the Fund should dedicate its resources to providing grants dollars that allow CDFIs to leverage the funds they need to grow their financing activities. Although a loan product might provide marginal benefits for CDFIs, we would urge the Fund to stay focused on the most critical capital needs of the industry until or unless equity capital is easily available in sufficient quantity.

(d) Is there a need for a CDFI federal loan guarantee and if so how would it be structured?

From our perspective, a federal loan guarantee could be quite helpful. In fact, the Fund should consider one or more of the three options presented below and they should prioritize them in the order presented. The financial crisis has heightened the need for credit enhancement in both conventional and community development financing markets. However, the CDFI Fund should carefully consider a number of issues when structuring a federal guarantee.

First, the guarantee should be designed to cover a pool of CDFI assets. One model to consider is the recent proposal by the Small Business Administration to create a Secondary Market First Lien Position 504 Loan Pool Guarantee. Although a loan level guarantee would provide individual CDFIs with greater liquidity, the Fund's focus should be on leveraging additional private sector resources from institutional and sophisticated individual investors. The collapse of financial markets has caused investors to seek investments of the highest credit quality or ratings. Credit enhancing or guaranteeing a pool of CDFI assets or securities backed by such assets could transform below investment grade instruments into investment grade instruments which could be sold in the capital markets.

Second, to facilitate the aggregation of pools of CDFI loans for placement or securitization, the Fund should consider guaranteeing interim funding instruments. CDFI intermediaries operating at scale must have access to warehouse lines of credit to pool and place or securitize CDFI loans. Without these warehouse lines of credit, it may be very difficult to create CDFI loan pools that could benefit from a pool level guarantee.

Finally, the Fund should consider a federal guarantee at the individual loan level for loans originated by CDFIs. The price tag for such a guarantee will not be insignificant but *must* be weighed in light of the potential benefits such an investment could bring. While markets appear to be coming back to life, most individual CDFIs are not able to attract large scale institutional capital at meaningful levels. Guaranteed loans are more likely to trade in capital markets and among and between individual CDFIs. We urge the Fund to take "the long view" and make a substantial investment in a federal loan guarantee that will allow industry intermediaries to leverage this credit enhancement on a scale previously not available to the CDFI industry. One way to make this investment more palatable would be to launch the guarantee on a pilot basis so that it could be reviewed and evaluated.

(e) Should a category be created specifically for CDFIs that serve a national market or are intermediaries? If so, what proportion of the appropriation should be allocated for such applicants?

We support the creation of a category that recognizes the unique role played by national CDFIs and intermediaries, to complement the functions of other types of CDFIs.

CRF strongly supports the creation of a separate category for CDFIs that serve a national market or are intermediaries. As a national CDFI intermediary, we believe that ability to scale the CDFI industry rests with intermediaries that can attract new sources of capital at scale and enable portfolio lending CDFIs to better meet the credit needs of their borrowers. Without national CDFI intermediaries the CDFI industry will continue to be constrained by the size of individual institutions' balance sheets and will therefore not be able to scale their financing activities and achieve meaningful impact. The current financial crisis has clarified the need for national intermediaries like CRF – which have also suffered as the capital markets simply ceased to function. However, we firmly believe that the current market conditions are *not* permanent and that new forms of off-balance-sheet financing will emerge to meet the credit demans of conventional and community developoment borrowers. The industry and, by extension, the Fund must be prepared to make an investment in national CDFI intermediaries that adapt new financing models to recapitalize and effeciently allocate resources to CDFIs across the country.

We urge the Fund to seriously consider creating a category for these national CDFI intermediaries on the basis that they have a much larger territory or footprint to cover and that they demonstrate their ability to support CDFIs across a number of geographical areas. Rather than advocate a set-aside of a specific percentage of the appropriation, we urge the Fund to place a high priority on ensuring that these types of CDFIs have meaningful access to Financial Assistance awards.

Should CDFIs be required to provide financial education to their customers; if so should there be a minimum level of education?

