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Mr. Scott Berman
Acting Chief Operating Officer
CDFI Fund
U.S. Department of the Treasury
601 13th Street, NW, Suite 200 South
Washington, DC 20005

Mr. Berman:

Please consider the following observations relative to a request for public comment on the CDFI Fund, FR Document 2010-4786. The opinions expressed are that of Funding Partners for Housing Solutions, Inc. (dba Funding Partners), a non-profit CDFI revolving loan fund specializing in housing development and preservation within the 64 counties of Colorado.

The following items are of greatest interest to the organization and its many community stakeholders.

B. CDFI Awards
2. Certification

(a) Prevailing criteria utilized for certification purposes fail to capture sufficient information for establishing both need and capacity of applicant organizations. Though it is clear that significant need persists among low-income populations and within underserved communities, the CDFI industry has matured such that higher expectations of accountability and performance must be established for new and renewing organizations. The certification process does not specifically require prospective organizations to conduct an objective assessment of market deficiencies not adequately served by other financial institutions, including CDFIs, public agencies, other non-profit organizations or the private market. There appears to be a presumption that more is good when, in practical terms, each additional institution redirects scarce resources for operational and program capital that may be better levered through cooperative alliances.

(c) As the industry has matured, establishing high expectations of accountability, financial management and organizational capacity are incumbent to *all* existing and prospective entrants to the market. At minimum, applicants must be required to demonstrate sufficient local support and sustained financial services activity over a three-year period prior to seeking official designation under the CDFI program. Moreover, all institutions must be able to demonstrate sufficient capacity and sophistication in managing loan portfolios, adhering to professional and regulatory standards of conduct, and successful recycling of capital. Most any organization, public, private or non-profit, is capable of putting capital into underserved markets; CDFIs must demonstrate an ability to *recover and reissue* its capital in such a manner that elevates the capacity of its clientele.

(d) Recertification is paramount to a legitimate industry designation. Organizations that have obtained the designation for special purposes, no longer operate as a provider of financial services, or do so incidental to other activities create an unfavorable image of the industry and further complicate educational efforts regarding the legitimacy of the designation. A formal process to determine whether an organization continues to serve its target market through effective programs and services should occur every three years as an optimum timeframe to demonstrate impact of financing activity.

(e) Certified institutions are required to submit Institution Level Reports annually through the CIIS, which provides a convenient and efficient conduit for disclosing material events. It is surprising to find submittal of this report requires a certification of accuracy and completeness though no disclosure as to whether the organizational has executed or subject to material changes to its intended purpose. Annual testament of material events should be included within this existing process.

(f) The Fund should impose a minimum level of financial soundness to retain certification, though definitions established under FHFA regulations for FHLB membership serve an entirely separate purpose. In fact, regulatory definitions for that purpose represent an extraordinary hurdle for many institutions to recognize any benefit of FHLB membership.

(i) The Net Asset ratio of 20% appears reasonable when considering restricted assets, though fails to adequately rationalize this important difference. An organization with 100% restricted net assets is positioned quite differently than another with 100% *unrestricted* net assets. In either case, it is unclear how this standard was derived within the legislative process as it appears to simply overcompensate for lack of regulatory oversight for the majority of CDFIs.

(ii) Positive net income measurements represent a material simplification of accounting standards. As most CDFIs report under fund accounting methods, certain investments and other restricted contributions to the organization are reported as income, which can mask significant weaknesses that would otherwise be evident through cash accounting methods. A more prudent measure might include net cash flow from operations, which excludes accrual accounting entries, both positive and negative, such as non-cash reserves, impairments, depreciation, and source-restricted investments. It is important to recognize a difference between operating income (or loss) and capital growth (or loss). A financial strength measurement should consider whether the organization is solvent *and* possesses sufficient capital to continue financing activities. A CDFI should demonstrate positive growth in both areas for at least 1 of every 3-year period and 3 of every 5-year period.

(iii) Establishing loan loss reserve standards is a difficult task within the industry as there are no established standards for reporting delinquency. Prior to implementing a reserve standard, the Fund should consider: (1) a standard for defining delinquency that is uniformly applied and interpreted. (2) consider standards that differentiate between venture funds, housing, business and microfinance portfolio. (3) recognition of the material difference between cash and accrual reserve entries. The latter recognizes asset impairment while the former demonstrates financial strength. Differentiation of these two entries is erroneously equated within the current program application process, indicating a material deficiency within the current review process.

