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MEMO TO: Donna Gambrell and Jodie Harris

FROM: Joe Neri, CEO

RE: Comments on Proposed Rules, Bond Guarantee Program

DATE: August 12, 2011

Thank you for the opportunity to comment on the rules for the CDFI Bond Guarantee Program. We have only provided comments in areas where we have a special interest; we know many other groups and associations are also commenting. We have many areas of agreement with other comments we have seen and there are several sections about which we may have a different perspective.

General comments

There are three primary issues for CDFIs and the Fund should expect that these will be issues across the industry. These are:

- Recourse ï CDFIs must be able to limit their recourse. We realize that this means the individual credits and their collateral must be exceptionally strong, but we believe that is in keeping with the intent of the program.

- Refinance ï CDFIs must be able to use funds to refinance or buy other loans. Only in this way will we be able to deploy the funds in a reasonable period of time.

- Affordability - Additional financial burdens including the expense from requirements to act in case of a default, and credit enhancement, will create challenges for the CDFI issuer and the CDFIs borrowers. The benefits of long term bonds can be quickly eroded with excessive fees, resulting in ultimate borrowers that may not have the greatest impact on the most disinvested communities, but are chosen because they can afford the fees. While a diversity of borrowers is appropriate for any portfolio, the highest priority must be the borrowers that serve low-income communities permanently and consistently.

We recognize that the use of aggregators to either issue (if the aggregator is a CDFI), or work for an issuer (a CDFI), is of interest to the Fund in order to ensure that funds reach smaller CDFIs. In this case, the CDFI applicant should be able to propose a structure for consideration by the Fund, and rules should remain flexible enough to account for the great diversity of financing strategies that we have in the CDFI industry.

A two-step process for approval of participation is also strongly endorsed, however, the initial step should require some information about the deployment plan and the underlying credits for the bonds, so CDFIs do not move to the Deployment Plan and expend time and expense to prepare a package of weak credits that will not be approved.

Finally, we urge the Fund to use its own existing systems for administration and monitoring, as well as the existing CARS rating system as part of its evaluation. The Fund does not currently underwrite CDFIs as part of its review, and funding decisions are generally handled by recommendations from consultants. The CDFI certification does not constitute an underwriting. Therefore, the Fund's internal capacity may be limited when it comes to reviewing balance sheets and financial projections. The CARS system can be a great help to the Fund in this regard, even as it is building staff that have underwriting skills. CARS is the only comprehensive evaluation system that is specific to CDFIs. Other rating agencies are not appropriate at this time because they lack industry knowledge.

Specific Comments

(b) Section 114A(c)(1) – Related to the capital distribution plan

The 90 percent requirement for deployment into the ultimate community development transaction makes sense as a minimum, but the ideal amount for deployment is 100 percent of net proceeds (over the course of the first 12 months). There may be times when the CDFI is unable to control a change in the 90 percent/10 percent balance through no fault of its own. In this case and assuming that the program is in compliance in all other respects, the CDFI should be allowed a period of time to remedy the situation. It takes time to replace loans and the CDFI should propose a reasonable time period based on a specific action plan, with frequent reports. The Principal payments may be paid on the original schedule from reserves held by the CDFI at the CDFI's discretion, or the CDFI may request that no principal payments be required during this period of time, and will present a plan for making those payments at a later date.

(c) Section 114A(c)(2) – Related to the relending account

In case of a default or other circumstance that returns any principal and interest to the CDFI outside of the scheduled payments, these funds, if not due to the FFB, should be held in the relending account and used to make scheduled payments. There may be circumstances in which the CDFI is seeking a replacement borrower to maintain the 90 percent deployment requirement, and if so the provisions of Section b above apply. The inherent interest rate risk from the relending account would be the responsibility of the CDFI.

(d)Section 114A(d) – Related to the 3 percent recourse

The three percent that is included in the statute is an adequate amount for a first loss account, and borrowing this amount as part of the bonds should be allowable. The CDFI Fund should not consider increasing the three percent – this only adds expense to the CDFI's borrower and is not warranted based on CDFI loss experience. The Fund should encourage CDFI applicants to propose structures that include strong credits based on standard underwriting procedures and also include proposals for addressing problems that arise in a portfolio in order to avoid default.

Many CDFIs have years of experience originating and managing portfolios financed by banks that are carried off-balance sheet and in which there is limited recourse to the CDFI.

For example, IFF established an Investor Consortium in 2004.

Investors agree to clear provisions for IFF's responsibility if a loan becomes delinquent. At 180 days, IFF must either buy the loan back from the investors (and then it is up to IFF to remedy the problem) or declare a loss and draw on IFF's two percent reserve first. If any funds are recovered from a loss, these funds are returned to investors. If the reserve fund is drawn, the IFF must reduce its servicing fee for a period of time until the loss reserve fund is returned to its original amount.

Provisions such as these are appropriate for the CDFI bond issue program, but an increase in the three percent reserve is not warranted.

Some CDFIs may have significant and consistent losses that are higher than three percent over a period of time, due to specialized or high risk lending. CDFIs functioning as aggregators may also have less-standard portfolios. If the Fund determines that there is a greater risk based on an underwriting, these CDFIs should be required to present proposals for credit enhancement to the Fund based on the past performance of that or similar portfolios, but the Fund should not attempt to proscribe what these might be in advance.

Section 114A(a)(3) ii – Related to timing of call on the guarantee

When the issuer or servicer learns that a borrower in the portfolio is delinquent, the issuer must make the payment on time to the FFB and immediately begin a process of monitoring as described above. If the issuer determines that the loan will continue to be delinquent the issuer is responsible for making payments while attempting to remedy with the borrower. At this point the goal is avoid drawing on the federal guarantee. If the issuer determines that the loan will default, the issuer must exercise the provisions to which it has agreed and continue to make payments. It should be left to the judgment of the CDFI whether to make these payments from the three percent loss reserve or from other funds. When the loan defaults, the guarantee is drawn on to make payments to the FFB. If there is any recovery from the loan's collateral or other sources, at any time in the future, these funds must be used to replace funds in the reserve. If the CDFI has already replaced the funds from other sources, the CDFI may repay itself.

