



August 12, 2011

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

SUBMITTED VIA E-MAIL: cdfihelp@cdfi.treas.gov

Dear Ms. Harris:

NCB Capital Impact appreciates the opportunity to comment on the implementation of the CDFI Bond Guarantee Program. This new CDFI Fund initiative represents an unprecedented opportunity to support economic development in communities nationwide. NCB Capital Impact strongly supports the CDFI Bond Guarantee Program and urges the CDFI Fund to expedite the implementation so that the industry may access all of the guarantee capacity authorized by the legislation. We look forward to working with the Fund to ensure the success of the CDFI Bond Guarantee Program.

Created in the Small Business Jobs Act of 2010 (Public Law 111–240 – September 27, 2010), the CDFI Bond Guarantee Program (CBGP) has long been championed by the CDFI industry and could dramatically increase CDFI access to lower-cost, long-term, patient capital to their neediest constituencies. As a national nonprofit organization and a certified CDFI, NCB Capital Impact improves access to high-quality health and elder care, healthy foods, housing, and education in low-income communities. Our impact is built on a diverse and extensive network of alliances, our depth of experience, and cooperative approach. We partner with public and private organizations that are like-minded in mission, and dedicated to long-term success. To date, NCB Capital Impact has deployed more \$1.6 Billion in loans, investments and assistance nationwide. Building upon our impact, CBGP could enable us to further expand our delivery of services in more low-income communities.

NCB Capital Impact is a member of the Bond Policy Group (BPG) coordinated by Opportunity Finance Network, a group of executives from a cross section of CDFIs (including banks, credit unions, and loan funds and others with a history of working with CDFIs) that represent a broad array of geography, financing sectors, size, and urban/rural markets. BPG has become educated about the various ways the program might be implemented and informed as to the impact it could have for our communities if structured and managed appropriately. ***To that end, we have attached both a “Position Paper” (Attachment I) and “Guiding Principles for Design and Implementation”***

(appended to end of document) that include both some general recommendations as well as responses to questions posed by the CDFI Fund.

The following recommendations are most critical to NCB Capital Impact's successful participation in the CBGP:

Program Structure and Bond Mechanics

The CDFI Fund should exercise maximum flexibility in implementing the CBGP. The program must allow a variety of bond structures in order to meet the capital needs of a diversity of CDFIs. The CDFI Bond Program must be flexible enough to accommodate aggregation of loans from various originators (directly or indirectly) as well as single originators. CDFI bonds should accommodate a full spectrum of asset classes and no one structure should dominate.

Program Eligibility

We agree that the CDFI Fund must ensure that all issuers have a strong track record of meeting the needs of low-income and disadvantaged communities. We do not believe it is necessary to place restrictions on recently certified CDFIs with one exception. We support the exclusion of previously uncertified entities seeking CDFI certification solely to access this program. We believe that the eligibility bar is already set high by the CDFI statute and is strong enough to negate non-mission entities who seek to take advantage of the program. Otherwise, the program should not exclude recently certified CDFIs that are worthy and have a strong, established track record in community development lending. If the CDFI Fund does consider restrictions on recently certified CDFIs, we recommend that the Fund use one of the following criteria: i) a CDFI must have received at least one previous CDFI Financial Assistance program award (within the past three years) to ensure that they have gone through the application process and meet the eligibility criteria of 12 C.F.R. § 1805.301 (Subpart C—Use of Funds/Eligible Activities); or ii) a CDFI must demonstrate its continuous engagement in community development finance arena serving low-income populations for at least the past five years. Finally, we urge the Fund to consider as eligible entities both individual certified CDFIs but also special purpose entities formed by a consortium of CDFIs to issue bonds collectively. These consortiums could mitigate risk, stretch transaction costs, and meet the \$100 million program requirement.

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. Therefore we advise caution on any limits to specific eligible uses.

Eligible Bond Proceeds must 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, 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. The Fund should not dictate or restrict the proportion of proceeds that can be directed to a particular use.

Risk Assessment and Mitigation

CDFIs have a strong record of success at serving distressed markets with minimal losses and delinquencies. The CBGP can and should rely on this unique expertise. 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. Historic loss and payment performance data from conventional financial markets are generally not reliable indicators of CDFIs' performance and should not be the basis for the Fund's risk assessment for the CBGP.

