Partners for the Common Good
PCG Investing in Social Change

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May 7, 2010

Mr. Scott Berman
Interim Chief Operating Officer
Community Development Financial Institutions Fund
U.S. Department of the Treasury
601 – 13th Street NW, Suite 200 South
Washington DC 20005

Re: Notice of Request for Comments (FR Doc. 2010-4786)

Dear Mr. Berman:

On behalf of the Partners for the Common Good (PCG), I am pleased to submit the enclosed comments on the Notice of Request for Comment on the Fund's Authorizing Statute published in the Federal Register on March 8, 2010. Over its fifteen year history, the Community Development Financial Institutions Fund (the "Fund") has played a pivotal role in the growth of the Community Development Financial Institutions (CDFI) industry. Today we have grown from a handful of small players to 800-plus CDFIs across the nation. Authorization of the Fund in 1994 was a major milestone in the evolution of our industry. Over the coming decades, the Fund will be equally critical as our sector forges new paths toward its goal of promoting economic justice and ensuring all people and communities have access to fair and responsible credit.

PCG believes that the Fund has done an outstanding job of carrying out its mission and programs. It has been responsive to the needs of the CDFI sector. None of the recommendations contained in this letter should be interpreted as a criticism that the Fund has done nothing less than an exemplary job. We strongly support the Fund. PCG believes it is a model that other Federal agencies should strive to emulate.

PCG fully supports and endorses the views articulated in the comment letters submitted by the CDFI Coalition and Opportunity Finance Network (OFN). We wish to bring emphasis to the recommendations of these industry leaders about the necessity of: (1) balancing the needs of all sectors of the CDFI industry; (2) recognizing that providing equity capital is the most important role the Fund can play; (3) supporting CDFIs as institutions rather than funding specific projects; (4) making the CDFI Program matching funds requirements more flexible; and (5) other matters outlined in the comment letters. We also concur with many of the observations offered by the Community Reinvestment Fund in their comment letter about the need to build institutions and systems to help CDFIs manage portfolio liquidity.

PCG fully supports and endorses the recommendations made in the comment letter submitted by the Community Development Bankers Association (CDBA). We believe the long term viability of the Fund's programs rests on its ability to serve the entire CDFI sector. Achieving this goal will likely require the Fund to reexamine many of its long standing practices and rethink its capacity building offerings. PCG has a special relationship with CDBA as its host organization. We are proud that the trade association has become the leading voice of a previously unheard sector of the CDFI industry and we support its recommendations.

The CDFI trade and practitioner organizations referenced above have done an excellent job in articulating positions PCG agrees with and endorses. Thus, our comment letter will focus on how the Fund can help address systemic challenges that now prevent the CDFI field from reaching greater levels of scale, sustainability and impact. Successfully breaking through these barriers will be the next great test to the industry as it moves to the next stage of its evolution. We believe the Fund and the Treasury Department can play pivotal roles in meeting these challenges and helping to create an inclusive prosperity in communities across our nation.

## 1. Who We Are

Created by a group of faith-based institutions committed to promoting economic justice and systemic change, PCG is the first national loan participation network dedicated to serving the needs of low income people and communities. We promote economic justice by partnering with CDFIs across the nation to serve borrowers that promote affordable housing, neighborhood revitalization, and healthy communities through support of day care, education, community health centers, human service providers, and other community needs. Our pioneering work is important because it creates new tools for CDFIs to manage liquidity, loan limits, and other balance sheet challenges that stymie the growth and local impact of the industry. Our strategy is to empower CDFIs. Our network is based on the loan participation and syndication models used successfully for decades by small community banks to leverage limited capital while managing risk.

## 2. The Infrastructure Gap and Next Evolution of the CDFI Industry

CDFIs have made impressive strides over the past decade-and-a-half since the Fund's authorizing statute was enacted. The number, scale and impact of CDFIs have grown exponentially as Federal monies have leveraged multiples of private sector resources. Our ability to reach greater levels of scale, sustainability and impact, however, is stymied. Systemic barriers impede our ability to access larger pools of capital and operating inefficiencies related to our focus on tough-to-serve markets increase our costs and impede industry-wide gains in enhancing sustainability.

At the heart of the system barriers lies an infrastructure gap. Within the context of this letter, "infrastructure" refers to a set of institutions, tools and systems that allow the CDFI field to collectively solve problems or access new resources that no CDFI can do alone. Infrastructure builds the long term capacity of the sector to reach increasingly greater levels of scale, sustainability and impact. In 2004, the Aspen Institute published the first in a series of papers examining various for-profit and non-profits subsectors whom had reached a sufficient level of scale to become sustainable. Among its findings, the researchers observed *"[n]o field can go to scale without appropriate infrastructure, and this infrastructure must be consciously invested in and built."* Despite the growing ranks of CDFIs, the industry is sorely lacking in the infrastructure needed to reach the next rung in its development.