Section 114A(e)(2) – Related to the number of issuers.

It is in the interest of this program that the CDFI fund select the highest quality issuers with the greatest capacity to move funds quickly. This will undoubtedly include large CDFIs and also several aggregators that will apply for funds as intermediaries for smaller CDFIs or CDFIs without the capacity to undertake this program of this magnitude. The important factor, particularly in the first year, is the quality of the issuers and their ability to deploy funds, and that the guarantee is used to both build the strength of the CDFI sector and drive funds to low -income communities.

Section 114A(a)(1) – Related to eligibility

ii, iii, iv

Entities that are not certified as CDFIs should not be eligible to apply (with one exception described in the next paragraph). There also should be minimum eligibility criteria for CDFI applicants, based on a proposed plan rather than the current size of the CDFI. There may be CDFIs that can make an application for the $100 million minimum even if they are relatively small. They may be able to demonstrate capacity through partners and through a pipeline of loans that indicate a particular need, with no other CDFI available to meet the need. The Fund should be open to these applicants, and base eligibility on other factors.

The Fund should make an exception if there is an applicant that does not have a CDFI certification but in every respect has carried out a mission of alternative finance for community development purposes for a minimum of five years, and is operating at a scale that can make a meaningful difference in community and economic development.

A greater concern is that non-mission-based entities or CDFIs that have parent companies that are not mission-based, will apply for the program and a) charge excessive fees for funds and b) make loans to entities that do not carry out community development or economic development programs that reflect a consistent commitment to serving low income communities that have no other options. The CDFI Fund must use internal policies ï not outside consultants ï to clearly and responsibly ensure that these funds are used for their intended purpose and that all transactions and all components of a transaction reflect this goal. Entities formed only for the purpose of applying for this program should not be eligible. If, after the first year, the Fund determines that there are not enough qualified entities or CDFIs to maximize the programôs opportunity, the Fund should work with industry leaders to establish a mechanism to deploy the guarantee. Solutions might include the establishment of new structures, new SPEs, or using existing capacity that might not obviously align with the goals of the program but can bring the needed skills and capacity to the CDFI field. Only loans originated by CDFIs or refinancing initiated by CDFIs should be eligible for this program. Non-CDFI aggregators should not be allowed to originate loans.

v.

An analysis of the number of CDFIs that lose certification will show that this is a very rare event. For the initial launch of this program, the CDFI fund should use internal information and data to determine whether any CDFIs it has certified might be in any danger of losing certification, and make certain that any CDFIs in this category are informed of this and discouraged from applying for the guarantee program. An open application process will not yield quality results if there are weaknesses in the system, and this should be the responsibility of the Fund.

CDFI certification does not equal underwriting, although this program will require the Fund to move to an underwriting and monitoring role. Overall this will strengthen the CDFI industry and the CDFI Fund.

In later years of the program, if an issuer that has participated in the program is in danger of losing certification, the Fund should share in the administrative responsibility of transferring the portfolio to another CDFI and absorb some costs.

(c)Section 114A(a)(8) - Related to issuers

ii, iii, iv, v, vi

CDFIs that are eligible and deemed qualified to participate in the program are also assumed to be qualified as issuers by the Fund. No entities that are not CDFIs should be eligible for applying to the program, therefore, they will not be issuers. A CDFI should be allowed to select an experienced bond issuer as a partner, for example, a municipal or state agency.

An aggregator should be a CDFI but a CDFI may also contract with an aggregator. The aggregator in this case does not originate loans, because only CDFIs should be allowed to originate loans (including selecting loans to refinance under the program).

Section 114A(a)(8)(B)(ii)(II) – Related to the Capital Distribution Plan

A Sources and Uses that qualifies is one that shows deployment within 12 months, and is able to project time to close. Exceptions include any proposals that are accepted that lend to small business or are solely revolving loan funds, or for partial revolving loan funds, for that portion.

A Capital Distribution Plan should resemble the IFF's Financial Forecast, attached. The Plan should include a projection for the full proposed term of bonds, showing assets, liabilities, reserve accounts, earnings and detailed expenses.

In the case of an application that is a revolving fund only, a forecast will reflect the balance sheet and operating statement of the CDFI applicant.

6(a) – Related to Accountablity

The Fund should require an annual report.

(c) The Fund should require certifications as funds are deployed, similar to New Markets Tax Credits.

(e) The Fund should use existing performance reports and data collections methods now used for CDFI FA awards, such as CIIS. No new systems should be devised so that efficiency can be maintained across the Fund's programs.

7. Prohibited uses ï any use proposed by a non-mission based CDFI and its parent, if applicable, should be a prohibited use.

8. Servicing

A program administrator may be a staff member of the CDFI that is designated to manage the federally guaranteed portfolio. The CDFI issuer may have the experience and capacity to be servicer and also program administrator.

iv. The issuer should be responsible for resolving troubled loans

v. Issuers should be compensated based on standard commercial fees, or a fee that the issuer deems will not add expense to the program that makes the loans unaffordable.

Only loans originated by CDFIs or refinancing initiated by CDFIs should be eligible for this program. Non-CDFI aggregators should not be allowed to originate loans.

Thank you again for the opportunity to comment on the Proposed Rules. Please do not hesitate to contact me at jneri@iff.org if you have any questions.

Joe Neri
CEO
IFF

Attachment: IFF Five Year Financial Forecast 2011-2015