The Fund should employ a robust —toolbox of strategies to mitigate risk and expand program participation. Some elements of that toolbox could include over-collateralization, covenants, third party guarantees, bond insurance, supplemental loss reserves funded by excess spreads, and a supplemental risk-sharing mechanism. The Fund should allow for the risk-share pool to be funded from various mechanisms including but not limited to: bond proceeds, CDFI investors, and investment cash flows (e.g. the spread between assets earned and debt service required for the bond).

Monitoring, Evaluation, and Impact

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.

Conclusion

In the coming weeks, the CDFI Fund will make critical decisions about implementing the CDFI Bond Guarantee Program. Please keep in mind that 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. 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.

Please contact us if you have questions or request additional information about NCB Capital Impact, please contact our Chief Operating Officer Annie Donovan at (703) 647-2303 or adonovan@ncbcapitalimpact.org or Chief Financial Officer Jeff Brenner at (703) 647-2306 or jbrenner@ncbcapitalimpact.org.

Thank you for your consideration of these recommendations.

Sincerely,

A handwritten signature in black ink that reads "Terry D. Simonette". The signature is written in a cursive style with a long horizontal stroke at the end.

Terry Simonette
Chief Executive Officer

ATTACHMENT I

Position Paper CDFI Bond Guarantee Program Developed by the Bond Policy Group

General Recommendations:

In implementing the CDFI Bond Guarantee Program, the CDFI Fund should exercise maximum flexibility. The program should allow a variety of bond structures, accommodate a broad spectrum of asset classes, and support the capital needs of a wide range of CDFIs. Each potential bond issue must be considered on its own merits. A "one size fits all" approach is not appropriate.

The following bond structures seem most likely to serve the needs of the CDFI industry, although the Fund should consider additional options that demonstrate promise. The answers to some of the questions the Fund asks in the Request for Comments will differ depending on the bond structure employed. Throughout the Position Paper we will be referring to these three bond structure options:

- 1) **Direct Issue:** A single CDFI would directly issue a guaranteed bond of at least \$100 million. That CDFI would then decide how to deploy the funds for eligible community and economic development uses.
- 2) **Pooled Asset-Backed Loans:** Several CDFIs would contribute at least \$100 million collectively in end borrower loan assets to a trust or special purpose entity (SPE) that is financed by guaranteed bond proceeds. The assets would meet the definition of eligible community and economic development uses. This would allow a wide range of CDFIs to access bond proceeds and likely reduce the need to raise substantial amounts of new equity capital.
- 3) **Pooled Loans/Investments to CDFIs:** A trust or SPE would issue a guaranteed bond of at least \$100 million backed by a pool of loans to or investments in CDFIs. This would allow a wide range of CDFIs to access the Bond on a relatively flexible basis.

Structure two and three above (Pooled Asset-Backed Loans and Pooled Loans/Investments to CDFIs) will require the use of an aggregation mechanism whereby a pool of eligible loan or investment assets that meet certain requirements and characteristics are assembled and funded with bond proceeds. Such "aggregator" might also perform certain asset pool management responsibilities during the life of the guaranteed bond. This aggregator could be the issuer or it could be a third party acting on behalf of the issuer.

Positions in Response to Specific Issues the CDFI Fund Identified in its July 1, 2011 Request for Public Comment

[In this section, the language from the Federal Register Notice appears verbatim followed by the *Position* developed collaboratively by CDFI leaders and other experts in italics.]

The CDFI Fund invites and encourages comments and suggestions germane to the mission, purpose, and implementation of the CDFI Bond Guarantee Program. The CDFI Fund is particularly interested in comments in the following areas:

1. Definitions (a) Section 114A(a) of the Act provides certain definitions applicable to the CDFI Bond Guarantee Program. In particular, Section 114A(a)(2) of the Act defines eligible community or economic development purpose as any purpose described in section 108(b) [12 U.S.C. 4707(b)] and includes the provision of community or economic development in low-income or underserved rural areas. The CDFI Fund is interested in comments regarding all definitions found in the Act as they relate to the program, including the following:

(i) How should the term "low income" be defined as such term is used in Section 114A(a)(2)?

Position: The CDFI Fund should use a definition of low-income geographies based on Metropolitan Statistical Area as defined in the CDFI Fund Authorizing Statute (7 CFR part 1805) rather than census tract. Applicants to the program should be allowed to target low-income geographies as well as low-income populations, even if the low-income populations benefitting from the financing are not located in low-income geographies.