(iv) Operating liquidity, as defined, is appropriate and the standards presented appear reasonable provided operating expense explicitly excludes non-cash entries such as loan loss reserve.

(h) As currently practiced, organizations are required to submit an annual financial audit as attachment to the Institution Level Report through CIIS. This appears reasonable while providing opportunity for the Fund to reconcile reported information in a consistent format. Consistent reporting format and a predictable schedule serves the industry well in its goal to achieve legitimacy.

3. Holding Companies, Subsidiaries and Affiliates

(a) With limited resources that will inevitably decline, if not in absolute figures at least by per-institution measure, it is unreasonable to allow related entities to compete under more favorable terms than the balance of applicant institutions. With or without regard to aggregate award limits, related entities should be expected to prioritize need internally and plan application cycles accordingly.

(b) To achieve greater integrity of the certification status, the Fund must hold all new and recertifying applicants to uniform standards. Certified institutions must be able to adequately demonstrate capacity, mission and expertise to fulfill all requirements of certification on its own merits, rather than by association. If an affiliate or subsidiary is not adequately capitalized or staffed to conduct financing and development services full-time and ongoing basis, then it cannot be considered a CDFI. It is merely a subsidiary or affiliated lending conduit.

(c) A holding company should not be considered eligible to seek certification as CDFI without adequate demonstration of its capacity to fulfill all definitions enumerated under subparagraph (A) of the Act.

4. Geographic and Institutional Diversity

(a) Geographic diversity of awards should be considered from a different perspective than appears prevalent in many discussions of the issue. As an institution in the Rocky Mountain and Midwestern region of the country, there are relatively few institutions on a state-by-state count than other regions of the country. This may appear to provide better opportunity for applicants within this region to secure capital through the Fund or other sources. However, population centers are smaller, of lower density and more isolated (geographic, political and economic) than other regions of the country. This presents much greater challenge in achieving economic sustainability as costs of service delivery are typically higher, volume tends to be lower, and fewer sources of capital are readily avialble.

Our organization has been approached at different times to assess feasibility of establishing a CDFI to serve all or parts of adjoining states – Kansas, Nebraska and Wyoming. After careful analysis, it became apparent that a single, well-capitalized institution could adequately deliver services and products across much of the geographic region. Smaller institutions serving portions of these states would have great difficulty achieving economic scale – attracting adequate loan fund capital, establishing consistent deal flow and retaining talented personnel capable of sustaining an organization long-term. The resulting need for continued external support indicates the organization would need to plan for significant geographic growth to continue serving the needs of its market.

The question, therefore, may need to focus upon whether there is adequate geographic diversity of awards to insure the presence of *well capitalized and highly competent institutions able to demonstrate sufficient scale* for meeting the needs of underserved regions and target populations proposed within the Act. In other words, fewer though larger commitments to institutions serving primarily rural and minor urban markets may be in order achieve geographic diversity objectives of the Fund.

5. Financial Assistance

(a) There does appear to be need for limiting financial and technical assistance support to those institutions striving to achieve operational scale, as opposed to those simply seeking to grow under the Core and SECA programs. With limited resources, the focus of awards must be towards those organizations demonstrating reasonable progress towards self-sufficiency coupled with highly competent program and service capacity. A separate competitive program may be considered for institutions larger than $50mm, though it should not dilute the current line item allocations to the CDFI Fund budget. Institutions above that threshold should be of sufficient scale to generate alternate or internal sources of capital while reinforcing expectations that ‘graduation’ from the program is beneficial and necessary for the Fund to deepen its community impact.

(b) Institutions larger than $50mm would benefit from liquidity vehicles, such as the Federal Home Loan Bank System. As is now apparent, the absence of FDIC insurance is a strong impediment to actualizing intended benefits of provisions included within HERA. Therefore, the Fund could establish an insurance fund, rather than direct investment, for institutions that have achieved sufficient scale to approximate a small community bank. The insurance fund should be a separate federal budget line item so as not to dilute resources from the SECA and Core programs.

