cfed
expanding economic opportunity

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Jodie Harris
Policy Specialist
CDFI Fund
U.S. Department of the Treasury
601 13th Street, NW., Suite 200 South
Washington, DC 20005

Dear Ms. Harris:

The Corporation for Enterprise Development (CFED) appreciates this opportunity to comment on the implementation of the CDFI Bond Guarantee Program (CBGP), which we see as an additional source of funding for CDFIs to increase investment in low- and moderate-income urban and rural communities throughout the U.S.

The following recommendations are critical to CDFIs' successful participation in the CBGP.

Program Structure and Bond Mechanics

CFED agrees that the broadest program flexibility should be afforded the CDFI Fund in the implementation of the CBGP to ensure maximum impact. Specifically, CFED supports broad and diverse bond structures, financing terms, issuer and asset mix and use of proceeds. Given the limited capacity of the CDFI industry, joint issuance by CDFIs will be essential to achieve the minimum threshold of bond issuance at $100 million. Moreover, it will be critical to achieve a high level of standardization of collateral to more efficiently and effectively evaluate the underlying cash flows to support bond repayment and to build a foundation for future securitization. CFED believes that the viability of the CDFI industry hinges on the ability to attract private capital to a relatively small but growing economic sector.

For the record, we believe that bonds should be both taxable and tax-exempt. In our view, the taxable nature of the bonds potentially discourages private investment in CDFIs and fails to take into account the diverse legal and tax structures of CDFIs. In some cases, tax-exempt 501(c) 3 bond transactions may be more advantageous to the

CDFI and will likely have broader appeal to investors. Tax-exempt financing should be available to CDFIs that have obtained their 501(c)3 tax status under Federal tax law and are working with state and local government agencies to support community investment activities. The principal advantage of tax-exempt financing is the lower interest cost in comparison to the interest rate on conventional or market rate debt available to the borrower. Investors generally are more willing to accept a lower rate of return because they do not have to pay federal income tax on interest payments received from the bonds.

Program Eligibility

The CDFI Fund should continue to apply its rigorous evaluation criteria in the approval of CDFI bond issues, specifically as it pertains to the qualitative aspects of mission-based activities and track record in meeting the needs of the target communities in which the CDFI focuses. Eligibility criteria should apply to the CDFI, as the Borrower. For consistency, appropriate criteria should also extend to the end Borrowers, even if they are not CDFIs, in line with the mission and community impact proposed in the application.

Capital markets transactions, however, require a significantly higher level of due diligence and should focus on management, operational and financial capacity. We believe that extensive technical assistance will be required for CDFI management teams to build internal capacity around bond issuance, capital deployment analysis, risk management, monitoring, financial and tax reporting and compliance and investor relations. We recommend that the expenses related to staff training/development be deducted from the bond proceeds or covered by a companion grant from the CDFI Fund or private investor.

Though each bond issue should be considered separately and on its own merits, the Fund must ensure that all issuers have a strong track record of meeting the needs of low income and disadvantaged communities, are mission-based, and can direct bond proceeds to appropriate community and economic development uses. There should NOT be a single issuer. Potential issuers should be able to compete for the opportunity to encourage national reach and fairness as well as to provide for including responses to diverse needs across populations and communities that may, on their own, constitute niche markets. A single issuer allows mainstream financial institutions to profit through their work to underwrite the bonds and evaluate the risk but does not accomplish the policy goal of bringing new institutional investors into the CDFI sector. The original reason for offering the government guarantee was to bring new investors to CDFIs so ensuring multiple issuers is important.

Use of Funds
CFED supports the maximum allowable eligible uses for CDFIs in their financing activities. Eligible Bond Proceeds should include all loan and investment types and financing segments as long as they meet the definition of community or economic development in the CDFI Fund authorizing statute. The range of uses should include but not be limited to refinancing, capitalization of a revolving loan fund, loans to and purchase of loans from other CDFIs, purchase of loans from non-CDFI originators, loan loss reserves, the required risk-share pool, debt service reserves, and/or sinking funds in support of a Federally guaranteed bond, investments of regulatory capital—all activities that are routinely undertaken by CDFIs or would be part of a strategy for prudent use of bond proceeds. In general, the Fund should not dictate or restrict the proportion of proceeds that can be directed to a particular use.