(ii) How should the term "rural areas" be defined as such term is used in Section 114A(a)(2)? For example, is a rural community any census tract that is not located in a metropolitan statistical area (MSA)? Respondents should discuss how a particular definition would enable the program to target businesses and residents in rural areas, and discuss whether there are particular measures that should not be used because they may inadvertently disadvantage certain populations (*i.e.*, provide examples of particular households or communities that would not qualify under specific definitions).

Position: The CDFI Fund should use the US Department of Agriculture's definition of rural areas in 7 CFR Part 3550, which defines rural area as:

(1) Open country which is not part of or associated with an urban area.

(2) Any town, village, city, or place, including the immediate adjacent densely settled area, which is not part of or associated with an urban area and which:

(i) Has a population not in excess of 10,000 if it is rural in character, or

(ii) Has a population in excess of 10,000 but not in excess of 20,000, is not contained within a Metropolitan Statistical Area, and has a serious lack of mortgage credit for low- and moderate-income households as determined by the Secretary of Agriculture and the Secretary of HUD.

(3) An area classified as a rural area prior to October 1, 1990, (even if within a Metropolitan Statistical Area), with a population exceeding 10,000, but not in excess of 25,000, which is rural in character, and has a serious lack of mortgage credit for low- and moderate-income families.

(iii) How should the term "underserved" be defined and/or measured?

Position: We recommend that the CDFI Fund look to the Fund's authorizing statute (Sec 103) and related regulations regarding "investment areas" and "targeted populations" in defining "underserved."

(iv) Should "eligible community or economic development purpose" be defined to allow a CDFI or its designated Qualified Issuer to only invest inside the CDFI Fund Target Market that it was certified to serve?

Position: No. It would be too limiting to restrict a CDFI or its designated Qualified Issuer to investments in the CDFI Fund Target Market that the CDFI was certified to serve. Investments in any distressed community are desirable and should qualify as an "eligible community or economic purpose."

2. Use of Funds

(a) The Act defines a loan as any credit instrument that is extended under the CDFI Bond Guarantee Program for any eligible community or economic development purpose. Section 114A(b) of the Act states that the Secretary of the Treasury (the Secretary) shall guarantee payments on bonds or notes issued by a qualified issuer if the proceeds of the bonds or notes are used in accordance with this section to make loans to eligible community development financial institutions (CDFIs) (1) For eligible community or economic development purposes; or (2) To refinance loans or notes issued for such purposes. The CDFI Fund invites and encourages comments and suggestions germane to the criteria and use of funds. The CDFI Fund is particularly interested in comments including the following:

(i) Should there be any limitations on the types of loans that can be financed or refinanced with the bond proceeds? Are there any uses of bond or note proceeds that should be excluded or deemed ineligible regardless of the fact that the use was in a low-income or underserved rural area?

Position: No. There should not be any limitations on the types of loans that can be financed or refinanced with the bond proceeds. The flexibility of the CDFI Fund's CDFI Financial Assistance Program which permits a wide range of activities provides an excellent model for the CBGP to emulate. (The relevant definitions appear in the CDFI Fund authorizing statute at 108 (b) and are reinforced in the regulations at 12 CFR part 1805.301.)

Any loan to a CDFI, and any loan made by a CDFI, its designate or a SPE is an eligible use of funds.

There should be no prohibition against using the CBGP in conjunction with other government programs such as the New Markets Tax Credit, the Low Income Housing Tax Credit, HOME funds or guarantee programs offered through the Small Business Administration or the US Department of Agriculture.

In practice, the bond pricing and repayment requirements will determine the most appropriate uses for the proceeds within the confines of "community and economic development" uses.

In addition, issuers should be allowed to use bond or note proceeds to fund the risk share requirement mandated by the statute, other supplemental credit and liquidity reserves that may be needed, and upfront costs of issuing the guaranteed bond.

(ii) Should the capitalization of: (1) Revolving loan funds; (2) credit enhancement of investments made by CDFIs and/or others; or (3) loan loss reserves, debt service reserves, and/or sinking funds in support of a Federally guaranteed bond, be included as eligible purposes?

Position: Yes. The capitalization of all the listed uses should be included as eligible purposes.

(1) Revolving loan funds

Many CDFIs conduct their lending business as a revolving loan fund and routinely capitalize their balance sheets with investments from the CDFI Fund. Many CDFIs conduct asset liability management in aggregate as opposed to loan by loan, and liability by liability. CDFIs don't always match fund each of their loan assets with debt liabilities, but will recycle their loan assets multiple times within the term of their liabilities. Therefore, we believe that bond proceeds can and should be allowed to be used in a similar manner as capital for revolving loan funds.