(c) Rather than issuing loans directly to institutions, there is greater need to support a liquidity market through intermediary organizations that function in a similar manner as FHLB system. Such intermediaries would differ in allowing small business, microfinance and other loan portfolio that otherwise do not conform to FHLB collateral or financial strength standards. Loans made to such intermediaries might function as warehouse lines of credit, credit enhancements or additional capital pool resources, though the primary function would be in the creation of liquidity mechanisms for small and intermediate size institutions that lack access to a secondary market. This model provides a more manageable delivery system, greater economy and enhanced compliance monitoring for the Fund, while allowing private institutions to react to market dynamics and progressively incorporate standardization protocols.

(d) A federal loan guarantee program would be highly beneficial in allowing greater access to private capital sources as well as promoting greater accountability within the industry through more uniform application of management standards. Rather than offering a guarantee directly to individual institutions, however, the guarantee might best be delivered through national or regional intermediaries. The Fund would offer a guarantee of paper issued by the intermediary, which in turn consolidates paper from local institutions able to demonstrate sound practices and consistent deal flow, albeit on smaller scale than the intermediary itself.

This approach allows intermediaries to specialize within regions or product mix, adapting to dynamic market conditions and streamlining Fund oversight responsibilities to fewer, well-capitalized institutions. Intermediary guarantee providers would assume responsibility for establishing relationships with local institutions, develop communication, compliance and product standards that conform to Fund requirements. Guarantee institutions could further leverage this model to attract additional third party credit enhancements on sufficient scale to improve limited opportunities available to small credit issuers.

(e) National and intermediary institutions should be eligible to compete for no more than 20% of Fund authority where the purpose of such award is limited to liquidity enhancement activities within the industry. Institutions operating with this space must be expected to derive lending capital and general technical support through alternate sources and internal development.

(g) Fund resources are stretched thin with expectations of further dilution of impact in the foreseeable future. To allow non-financial institutions to compete for Fund resources represents unreasonable burden to active CDFIs attempting to reach economic scale.

(h) Development services may take numerous and varied forms in fulfilling the mission of the Fund and individual institutions. Formalization of financial education definitions would appear to be problematic given the diverse product and service offerings within the industry. Structured educational programming is among the most difficult undertakings of a CDFI in terms of logistics, content and cost. Informal education, as part of the financial services delivery process, can best tailor the effort to individual client needs and capacities while raising the direct linkage between cost and benefit of the activity. Referral to third-party entities that specialize in educational programming remain the most efficient option for many CDFIs.

6. Award Cap

(a) There is need to limit availability of Fund resources in any given year to a maximum award amount. With the number of institutions in strong growth mode, Fund resources represent a critical source of capital to propel most organizations forward. Strict merit-based award processes can greatly distort outcomes in favor of those organizations most able to afford consultants and contractors for delivering a compelling story and those which have already developed a 'winning formula' under the application process. Over the past several cycles, awards have been limited to the top quartile of applicants at most, a clear indication that awardees are among the strongest within the industry.

(b) Subsidiary and affiliate CDFIs should not have an award limit different from the parent organization provided all are considered collectively, rather than individually.

(c) All related entities must be considered as a single, collective application to prevent circumvention of annual and 3-year award limits.

(d) Given the absolute funding resources of the Fund and number of certified institutions, the $5 million award limit remains a reasonable threshold in spite of recent improvements to the Fund budget. The growth in number of certified institutions have effectively diluted the level of resources to any institution within a given funding cycle that is further eroded by serial awardees.

7. Matching Funds

(a) Retaining a dollar-for-dollar match requirement is appropriate, subject to comments noted below, as it promotes community involvement and accountability. The industry cannot expand collective impacts based solely upon the resources of the Fund. It requires individual institutions to refine its message, improve its capacities, and engage appropriate sources of leverage to achieve the mutual objectives of the institution, the Fund and CDFI industry.