We believe the Fund and Treasury Department could play pivotal roles in breaking through systemic barriers that hold back CDFIs, including private sector capital formation, accessing permanent and affordable sources of liquidity, and enhancing operational productivity with information technology advances. We strongly urge you to work with the CDFI industry to explore how the Federal government can help build the infrastructure to enable CDFIs to grow and reach sustainable levels of scale and impact. The CDFI industry has many infrastructure gaps:

- We need greater access to equity markets for capital formation.
- We need tax and other incentives to encourage private sector investment in CDFIs.
- We need better access to capital markets to recycle lending capital to leverage our balance sheets; thus, need functioning secondary markets and other permanent structures to manage liquidity.
- We need an operating and regulatory environment that is sensitive to the challenging work we do with an appreciation of the "double bottom line" we balance.
- We need information technology and capacity building tools to enhance our knowledge base, improve operational efficiencies, and reduce costs, including systems to:

  (1) Monitor and track social impact in an economically feasible manner;

  (2) Understand and analyze markets;

  (3) Share lending and investment opportunities;

  (4) Exchange best practices; and

  (5) Communicate our stories and successes with all of our stakeholders within our local, state, regional, national and global communities.
- We need enhanced standardization in documentation and systems that will streamline the efficiency of our operations – but which respect

our necessity to often tailor our products and services to the realities and constraints of our borrowers.

- As more and more of the assets of our nation move from the banking sector to new asset managers, we need support to create partnerships with insurance companies, pension funds, mutual funds, investment banks, and others,

CDFI infrastructure needs cover a broad spectrum. Accessing capital markets and enhancing liquidity management are prominently among industry-wide challenges that will require dedicated investment in institutions, tools and systems. CDFIs need help in accessing a continuum of capital markets. The Fund and Treasury can assist by helping CDFIs access government institutions and tools already serving the traditional financial services sector (e.g. supporting access to Federal Home Loan Bank system, providing a guarantee for tax exempt bonds for CDFI-originated economic and community development loans, a Federal Reserve-style discount window for short term borrowing for all CDFIs).

Federal investment in new infrastructure institutions, tools, and systems could help CDFIs: (1) leverage new capital: (2) manage long and short term operating and portfolio needs; and (3) cultivate permanent sources of affordable long term financing for its borrowers. Treasury could systemically change CDFI capital formation by supporting changes in the tax code that offer incentives for institutional and retail investors to support CDFIs (e.g. creating tax deductions for investments in for-profit CDFIs, exempting investors from taxation on earnings derived from investments in CDFIs and/or interest earned on loans and deposits to CDFIs). Federal support (e.g. grant, contracts) for infrastructure innovations such as the CDFI Ratings and Assessment Rating System (CARS) will build the credibility of non-depository CDFIs with government agencies and investors, as well as demonstrate the transparency of the sector in a new era of accountability.

The Fund and Treasury should also support infrastructure investments in information technology to improve CDFI operational efficiency and cost effectiveness. Innovations such as TRF's on-line Policy Map hold promise of helping the entire CDFI industry enhance quality and reduce the cost of: (1) market analysis; (2) tracking and evaluating social impact; and (3) revolutionizing the effectiveness of CDFIs in telling their stories to stakeholders in the public and private sectors. On-line survey instruments hold promise for enhancing the ability of CDFIs to gather feedback from actual or prospective customers about its products, services, delivery systems, and impact in a cost effective manner. Nascent on-line peer-to-peer lending websites may hold promise for delivering capital to some segments of CDFIs or CDFI borrowers. Other technology investments that could benefit the entire industry include creating CDFI-centric software that is fully integrated to meet loan servicing, accounting, and investor and funder management needs. Finally, training and encouraging robust use of online communications tools could significantly enhance the branding of the

CDFI industry and ensure its story is heard by more and more external stakeholders.

### 3. Need for Liquidity Management Infrastructure

### A. Our Industry Challenge

Our industry's lack of infrastructure for managing portfolio liquidity provides an illustrative example of the CDFI industry's infrastructure gaps. Over the past two years, the liquidity crisis within the broader financial services sector has exacerbated and highlighted the long term challenges of the CDFI industry in managing portfolio liquidity. As noted by OFN in its comment letter, it's most recent quarterly Market Conditions Report (Q4 2009) indicated that more than half of the CDFI respondents saw demand increase over the prior year. More than two-thirds expect demand to increase in Q1 2010. More than half of the CDFIs indicated they faced capital constraints. In this period of economic instability and credit contraction, liquidity is one of the most pressing needs and concerns of the industry.