Examples of the kind of revolving loan fund uses that are current CDFI practice, and that would be expanded by the bond, include but are not limited to:

- *Acquisition and predevelopment real estate loans for construction of affordable housing, health clinics, and healthy food retail outlets which are usually short term in nature and taken out by construction loans and permanent mortgage loans*
- *Small business equipment loans that amortize over a medium term and get replaced by new equipment loans*
- *Small business working capital lines of credit whose usage revolves based on the borrower's working capital needs*
- *Financing in markets with temporary disruptions. For example, over the last couple of years when the LIHTC market was very challenging, CDFIs were able to continue to support tax credit deals until the tax credit exchange and other programs were made available to help fill gaps.*

(iii) Should there be any limits on the percentage of loans or notes refinanced with the bond proceeds? If so, what should they be?

Position: No. Using bond proceeds for refinancing of all types is highly desirable. Compelling reasons include the following:

- *The CBGP's authorizing statute explicitly permits refinancing in sections 114A(a)(3) and 114A (b)(2).*
- *Refinancing can actually increase the amount of capital in the market, not simply replace existing capital, particularly if it takes the form of providing a secondary market. If lenders know that there is a secondary market that provides them liquidity in the event that they need to convert a loan asset into cash, they are more likely to engage in more lending.*
- *Refinancing allows lenders to more appropriately match the useful life of an asset with financing terms, such as when a long term mortgage refinances a short term real estate construction loan.*
- *Refinancing a portion of CDFIs' balance sheet with bond proceeds could lead to more stabilized balance sheets, better mechanisms for asset liability management and more financing capacity. Existing lenders and funders to CDFIs will take comfort in knowing that CDFIs have multiple sources of capital and are not dependent on one or two funders. In fact, they are likely to be more willing to increase their financing in cases where a borrower has greater*

access to capital. Contrary to first impressions, using the bond to replace existing debts can actually lead to growth in CDFI's capitalization.

- *For decades, CDFIs have had to structure their loan assets to meet the terms of their liabilities which at times have constrained their ability to respond to the needs of their borrowers. Given that most lenders and funders to the CDFI field lend for ten years or less, CDFIs have had to either endure asset liability mismatches, or force long term needs into short term solutions. For example, this mismatch might mean a CDFI provides 5 -7 year loans with 20 year amortizations. In order to manage the associated interest rate and duration risk, CDFIs currently have to create "buckets" limiting the dollar amount of loans they can provide for these longer term needs. Having access to 30 year bond capital will allow CDFIs to refinance their existing loan assets to more appropriately meet the need of their borrowers.*
- *New Markets Tax Credit deals in year 7 will need refinancing and likely longer term loans than most CDFIs will be able to provide if bond proceeds are not allowed to be used for this purpose.*
- *The pressure of rapid deployment as required by the capital distribution plan in the statute may mean that early issues focus more heavily on refinancing than later ones, as CDFIs build a pipeline and build up the risk reserves required.*

In a pooled asset-backed loan structure, refinancing will be particularly important because even if the Fund allows individual bond or note tranches to be issued in amounts less than the \$100 million guarantee, it will be challenging for most issuers to have new funded assets within twelve months of the award of a CDFI Guarantee. CDFIs could likely close loan and investment commitments within twelve months of the granting of the guarantee, but the funding of the commitments may take longer based on the nature of the borrowers' needs.

(iv) Should CDFIs be allowed to use bond proceeds to purchase loans from other CDFIs? If so, should the CDFI that sells the loans be required to invest a certain portion of the proceeds from the sale to support additional community development activities?

Position: Yes, CDFIs should be allowed to use bond proceeds to purchase loans from other CDFIs. Demand for financing in the communities served by CDFIs exceeds supply (as evidenced by the market demand survey and quarterly market conditions reports conducted by Opportunity Finance Network¹) so there is no need to mandate a redeployment requirement. In March 2011, Opportunity Finance Network and the National Federation of Credit Unions surveyed a broad cross section of the CDFI industry, receiving a total of 257 responses. These survey responders identified \$55 billion in market demand. 45% of respondents would use additional capital made available through the CBGP for deeper penetration of existing markets with existing products, while 54% of respondents would use the new capital, in part, to expand into

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http://www.opportunityfinance.net/store/downloads/CDFI_Market_Conditions_Q111_Report_I.pdf

new markets and/or launch new products. So clearly, based on the need of the communities served by CDFIs, there is no reason to mandate reinvestment of proceeds.