CRF does not favor requiring CDFIs to provide financial education to their customers. CDFIs use a wide range of business models to serve an array of customers across the country. Many CDFI borrowers may not need financial education making such a requirement onerous and unnecessary. Thus while financial education may be useful and appropriate for some CDFIs that offer consumer loan products such a blanket requirement should not be imposed on the industry. We would prefer to see the Fund offer encouragement through its programs as it has done with the Financial Education and Counseling pilot program.

6. Award Cap

(a) Should CDFI Fund award amounts have a cap or should award amounts be based on merit and availability?

CRF appreciates the CDFI Fund's important role in providing access to capital for CDFIs. However, we are concerned that the way in which the Fund distributes its resources may have the unintended effect of creating an industry characterized by a large number of relatively small CDFIs that have difficulty getting to scale and achieving significant impact. CRF recognizes there are limitations on federal appropriations and that the Fund needs to award financial resources in a manner that supports a national industry. Therefore, we favor retaining a cap on annual awards but one that is larger than the current $2 million limit. The cap should be increased due to inflation, and should reflect the overall size of the appropriation available in any given year.

(b) Should subsidiaries and affiliates have a funding cap that is separate from their parent CDFI?

CRF does not support a funding cap for subsidiaries and affiliates that is separate from their parent CDFI. As noted in (a) above, as long as demand for award funds continues to significantly outstrip federal appropriations, CDFI entities (parent organizations and their subsidiaries and affiliates) should remain under the same award cap.

(c) Should the CDFI Fund make an award to only one affiliated organization during the same funding round?

Yes, for the same reasons we noted above in (b), CRF believes the CDFI Fund should make an award to only one affiliated organization during the same funding round.

(d) Is "$5 million of assistance in total during any three-year period" too restrictive? If so, what are the alternatives, if any?

CRF strongly urges the CDFI Fund to lift the $5 million cap on assistance during any three-year period as it is too restrictive given the evolution of the industry. In 1994, when the legislation was enacted and this cap was established it seemed reasonable to limit the award amount to a single entity so as to ensure funds would be available to seed a national industry. However, as CDFIs have evolved and grown in size and scope, this cap has become woefully outdated. Not only has the cap failed to keep pace with inflation but it makes no distinction between national CDFIs whose business model requires a significantly larger amount of capital and that of a much smaller CDFI working in single state or community. In addition, as we explained above in the Financial Assistance section (e), national intermediaries perform an important function by helping to identify and allocate resources to CDFIs across the country, providing liquidity to those organizations that may have signficant loan demand but inadquate loan capital. Deploying these resources more efficiently would benefit the entire industry and should not be subject to an arbitrary cap of $5 million over a three-year period.

7. Matching Funds

(a) Does the dollar-for-dollar matching funds requirement restrict a CDFI's ability to apply for a financial assistance award? If so, what should be the matching funds requirement?

(b) Should the matching funds continue to be restricted to comparable form and value or should any type and source of funding be allowed as matching funds?

The CDFI Fund raises important questions regarding the current matching funds requirement in both (a) and (b) above. A key principle of the Financial Assistance program is that Fund awards must be matched by private sector (non-federal) resources. CRF supports the concept of providing matching funds, however we believe the existing matching requirements are seriously constraining the ability of CDFIs to access Fund resources.

In our opinion, the matching requirements should be revised to reflect the new realities facing CDFI industry. CDFIs need equity to stabilize their balance sheets and raise new debt for their lending and investing activities. Given that they rely on declining foundation grants and shrinking retained earnings for matching funds they simply cannot raise the match monies needed to access Fund awards. Furthermore, equity requirements for CDFIs have increased in response to the financial crisis forcing these instititutions to either deleverage, through loan sales or repayments, or raise equity. Both of these options are proving to be increasingly difficult. The Fund must dedicate its resources to providing equity to industry participants but to do effectively it must modify the current matching funds requirements.