(b) Awards should *only* take the form of restricted grants and credit enhancements in the form of loan guarantees or fund insurance. As a continual evolutionary process, CDFIs are forced to seek capital sources that demand market rate returns adjusted for relative credit risk assessments and social/environmental impacts. To improve the pricing for such forms of capital, a CDFI must be able to demonstrate adequate liquidity, typically in form of cash loan loss reserves. Moreover, capital providers are disinclined to provide long-term investments, preferring shorter-term placements of 5 years or less.

These two factors deliver significant challenge as the industry matures, with further exacerbation should the Fund merely mirror terms offered by the private sector. In the absence of “profit potential”, CDFIs are severely limited by: ability to accumulate cash reserves of sufficient level to meet capital provider expectations; higher cost of capital that lessen the impact and diversity of CDFI activities; and, shorter capital duration that greatly diminishes sustained program implementation, adaptive response of financial product development, and diminished capacity for long-term planning. Sound business practices are borne of strategic planning and disciplined execution, whereas reactionary decision-making will become far more prevalent as CDFIs contend with greater homogeneity within their capital base.

(d) Referencing comments above, the matching form provision should be removed, allowing the Fund to exercise greater discretion as to when it is most appropriate to award a loan, grant or guarantee. Terms of the award should be considered long-term with low or no costs associated in recognition of the nature of the industry and capacity of beneficiary populations.

C. CDFI Training

(b) Several well-recognized and highly competent service providers offer formal educational programming and consultant services to CDFIs across the country. Should the Fund elect to implement the Capacity-Building Initiative, it would be most advantageous to sponsor regional trainings offered by established providers rather than duplication. More important than offering classes on how to underwrite loans and manage a portfolio, the Fund should focus its efforts upon the development of standardized data collection, interpretation, reporting of activity impacts and financial diagnostics of CDFIs. A lack of standardization poses the greatest threat to the long-term viability of the industry. With the Fund, trade associations and individual CDFIs all working from divergent baseline data, interpretation of impact metrics and capacity to deliver a consistent definition of the industry, it is little wonder that CDFIs remain heavily dependent upon the Fund and its program budget.

(c) Information technology is a critical component to capacity building. CIIS is limited to a data-entry system that attempts to interpret all manner of CDFI activities. It would be more beneficial to establish a system that better interacts with field systems and tailored to relevant activities of the institution. Coordinating the development of uniform standards for data collection with enterprise management software would greatly enhance professionalism within the industry while allowing for some flexibility within individual institutions comfortable with designing independent systems.

D. Liquidity Enhancement

(a) As portfolio lenders, liquidity is of significant concern to those organizations that have developed a successful business model. There is considerable and detrimental community impact when a CDFI is unable to deliver financial products in acceptable form and in a timely manner to its clients. Our organization has, at times, faced period of over-commitment or funded in excess of reserve covenants placed within capital agreements in order to sustain momentum and meet legitimate needs of the market. In every case, those periods extended for no more than a 90-day period and all reasonable care was exercised to prevent adverse action to the organization. However, access to liquidity enhancement vehicles would be of considerable benefit while removing this additional and potentially fatal business risk.

(b) As structured, LE appears to be of considerable value to larger regional or national intermediaries that specialize in "warehouse" financing that might not otherwise qualify under the Core/SECA programs should those programs skew more heavily towards "retail" institutions.

(e) While the initiative to allow FHLB System banks to consider CDFI membership is unlikely to garner anticipated participation levels, there remains some possibility of salvaging its intent. Either directly, or through a CDFI intermediary that has obtained a full or partial portfolio guarantee from the Fund, could seek membership in a FHL Bank. FDIC insurance and collateral asset standardization each provide considerable risk profile enhancement for regulated institutions, which is not likely to be replicated within the CDFI industry. However, movement towards a loan guarantee program, coupled with more robust compliance standards within the industry and additional enhancements that might derive from discretionary programs of a System Bank, may provide greater functionality of this newly created liquidity vehicle.

Funding Partners greatly appreciates this opportunity to inform this important function of the U.S. Department of the Treasury. Creating greater access to capital and credit within underserved markets and among low and moderate-income households represents a critical economic development activity. The benefits of a well-designed and professionally implemented CDFI Fund will continue to pay dividends for generations yet come!

Please feel free to contact me for clarification or additional comment as appropriate.

Respectfully,

Joe Rowan

Joe Rowan
Executive Director