Such artificial constraints often cause unintended consequences such as forcing CDFIs to lower standards or conversely make loans that could be made by conventional lenders due to compressed timeframes for origination, closing and funding of loans and investments. Strict reinvestment requirements in the New Markets Tax Credit program have led to instances where redeployment met the letter of the requirement but not the spirit for fear of non-compliance.

(v) Should the CDFI Fund place additional restrictions on the awardees' loan products, such as a cap on the interest rate, fees and/or late payment penalties or on the marketing and disclosure standards for the products? If so, what are the appropriate restrictions?

Position: No. Additional restrictions are not required. The CDFI industry has an established track record for lending responsibly. The success and growth of the CDFI field over the past thirty years is based on its reputation for offering responsible products and underwriting and lending in a responsible way.

(b) Section 114A(c)(1) states that a capital distribution plan meets the requirements of the subsection if not less than 90 percent of the principal amount of guaranteed bonds or notes (other than the cost of issuance fee) are used to make loans for any eligible community or economic development purpose, measured annually, beginning at the end of the one-year period beginning on the issuance date of such guaranteed bonds or notes. The CDFI Fund welcomes comments regarding this provision, specifically regarding what penalties the CDFI Fund should impose if an issuer is out of compliance.

Position: Since CDFIs make loans for eligible community or economic development purposes, the "not less than 90 percent" requirement should be deemed met upon receipt of bond proceeds by a CDFI. For example, in a direct issue structure where the issuer is a CDFI or a SPE controlled by a CDFI, the "not less than 90% percent" deployment would be met immediately. Under a pooled loans/investments to CDFI structure, the "not less than 90 percent" requirement would be met when funds are disbursed to the CDFIs participating in the pool.

Likewise, the "not less than 90 percent" requirement should count legally binding commitments to lend and invest, not funded disbursements. CDFIs often make capital available to small businesses and entities engaged in new construction or development in the form of revolving loans and deferred draw loans so that the borrowed funds are only supplied when needed. These loan products are responsive to borrower needs and should not be excluded or disadvantaged in this program due to inflexible capital distribution definitions.

(c) Section 114A(c)(2) states that not more than 10 percent of the principal amount of guaranteed bonds or notes –, multiplied by an amount equal to the outstanding principal balance of issued notes or bonds, minus the risk-share pool amount—may be held in a relending account and may be available for new eligible community or economic development purposes.

(i) How should the CDFI Fund define "relending" account as stated in Section 114A(c)(2)? How should it differ from the loans made under Section 114(c)(1)?

Position: The 10% relending account, 114A(c)(2), and the 90% deployment requirement, 114A(c)(1), work hand in hand. The purpose of the relending account is

to allow CDFIs (and the SPEs in model two and three) to collect and then relend unexpected principal prepayments and expected repayments of loans and investments with maturities that are shorter than the bond maturity. The purpose of the 90% deployment requirement is to ensure that a good portion of the bond proceeds are deployed in underserved communities. Both provisions have laudable objectives. However, issuers will need to set aside cash accounts for liquidity (to manage asset-liability matching) and for credit or risk share purposes. These cash reserves should not count as part of the relending account because it will not leave enough capacity to accommodate prepayments and shorter term maturities. Moreover, these same cash accounts should be included in the definition of deployment for purposes of the 90% deployment requirement, because they will be needed to ensure prudent risk mitigation and cash flow management operations in the use of the bond program.

The following example illustrates our proposal:

A \$100 million bond has a \$3 million cash CDFI risk share account, a \$500,000 cash reserve for asset liability management purposes, and a maximum of \$10 million designated as a relending account. Neither the \$3 million cash in the risk share account nor the \$500,000 in the liquidity reserve would count toward the \$10 million relending account limit. However, both accounts would count as deployed proceeds for purposes of the 90% deployment requirement.

(ii) If the capitalization of revolving loan funds is deemed an allowable use of funds under Section 114A(a)(4), what activities would be eligible under the relending account?

Position: Capitalization of revolving loan funds should definitely be deemed an allowable use of funds. An illustrative list of activities that CDFIs do through a revolving loan fund is provided in the answer to 2 (a)(ii). However, repayments under a revolving loan facility should be excluded from the definition of relending accounts. Since funds are lent and repaid continually over the life of the facility, repayments are normal in revolving loan funds. Borrowers are expected to draw funds only when they need them and repay them as soon as funds are available. Revolving loan fund repayments are different from repayments or prepayments of term loans and as such, should not count as balances in the CBGP's relending account. Moreover, as long as a revolving loan facility remains in force and is available for use by the borrower (i.e., is a legally binding commitment to lend), irrespective of its outstanding balances, it should count as "deployed" under the 90% deployment requirement. If a revolving loan facility expires prior to the maturity of the bond, then it should be considered as part of the relending account and subject to "relending" and count as "un-deployed" for purposes of the 90% deployment requirement.