With respect to purchase of loans from non-CDFI originators, non-CDFI Sellers of Loans should meet Basic Eligibility Approval Standards as set by the CDFI-issuer. The CDFI-issuer should submit its eligibility approval standards to the CDFI Fund for review and approval. These standards should include, but not be limited to, financial and operational capabilities, demonstrated track record in originating, selling and servicing commercial, real estate and community development and compliance with all applicable Federal, State and local regulations. Non-CDFI Sellers should be required to execute an Origination and Sales Agreement with the CDFI. The purchase of non-CDFI originated loans should only be allowed from entities that meet the Basic Eligibility Approval Standards. Applicable representations and warranties will apply with full recourse to the non-CDFI in the event of material non-compliance.

We highlight additional specific recommendations below:

- CFED has observed that financing for small business start-ups and underfinanced business sectors such as small contractors in construction and related fields, is virtually non-existent given the associated risk profile. Yet these businesses are often the economic driver for community re-development. We strongly support making loans available for start-ups and other under-financed sectors up to $100,000 or higher, in special situations, but not to exceed $250,000, where significant job creation is realized.

- Incentivize applicants to focus on sectors that have experienced significant distress. For example, the residential real estate market and small business lending both have significant demand that could result in effective use of capital to significant benefit for end borrowers and the economy.

- Refinancing should be an eligible use of bond proceeds. In the first two years, there should be no restriction on the proportion of the proceeds that can be used for refinancing. In years three and later, the refinance limit should be capped at 50%. (This will facilitate timely deployment of bond proceeds in the earlier years, while ensuring that the CBGP catalyzes new lending in the later years.

- CDFIs should be allowed to use bond proceeds to purchase loans from other CDFIs and from non-CDFIs, as stated above. Criteria should address concentration risk.

- Over the long-term, CFED believes that bond financing should be reflected on the balance sheets of CDFIs to strengthen the financial capacity of the organization. We recognize, however, the limited capacity of the CDFI sector at the present time to hold bonds on their balance sheets and therefore, support off-balance sheet financing through a special purpose entities. Program design should protect the applicant CDFIs by limiting recourse to the SPE.

- CDFIs should be able to service their own loans. We concur with the Association for Enterprise Opportunity which notes that CDFIs typically collect payments directly from their borrowers. They also have other collection practices that are unique to their markets. For these reasons, the Program must allow a CDFI or any of its subsidiaries to act as the primary servicer of its own loans.

- CFED wants to ensure that any rules related to housing and community development allow for investments in single family manufactured homes and resident-owned manufactured home communities. The nearly 7 million occupied manufactured homes in the U.S. represent 7% of the total housing stock, 11% of all housing for low- and moderate-income (LMI) families and the largest source of unsubsidized affordable housing in the country. Yet there are unique characteristics of the sector and the financing of the sector which distinguish and segregate it from the rest of the residential market. (See discussion in Comment Letter to CFPB on supervision of non-bank lenders, August 15, 2011, available upon request.) Manufactured home owners are an LMI group that is in severe need of improved financing options, which are the subject of CDFI efforts. The CBGP can be a source of capital to address the needs of this market.

Risk Assessment & Mitigation

CFED supports very robust underwriting, risk and mitigation efforts for the CBGP. While CDFIs have a strong record of success at serving distressed markets, loss performance has varied greatly across CDFIs. We believe that underwriting criteria (e.g., leverage, cash flow coverage, asset quality) and risk mitigation techniques (e.g., required credit enhancement, liquidity requirements, interest rate protection, etc.) should be based on the specific risk profile of the planned use of proceeds and on the loss performance history of the participating CDFI, not on a generic, one-size-fits-all set of requirements.