We suggest the following changes be made:

- Modify the requirement that matching funds "….be at least comparable in form and value to assistance provide by the Fund" by requiring CDFIs to match Fund assistance with non-federal resources that are "comparable in value". In other words, permit CDFIs to match equity assistance from the Fund with debt or retained earnings or private sector sources. The CDFI Fund clearly recognized the need for flexibility in the last two Financial Assistance ("FA") funding rounds when they waived the matching funds requirement altogether. Without this flexibility, CDFIs will be constrained from applying for assistance awards and will not be able to maintain or expand their lending activities at the time when they are most needed.

- Establish a new conversion scale that articulates the ratio of debt needed to match an equity award request. For example, if a CDFI applies for an FA award with matching funds in the form of a debt, such as a Program Related Investment ("PRIs"), then the loan match would be converted into an equivalent amount of grant dollars; $1 of grant assistance might require a match of $2 or $3 of PRIs and so forth. Conversely, the new scale should reward CDFI applicants that generate profits (e.g. an increase in Net Assets) in this difficult economic environment by alllowing them to use *half* the amount of retained earnings as a match for their FA award request.

- Extend the "look back" period associated with the matching funds requirement for both grants received and retained earnings to allow CDFIs to use additional resources to meet these requirements. This modification would be especially helpful given the challenges CDFIs have had in recent years generating income and attracting grant resources.

This revised matching funds requirement preserves the concept of pairing public sector resources with private sector dollars while assisting CDFIs in the "deleveraging" process which is essential to put the industry on a more stable long-term footing. This approach would allow applicants to utilize other forms of matching resources while recognizing that using debt as match will generate a smaller grant from the CDFI Fund than if grant dollars had been used. With so many CDFIs unable to borrow additional resources because they are "equity constrained" the Fund must ensure that match requirements do not prevent qualified CDFIs from appyling for financial assistance awards that will enable them to serve their Target Markets especially during this period of economic hardship.

(c) The statute provides certain exceptions to the matching funds requirement and provides the CDFI Fund the flexibility to reduce the match requirement by 50 percent in certain circumstances. Is this appropriate?

(d) The statute allows the applicant to provide matching funds in a different form if the applicant has total assets of less than $100,000; serves nonmetropolitan or rural areas; and is not requesting more than $25,000 in assistance. Should this provision apply to all applicants? Should the asset size and assistance request be increased?

The statute provides flexibility in meeting the matching funds requirement for applicants that are small in size, those serving nonmetropolitan and rural areas or those seeking small amounts of assistance. While these exceptions provided appropriate flexibility when the statute was first enacted, as we described above, today's economic realities have made the existing matching requirements highly restrictive for most CDFIs. The modifications we proposed above in sections (a) and (b) would make the current exceptions more broadly available to all CDFIs regardless of size, award request or markets served. We think this approach is appropriate in light of current economic conditions and the importance of ensuring the continued flow of capital and credit to underserved communities. We favor retaining the exception that provides the Fund with the flexibility to reduce the match requirement to 50% for those CDFIs facing severe constraints on their abiltiy to access such funds.

D. <u>Capitalization Assistance to Enhance Liquidity</u>

The CDFI Fund is seeking comments on issues relating to the Liquidity Enhancement ("LE") Program, particularly with respect to the following questions:

(a) Do CDFIs have a liquidity need?

(b) Would the LE Program, as structured, help address CDFIs' liquidity needs?

(c) Should the restrictions related to the award cap and/or matching funds be removed as a means to create larger impacts?

(d) What changes are needed to make this a viable initiative?

(e) Are there other program ideas better suited to providing liquidity for CDFIs?

CRF was influential in shaping the LE Program during the on the CDFI Fund's enabling legislation. We foresaw the need for a secondary market for CDFI loans as a way to scale the industry given limited resources. As a national CDFI intermediary dedicated to transforming "…the community development finance system by accessing the capital markets on behalf of local development lenders …" CRF is particularly invested in seeing the LE Program activated. For the industry to have sufficient resources to meet the demand for capital and credit in their communities, CDFIs must consider loan sales and other off-balance sheet financing options. CRF pioneered the use of securitization for small business and affordable housing loans and while these markets are closed at the moment, we believe new forms of structured finance will emerge in the conventional capital markets. If domestic emerging markets are to utilize these off-balance sheet financing innovations, the Fund must make a meaningful investment in organizations that adapt these structures and techniques for use by CDFIs. The LE Program provides an excellent vehicle through which the CDFI Fund can capitalize Liquidity Providers – organizations that will build and operate a critical piece of the new liquidity infrastructure needed to serve this industry. While this cannot be done "on the cheap" there will be a significant payoff down the road in the form of an enduring mechanism for CDFIs to access liquidity especially in times of financial stress.