As explained in the answer to 2(a)(ii), revolving loan funds can be a valuable tool for small businesses and construction projects, which lead to job creation and expansion. Definitions of relending accounts and deployment that enable the CBGP to finance such important economic development activities are consistent with statutory requirements and intent.

(iii) If additional reserves are held, should they be permitted to be funded from the relending account?

Position: If additional reserves are mandated, they should be excluded from the definition of the relending account and counted as deployed for purposes of the 90% deployment requirement. Please see (c)(i), definition of relending account.

(iv) Should a sinking fund, or any other reserve to allow for the payment of debt service, be permitted to be funded from the relending account?

Position: If a sinking fund or other reserve is required, it should be excluded from the definition of the relending account and counted as deployed for purposes of the 90% deployment requirement. Please see (c)(i), definition of relending account.

(d) Section 114A(d) states that each qualified issuer shall, during the term of a guarantee provided under the CDFI Bond Guarantee Program, establish a risk-share pool, capitalized by contributions from eligible community development financial institution participants, of an amount equal to three percent of the guaranteed amount outstanding on the subject notes and bonds.

(i) In the event that the CDFI Fund determines that there is a risk of loss to the government for which Congress has not provided an appropriation, what steps should the CDFI Fund take to compensate for this risk?

a. Should the interest rate on the bonds be increased?

b. Should a larger risk-share pool be required?

c. Should the CDFI Fund require restrictions, covenants and conditions (*e.g.*, net asset ratio requirement, first loss requirements, first lien position; over-collateralization, replacement of troubled loans)?

Position: If the CDFI Fund determines that the risk of loss is greater than 3% and Congress has not appropriated funds for losses, the Fund should work with the qualified issuer or applicants to utilize a “toolbox” of credit enhancements to compensate for additional risk. Some examples of risk mitigation tools are:

- ***Over-collateralization***
- ***Affirmative covenants***
- ***Third party guarantees and/or bond insurance***
- ***Recourse: should vary based on the risk of each bond***
- ***Increased interest rates on loans or investments made from the qualified issuer to CDFIs or end-borrowers. This excess spread would then be used to fund reserves that could be used to mitigate losses.***
- ***Create a supplemental risk-sharing mechanism: the Fund could create other cash reserve pools in addition to 3 percent risk-share pool. This additional cash reserve could be funded from sources including bond proceeds, third-party CDFI investors, or investment cash flows.***

The length of time that the risk-share pool should remain intact depends on the issuing structure of the bond. Because bond risk can be more easily determined after some years of seasoning, the Fund should allow a lower risk-share for more seasoned issues where justified by bond performance.

(ii) How should the CDFI Fund assess and compensate for different levels of risk among diverse proposals without unduly restricting the flexible use of funds for a range of community development purposes? For example:

- a. Should the CDFI Fund take into account the participation of a risk sharing partner? What should be the parameters of any such risk-sharing?
- b. Should the Fund take into account an independent, third-party credit rating from a major rating agency?

Position: The CDFI Fund should evaluate each application based on its individual merits. The Fund should make use of expert resources in and outside the Federal government with experience in underwriting community and economic development transactions. The Fund should consider the historical loss data of the CDFI industry. Where available, it should look at performance history of CDFIs at the asset level. This data is significantly more valuable than any proxy developed from data available regarding conventional markets. The CDFI market place is different and we do business very differently.

As part of the application process, applicants should be expected to quantify the risk in their proposal and demonstrate their ability to cover this risk.

(iii) Are there restrictions, covenants, conditions or other measures the CDFI Fund should not impose? Please provide specific examples, if possible.

Position: The CDFI Fund should work with the qualified issuer or applicants to utilize a "toolbox" of credit enhancements to mitigate risk including affirmative covenants or other measures.

(iv) Should the qualified issuer be allowed to set aside the three percent from the bond proceeds or should these funds be separate from the proceeds?

Position: The Fund should allow for the risk-share pool to be funded from various mechanisms including but not limited to: bond proceeds, third-party CDFI investors, or investment cash flows (e.g. the spread between assets earned and cash required to service the bond).