Underwriting standards should be standardized across asset classes to the extent practical, however, CFED supports flexibility to adapt underwriting standards for particular segments to reflect the unique nature of the asset class, geography or end borrower. For example, underwriting standards for manufactured home finance will be different in some respects than those for site-built home loans, and underwriting standards for resident-owned communities will be different than those for other commercial loans.

In addition, bond proceeds should allow for reinvestment through revolving loan funds. This reinvestment is critical for small business lines of credit resulting in multiple loans to the same entrepreneur over time. Proceeds from the repayment of the underlying loans being financed by the bond issuance should be allowed to be reinvested for the term of the bond in the new underlying loans (rather than being required to repay the bond).

A key challenge is the lack of adequate historic loss and payment performance data of the CDFI and community development sectors. To that end, CDFIs' performance should not be the basis for the Fund's risk assessment for the CBGP.

CFED also supports an expansive offering of risk mitigation strategies including but not limited to over-collateralization, covenants, third party guarantees, bond insurance, supplemental loss reserves funded by excess spreads, and a supplemental risk-sharing mechanism. Funding for the risk-share pool should be diversified to include bond proceeds, investment cash flows and investments or guarantees from CDFI investors.

Monitoring, Evaluation & Impact

CFED strongly recommends that CDFI performance evaluation be outcome-based and that CDFIs be held accountable to the outcomes and impact that they propose to produce under the Program. Outcome measures should incorporate the full range of

CDFI activity and include measures relevant to consumer, small business and real estate finance and community development. Performance measures should reflect jobs (created and retained) and wages, business activity, quality of life (crime and poverty reduction, educational attainment, improved health conditions) and tax revenue increases.

CFED proposes that performance measurement focus on four key areas: (1) input (public investment); (2) output (private investment, jobs created/retained, etc.); (3) efficiency (costs per job; personal income and benefits) and (4) outcomes (economic development and increased opportunities to create new jobs and homeownership and to build personal and business income and assets.

Conclusion

In the coming weeks, the CDFI Fund will make critical decisions about implementing the CDFI Bond Guarantee Program. Please keep in mind that a core strength of the CDFI industry is its diversity, and a one-size-fits-all approach in the regulations will seriously limit the program's success. CFED also comments on a number of specific questions for which the Fund has requested input (see Attachment A).

The diversity of the industry also makes it difficult to mandate specific outcomes and impact, a priori, demonstrating the necessity of a program that assesses each bond application on a case-by-case basis. Throughout its history, the CDFI Fund has demonstrated flexibility and an appreciation for the unique contributions of different types of CDFIs. This operating philosophy will be particularly important in writing regulations for the CDFI Bond Guarantee Program. Thank you for your consideration of these recommendations.

Sincerely,

Andrea Levere

Andrea Levere
President

Attachment A

1. **Definitions**

(i) We recommend that the definition of low- or moderate-income community be the same as that used for eligibility and screening of community development financial institutions (CDFIs) by the CDFI Fund. However, Census-based definitions involve significant time lags that may fail to reflect the impacts of recent negative economic trends on specific communities and tracts, and we urge your consideration of this concern.

(ii) We believe the current definition of rural the CDFI Fund uses should be used. When possible definitions should be consistent for all CDFI programs. That language should include the definition from section 379E(a)(3) of the Consolidated Farm and Rural Development Act (7 U.S.C. 2008s(a)(3))) which also guides USDA investments. However, since the USDA has eleven definitions of rural – ranging from communities of less than 20,000 to those of less than 50,000 and some including exurbs, a comprehensive definition should be used.

(iii) Underserved should be defined by similar criteria with other Fund programs including the core program and the New Markets Tax Credit. The definition should include low income, disinvestment, out migrations, high concentrations of African American, Latino or Native American residents, and other factors the CDFI aims to serve.