While the community development finance field has achieved some level of scale, its continued growth and ability to thrive will depend on the development of institutional infrastructure to address a number of key challenges – including liquidity management. Too little capital reaches communities that need it most. Despite the desire of CDFIs to do more, lack of portfolio liquidity and insufficient equity capital to leverage new debt to support additional lending will constrain the capacity of our sector. The non-standardized nature of most community development transactions limit the sector's ability to sell assets on the secondary market and force most CDFIs to hold their loans in portfolio until maturity. PCG wants this to change. We want to unlock the balance sheets of CDFIs and unleash their capacity to get capital into their communities. Until the CDFI industry builds this infrastructure, its ability to move beyond the status of isolated, small-scale portfolio lenders is limited.

PCG has been working to build tools and systems to help CDFIs to address portfolio liquidity problems through development of the first national loan participation network dedicated to community development finance. However, the liquidity needs of the industry are great and no single strategy can solve all problems. Liquidity challenges come in many forms -- ranging from operating to portfolio liquidity. Like the traditional financial services industry, CDFIs need a variety of institutions, tools and systems to meet the diverse needs of a diverse sector.

### B. Defining the CDFI Portfolio Liquidity Problem

CDFIs face barriers to managing portfolio liquidity linked to the types of financial products offered and the way they do business. CDFI-originated loans are often tailored to the needs of individual borrowers -- a feature that distinguishes them from traditional lenders. Loans are often priced below-market on a risk-adjusted basis. Customization and below-market pricing is highly beneficial to borrowers, yet has hampered the ability of many CDFIs to take advantage of secondary markets and other portfolio liquidity management tools available to the broader financial services sector. This lack of access forces CDFI to operate largely as portfolio lenders. Coupled with the lack of sufficient equity capital to support new borrowing, portfolio "illiquidity" keeps the CDFI field small and its impact potential unrealized. To reach new levels of scale and sustainability, the field must find strategies to move loan assets (in whole or part) off of the balance sheets of CDFIs as a means of recycling capital to make new loans.

The traditional financial services industry has evolved to provide multiple infrastructure tools and institutions to manage portfolio liquidity. These developments include: (1) active (albeit temporarily dysfunctional) secondary markets for mortgage, small business, higher education, consumer, and other types of loans; (2) access to affordable Federal agency borrowing windows (e.g. Federal Home Loan Banks, Federal Reserve); (3) loan syndication and participation networks; (4) formal and informal networks of correspondent lenders; (5) bankers' banks and corporate credit unions; (6) access to bond markets; (7) deposit insurance; and (8) deposit raising innovations (e.g. CDARS). Within the CDFI industry, only a small handful of under funded institutions (relative to need) are working on strategies to address this very large scale problem.

To fully respond to demand within communities and realize their social impact potential, the CDFI industry needs to explore multi-pronged strategies to manage portfolio liquidity. Where possible, the CDFI industry should strive to gain access to established tools and institutions. In other cases, it may need to build and grow infrastructure tools and institutions that are tailored to its unique needs. Enhancing liquidity will grow the scale and impact of the entire industry over the long term and will help CDFIs get capital to people and communities that need it most. The Fund can help by providing support for development of critical infrastructure tools and institutions to address these challenges.

### C. Capitalization Assistance to Enhance Liquidity:

The Fund's authorizing statute created a Liquidity Enhancement Program (LEP) (12 U.S.C. 4712) that has never been implemented. In general, the statute authorized the Fund to provide assistance for the purpose of capitalizing organizations to purchase loans or otherwise enhance the liquidity of CDFIs if the primary purpose of the organization is to promote community development. We believe this authorization contains the building blocks to address many CDFI portfolio liquidity problems. This program could also advance industry efforts to access new and larger pools of capital to support the work of CDFIs.

The LEP needs to be funded and updated to reflect current market conditions, as well as the evolution of the CDFI industry since the statute was created 15 years ago:

- Removing Barriers to Success: The authorizing statute contains several barriers that should be removed to promote investment in infrastructure institutions and tools that will help CDFIs manage liquidity. Unless these barriers are removed, the LEP will be severely limited in its ability to develop products, services and tools that are sensitive to the needs of the community development industry and the types of customers we serve. The authorizing statute should be amended to eliminate: (1) the requirement to raise matching funds; (2) the cap on awards; and (3) the prohibition on LEP awardees participating in other Fund initiatives.

  Based on the realignment of the market that has taken place over the past two years, it will likely be many years before there will be sufficient equity capital available to meet the matching funds requirements. This lack of equity will hamper the growth of liquidity management institutions and their ability to grow to a large enough scale to serve the CDFI industry. The leverage of the LEP without an equity match will still be very significant. Receipt of Federal equity capital will enable Liquidity Management Fund (LMFs)[1] to leverage private market debt and other resources that otherwise would not be deployed to help low income communities.