(a) Do CDFIs have a liquidity need?

As describe above in the section entitled, " The State of the CDFI Industry and the Need for Liquidity," CDFIs have a serious liquidity need which has been exacerbated by the financial crisis. Our observations are supported by findings reflected in the Fouth Quarter 2009 CDFI Market Conditions Report published by the Opportunity Finance Network, where CDFI respondents reported that "Liquidity constraints persist and in some cases are worsening. Consistent with the previous quarter, half of respondents reported that they were capital-constrained. Among the trend sample, the number of respondents reporting that they are capital-constrained rose gradually between the second and third quarter (from 48% to 52%), and in the fourth quarter reached 62%."[3]

Liquidity is a challenge for CDFIs who offer highly customized and flexible loan products to meet the needs of their borrowers who lack access to conventional forms of credit. This customization makes the sale of CDFI loans more difficult and consequently, most CDFIs act as portfolio lenders. CRF is highly attuned to the liquidity challneges of CDFIs because of our role in building a secondary market for their loans. To enhance the liquidity of CDFI loans we have been actively encouraging greater standardization in documentation and underwriting in the context of the unique nature of CDFI loans. The CDFI Fund and the industry must work together to develop strategies to move loans off their balance sheets and develop a framework for accessing new sources of liquidity with which to make new loans. This effort will involve adapting tools and strategies from mainstream capital markets, as CRF has done, as well as developing new tools designed specifically for the CDFI industry.

(a) Would the LE program, as structured, help to address CDFI liquidity needs?

(b) Should the restrictions related to the award cap and/or matching funds be removed as a means to create larger impacts?

(c) What changes are needed to make this a viable initiative?

In general, the Liquidity Enhancement Program should be differentiated from the other capitalization programs of the Fund with respect to the following two functions unique to the secondary market makers or liquidity providers: Balancing the supply and demand for capital; and Balancing Institutional needs. The first function channels capital from geographies and institutions with excess capital to those who need it using market mechanisms. The second creates a value chain among distinct institutions. For example, a large pension fund or insurance company is not structured to make individual small business loans. Rather, it looks for investments it can make at scale in pools of small business loans. Conversely, individual CDFIs may be perfectly suited to originate individual busienss loans, but they cannot originate enough loans to deliver them to the pension fund at the scale required.

The Liquidity Enhancement Program should focus solely on building intermediary institutions that can perform one or both of these functions. To do so, it must be updated to reflect the evolution of the CDFI industry as well as current market conditions, including inflation, the capital needs of institutions and the difficulty of raising matching funds. As presently structured, the requirements would severely limit the scope of the program and constrain organizations acting as liquidity providers.

We would strongly urge the Fund make the following modifications to the program requirements:

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[3] CDFI Market Conditions Report, Fourth Quarter 2009, The Opportunity Finance Network, March 2010, page 8.

· *Waive the matching funds requirement*: As previously noted, changes in the marketplace over the past two years have made it exceptionally difficult to raise matching funds in the form of equity. Maintaining this requirement may exclude organizations that cannot raise matching funds but have the expertise to participate in the LE Program. Even without a match requirement, liquidity providers will leverage federal equity capital with private sector resources that might not otherwise support community development financing.

· *Eliminate the cap on awards*: This will allow successful organizations to scale their operations and provide liquidity support for the benefit of the broader industry.