(iv) Eligible community or economic development purposes should be allowed outside of a target market if the CDFI can make the case that it provides needed services and/or generates jobs or economic growth for residents of its target market.

2. **Use of funds**

As the intent of the CBGP is to provide new capital sources for CDFIs, its uses should support CDFIs in their financing activities, both existing strategies and new ones made possible by the CBGP or by the evolving responses of CDFIs to changing market needs and demands.

(ii) Should the CDFI Fund permit an entity not yet certified as a CDFI to apply for CDFI certification simultaneous with submission of a capital distribution plan?

Ideally, an applicant should have been certified as a CDFI before submitting a capital distribution plan. However, to accommodate potential new CDFIs, we recommend that the entity at least have submitted its application to be certified as a CDFI no less than twelve (12) months before submitting a capital distribution plan.

(iii) Should the CDFI Fund allow all existing CDFIs to apply, or should there be minimum eligibility criteria?

Reasonable minimum eligibility criteria should be applied, including, for example, minimum net asset size of $1 million; minimum loans receivable of $10 million; operating history of three years or more. These criteria would apply to the applicant CDFI, not to its Special Purpose Entity (SPE).

5. Capital Distribution Plan

The CFPB should recognize and utilize channels, procedures, and financial instruments that have been utilized by the CDFI Fund and Treasury, including use of intermediary CDFIs. In addition, foundations should be allowed to support CDFIs that apply for bond issuances. Options could include a subordinate, unguaranteed tranche of the bond in which foundations could invest to help lower the cost of capital. In addition, foundations could pledge the required 3% reserve.

The Fund should encourage CDFIs to form Special Purpose Entities. As consortia of CDFIs form a legal structure to pool their assets to secure the $100 million bond, we may see collaborations by region, by sector, by foundation relationship. For example, collaborations could focus on commercial real estate loans in the Southeast; small business loans in the Pacific North West, or all grantees of a certain foundation. All types of consortia should be acceptable.

(iii) Should the CDFI Fund require specific intended uses of all the bond proceeds in the capital distribution plan or should the qualified issuers just be required to demonstrate an intended pipeline of underlying assets?

The applicant should indicate to the CDFI Fund the intended uses of the bond proceeds through its capital distribution plan which can include proposed uses, intended pipeline of underlying assets or a combination thereof.

(v) Should the CDFI Fund set minimum underwriting criteria for borrowers? Should applicants be required to demonstrate satisfaction of those criteria in the capital distribution plan?

As stated above, if the CDFI Fund does set minimum underwriting criteria**,** there should be different underwriting standards appropriate for different asset classes. Furthermore, there must be the flexibility to adapt underwriting standards for particular segments. For example, underwriting standards for manufactured home finance will be different in some respects than those for site-built home loans, and underwriting standards for resident-owned communities will be different than those for other commercial loans. With these provisos, applicants can be required to demonstrate satisfaction of minimum criteria appropriate to the particular asset class segment in their capital distribution plans.

6. Accountability of Qualified Issuers

Performance evaluation should be outcome-based. No two bond issues will look the same or produce the same results. CDFIs should be held accountable to the outcomes and impact that they propose to produce under the Program. Outcome measures should incorporate the full range of CDFI activity and include measures relevant to consumer finance and community development as well as more common measures of jobs created or housing units financed. The Fund should realize that some of these deals will change over time and prepare some accommodation for change of ownership for the underlying assets.

> (d) What support, if any, would applicants and awardees like to receive from the CDFI Fund after having issued a bond?

Applicants and awardees will need intensive technical assistance. If the Fund cannot fund or provide technical assistance for them, applicants should demonstrate that they have lined up financial institution partners and/or other sources of technical assistance prior to receiving an allocation.

7. Prohibited Uses

We advise caution on any limits to specific eligible uses beyond those of good sense: obviously like illegal activities should be excluded as should liquor stores, tattoo parlors, gaming facilities, tanning salons, etc.