3. Guarantee Provisions

(a) Section 114A(a)(3) defines a guarantee as a written agreement between the Secretary and a qualified issuer (or trustee) pursuant to which the Secretary ensures repayment of the verifiable losses of principal, interest, and call premium, if any, on notes or bonds issued by a qualified issuer to finance or refinance loans to eligible CDFI. The CDFI Fund invites and encourages comments and suggestions relating to the guarantee provisions, especially:

(i) Should the CDFI Fund define and determine "verifiable losses of principal, interest, and call premium?"

Position: Losses of principal, interest and call premium should be defined as failure of the issuer to make bond payments in amounts and on dates that are contractually mandated by the underlying bond documentation.

(ii) Should the CDFI Fund permit a call upon the guarantee at any point prior to the issuer liquidating the available assets? If so, under what condition should a call on the guarantee be permitted?

Position: Yes. Bond payments must be made as contractually due in regard to both amounts due and due dates. The investor must be insulated from any problem the pool of assets or issuer is experiencing.

When evidence exists that the issuer is unlikely to pay when contractually obligated, then the guarantee should be exercised and the CDFI Fund should ensure payments are made as contractually required, much like how bond insurance operates. The CDFI Fund should work with the issuer, aggregator, and originator/servicer to exercise all rights, remedies, and restructuring opportunities before the bond structure is collapsed, assets liquidated or the bond balance reduced.

Examples of such remedies would include the substitution of non-performing assets, liquidation of underlying collateral, liquidation of risk share and supplement credit reserves, and exercise of recourse if available.

The government should work with the issuer/aggregator to ensure minimal losses and stabilization of the rest of the asset pool or issuer's remaining obligations. If necessary, the government should also consider using the services of a special servicer to deal with nonperforming assets.

(b) Section 114A(e)(1) indicates that the Treasury guarantee shall be for the full amount of a bond or note, including the amount of principal, interest, and call premiums not to exceed 30 years. The Treasury may not guarantee any amount less than \$100 million per issuance.

(i) Should the CDFI Fund set specific guidelines or prohibitions for the structure of the bond (e.g., callable, convertible, zero-coupon)?

Position: The CDFI Fund should not set specific guidelines or prohibitions for the structure of the bond. The following bond structures seem most likely to serve the needs of the CDFI industry, although the Fund should consider additional options that demonstrate promise.

- 1) Direct Issue: A single CDFI would directly issue a bond of at least \$100 million. That CDFI would then decide how to deploy the funds for eligible community and economic development uses.***
- 2) Pooled Asset-Backed Loans: Several CDFIs would contribute at least \$100 million collectively in end borrower loan assets to a trust or special purpose entity (SPE) that is financed by guaranteed bond proceeds. The assets would meet the definition of eligible community and economic development uses. This would allow a wide range of CDFIs to access bond proceeds and likely reduce the need to raise substantial amounts of new equity capital.***
- 3) Pooled Loans to CDFIs: A trust or SPE would issue a bond of at least \$100 million backed by a pool of loans to or investments in CDFIs. This would allow a wide range of CDFIs to access the Bond on a relatively flexible basis.***

The latter two structures are critical to ensuring that CDFIs of all sizes can participate in the CBGP.

We also encourage the Fund, consistent with the Act, to approve allocations of guarantees in the amount of \$100 million while allowing guaranteed bonds to be drawn down in amounts less than \$100 million. Bonds could be issued in smaller increments as part of one application as long as each guarantee covered no less than \$100 million of bonds.

(ii) Should bonds that are used to fund certain asset classes be required to have specific terms or conditions? Should riskier asset classes or borrowers require additional enhancements?

Position: No specific terms or conditions should be required at the programmatic level. Every application should be analyzed individually on an application-by-application basis. There should be no minimum terms or conditions. As it has over the past 15 years to great effect, the Fund should entrust CDFIs to make end-borrower risk assessments. Under a Direct Issue or Pooled Loans to CDFIs bond structure, the financial wherewithal of the CDFI should be analyzed to determine whether a CDFI qualifies to participate in a CBGP bond issue and what supplemental credit enhancements might be necessary. In these cases, the Fund should apply the loss and payment experience of the CDFI as indicators of risk as opposed to conventional market indicators.