  The restriction prohibiting LEP awardees from participating in other Fund initiatives should be eliminated. The entities most likely to have the expertise, track record, and interest in developing products, services and tools that will meet the liquidity needs of the CDFI industry are those already working in the sector. To eliminate this group of institutions would be shortsighted because it will eliminate the ideas and opportunities with the highest probably of success.

  The award cap should be eliminated to enable LMFs to leverage more debt and expand the scale of their activities to sufficient enough levels to serve many CDFIs and be effective conduits to large pools of investor capital.

- Flexibility in Use of Funds: The authorizing statute's eligible use of funds should be flexible to support a wide range of liquidity management tools, strategies and business models. At this stage in the evolution of the CDFI industry, flexibility is needed to explore multi-pronged approaches to manage portfolio liquidity.

  The authorizing statute states the Fund may provide assistance for the purpose of providing capital to organizations "to purchase loans or otherwise enhance the liquidity of CDFIs". If the phrase "*otherwise*

[1] Liquidity Management Funds (LMFs) are a general term used to describe organizations eligible to participate in the LEP (based on the statutory requirements described in 12 USC 4712 that have a primary purpose of promoting community development) and provide products and services that help CDFI manage liquidity. Including (1) purchase of loans or loan participations, or loan syndication; (2) sale of loans, asset-backed securities; (3) management of partnerships, limited liability companies; (4) origination of loans and investments in CDFIs; and (5) other activities deemed appropriate by the Fund.

*enhance the liquidity of CDFIs*" is interpreted broadly, the use of funds is flexible enough to allow innovation and experimentation with a variety of strategies, products and tools that can address liquidity challenges within a diverse industry. If this language is viewed more narrowly, a corresponding technical amendment is recommended to 12 USC 4712(f) to allow a broader set of strategies. At this stage in the evolution of the CDFI industry, flexibility is needed to explore multi-pronged strategies and tools to manage portfolio liquidity.

- Where possible, the CDFI industry should strive to gain access to established tools and institutions. In many cases, it may be necessary to build and grow infrastructure tools and institutions that are tailored to its unique needs. Enhancing liquidity will grow the scale and impact of the entire industry over the long term and will help CDFIs get capital to people and communities that need it most.

**D. Promoting Liquidity Management Innovation:**

We strongly urge the Fund to encourage innovation through the LEP to test a variety of strategies to address liquidity challenges impacting various sectors of the industry. If the LEP's current statutory barriers cited are removed and the use of funds is flexible, LEP will become a critical tool for solving a variety of liquidity challenges facing CDFIs. The models cited below are examples of the types of products, services, and tools that could help a variety of CDFI manage liquidity. LEP capital could be used to support a variety of new and existing liquidity management tools, including:

<u>Equity Capital for Liquidity Management Funds</u>: Equity capital could be used to support the growth of existing and new CDFIs or others operating Liquidity Management Funds (LMFs) that help CDFIs manage liquidity by: (1) advancing loans or lines of credit to or facilitating placement of deposits in CDFIs to support relending; or (2) purchasing CDFI originated assets to hold in portfolio or sell to third parties (thus allowing CDFIs to recycle loan capital such as secondary markets, participation and syndication networks).

<u>Loan Acquisition Guarantee Facility</u>: Create a full or partial guarantee instrument for lenders and/or investors that purchase CDFI-originated assets screened by 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 will help build industry infrastructure by supporting development of secondary markets, loan syndications or participation networks, and other liquidity management tools.

<u>CDFI Institution Level Guarantee Facility</u>: Create a full or partial guarantee instrument for third parties that make loans and investments into CDFIs. Monies advanced with this guarantee should be eligible to be used as

collateral for FHLB advances, making the FHLB financing accessible to a broad range of CDFIs authorized for FHLB membership under Housing and Economic Recovery Act of 2008 (HERA).

There are a multitude of other smart and innovative ideas that have been discussed within the CDFI industry over the past decade–plus that could prove to be critical building blocks in the CDFI liquidity management infrastructure. All of these ideas and others could benefit from a flexible Liquidity Enhancement Program with a dedicated source of funds that does not compete for resources with other important Fund initiatives.

**Conclusion:**

As the Fund embarks on the process of considering authorizing changes, we urge the agency and Congress to imagine the role CDFIs can play over the next decade or two. We invite the Fund to work with the industry to create a compelling vision of the next stage of its evolution in promoting access to capital and an inclusive prosperity.

We sincerely appreciate the opportunity to comment on the Fund's authorizing statute. We welcome the opportunity to work with the Treasury Department and the Fund to explore ideas and a renewed vision for our industry.

If you have any questions, please feel free to contact me at (202) 689-8935 ext 22.

Sincerely,

Jeannine Jacokes
Chief Executive Officer