· *Remove the prohibition on LEP awardees participating in other CDFI Fund initiatives*: This restriction, like the matching requirement, is shortsighted in that it could prevent the very organizations with the strongest expertise, track record and interest in developing solutions to address CDFI liquidity needs from participating in the program.

· *Ensure the flexible use of assistance under the LE Program*: This will serve to encourage innovation and the use of a variety of strategies and tools to manage portfolio liquidity. Where possible, the CDFI industry should strive to gain access to established tools and institutions that provide liquidity. However, it may be necessary to develop a liquidity infrastructure that is tailored to the unique needs of CDFIs. The Fund might consider funding pilot programs and evaluations of these efforts to identify one or more successful strategies.

(a) Are there other program ideas better suited to providing liquidity for CDFIs?

Over the last year or so, a number of proposals have been circulated by industry participants to create specific liquidity mechanisms for CDFIs through the use of a federal guarantee. Each of these proposals would require substantial investment over a number of years. However, if sufficient resources are invested and CDFIs gain access to the capital markets, then the investment of those scarce public resources will have been used to leverage substantial private capital that could stregthen the equity position of the industry. Therefore, we urge the CDFI Fund to encourage innovation through the LE Program to test a variety of strategies to address liquidity challenges facing the industry.

- Providing equity capital for Liquidity Providers that could be used to support the growth of existing and new CDFIs or other Liquidity Providers that help industry participants to manage liquidity by: (1) advancing loans or lines of credit to or facilitating placement of deposits in CDFIs to support relending; (2) purchasing CDFI originated assets to hold in portfolio, sell to third parties, or securitize by issuing asset-backed securities, allowing CDFIs to recapitalize their loan funds through the use of secondary markets, loan participation and syndication networks and the capital markets; (3) management of partnerships, limited liability companies; (3) origination of loans and investments in CDFIs; and (4) other activities deemed appropriate by the CDFI Fund.

- Creating a Loan Acquisition Guarantee Facility that provides a full or partial guarantee instrument for lenders and/or investors that purchase CDFI-originated assets underwritten by CDFI Fund-approved Liquidity Management Funds (LMFs). The facility could offer low cost, long-term loans and lines of credit to LMFs to: (1) temporarily warehouse CDFI-originated assets for sale to investors; and (2) support lending and/or investing. This facility could help build a liquidity infrastructure for the industry by supporting development and expansion of secondary markets, loan syndications or participation networks, and other liquidity management tools.

- Creating a CDFI Institution-Level Guarantee Facility a full or partial guarantee instrument for third parties that make loans and investments into CDFIs. Monies advanced with this guarantee may be eligible to be used as collateral for Federal Home Loan Bank ("FHLB") advances, making FHLB financing accessible to a broad range of CDFIs authorized for FHLB membership under Housing and Economic Recovery Act of 2008 ("HERA").

- Creating a Pool Guarantee to enhance securities backed by community development loans that would allow CDFIs to invest their idle funds in lower grade securities. To better allocate liquidity within the CDFI industry, the Fund could create a federal guarantee that would be applied to a pool of community development loans. Liquidity Providers that securitize or transform these loans into securities could use the guarantee to credit enhance below investment grade tranches of these securities thus making them eligible for CDFIs to invest in. Many industry participants hold substantial cash positions but are unable to put these excess resources to work in CDFI assets as they may need access to these funds to meet liquidity needs. By credit enhancing these below investment grade securities, a federal guarantee would enable investors to more easily sell their holdings to generate cash thus improving the relative liquidity of securities backed by community development loans and broadening the overall market for investors.

CONCLUSION

In closing, we would like to reiterate our strong support for the CDFI Fund and commend Director Gambrell and her staff for undertaking such a thorough and comprehensive review of the Riegle Community Development and Regulatory Improvement Act of 1994. Over its 15 year history, the CDFI Fund has established an impressive track record of developing and implementing programs that effectively leverage private resources to catalyze community revitalization activities across the country. We appreciate the opportunity to share our views on the Fund's statute and its programs. Please do not hesitate to contact me with questions regarding the comments provided in this letter.

Sincerely,

Frank Altman
President and CEO