As part of its review of Capital Distribution Plans, the Fund should account for different asset classes when considering the terms and conditions of a bond issue. For example, in a pooled-asset backed structure the Fund will likely want to consider the extent to which the asset pool aligns with the maturity of the bonds being issued. The Fund may also want to consider whether there is adequate liquidity available to deal with the maturity of the underlying assets and repay the bonds.

(c) Section 114A(e)(2) states limitations on the guarantees. (1) The Secretary shall issue not more than 10 guarantees in any calendar year under the program. (2) The Secretary may not guarantee any amount under the program equal to less than \$100 million but the total of all such guarantees in any fiscal year may not exceed \$1 billion.

(i) Can qualified issuers apply for multiple issuances? Should there be a limit per qualified issuer? If so, what should that limit be?

Position: The Fund should not impose a limit on the number of issuance/guarantees for which issuers are allowed to apply or qualify. However, the Fund should implement the CBGP in a manner that accommodates and reflects a broad cross section of the CDFI industry and not allow concentration among too small a number of participants.

4. Eligible Entities

(a) Section 114A(a)(1) defines an eligible entity as a CDFI (as described in section 1805.201 of title 12, Code of Federal Regulations, or any successor thereto) certified by the Secretary that has applied to a qualified issuer for, or that has been granted by a qualified issuer, a loan under the program. The

CDFI Fund welcomes comments on issues relating to eligible entities, particularly with respect to the following questions:

(i) Should the CDFI Fund require one qualified issuer (or appointed trustee) for all bonds and notes issued under the program?

Position: The Fund should not require one qualified issuer (or appointed trustee) for all bonds and notes issued under the program because doing so would prevent multiple CDFIs from becoming direct issuers.

(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?

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

(iv) The Act states that a qualified issuer should have “appropriate expertise, capacity, and experience, or otherwise be qualified to make loans for eligible community or economic development purposes.” How should the CDFI Fund determine that a qualified issuer meets these requirements?

Position: The CDFI Bond Guarantee Program (CBGP) represents our nation’s strong commitment to community development finance, and possibly its largest investment. As such, qualified bond issuers should demonstrate a significant and sustained track record of investing in and supporting economic development in low-income communities. At minimum, a qualified issuer should be a certified CDFI in good standing and can be for-profit or non-profit. The Fund should structure the CBGP application process in a manner that advantages applicants whose organizational activity aligns closely and consistently with eligible community and economic uses contained in 12 CFR part 1805.301. In cases where a bond issue is structured through a Single Purpose Entity (SPE), the Fund should apply these principles to the CDFIs participating in the bond issue under the SPE. CDFIs created expressly for the purpose of qualifying for the CBGP should not be eligible to participate in the program. As such, the Fund should use care in determining that applicants have a history of lending and investing for economic and community purposes and are motivated to do so for mission-related reasons only.

In evaluating newly-certified CDFIs, the Fund should consider:

- ***For CDFIs that are part of, or controlled by, another corporation(s), the other corporation(s) must also have a primary mission of community development;***
- ***Using mission and track record in low- income communities as the primary means to make decisions about the eligibility of these institutions;***
- ***Strategies and operations that align strongly with their community and economic development mission;***
- ***Effective deployment of operational and financing resources in pursuit of their mission;***
- ***Clear accountability to a low income market and a demonstrated history of working successfully in that market;***
- ***Accurate tracking of appropriate output data and continuously tracking outcome measurements.***

For the purposes of the CBGP, SPEs should not be considered “new entities,” since they are designates of existing CDFIs.

Separately, the structure of the bond issue in question should also be considered:

- *Direct Issue: under this structure, eligibility requirements should be applied to the issuing CDFI. The Fund has a long history of assessing CDFI performance capacity through its FA and TA programs, and as such, the existing standards provide an appropriate measure of experience, expertise, and capacity in delivering economic development services to low-income communities. It is important that the definition of an “experienced, expert, and capable” CDFI is uniform across Fund programs.*
- *Pooled-Asset-Backed Loans: under this structure, CBGP eligibility requirements should apply to the CDFIs that are originating (and likely servicing) asset-backed loans to the SPE. Here, we point to Sec. 107(a) of the CDFI Fund authorizing statute as the principal source of determining whether a CDFI has the experience, expertise, and capacity necessary to participate in the CBGP. CDFIs originating loans that are part of this structure should demonstrate the organizational capacity to execute their respective role in an asset-backed bond, e.g. the ability to originate loans in the time period proposed, underwrite to the standards that the Issuer or aggregator requires, have the appropriate systems in place to manage their loans after origination, etc.*
- *Pooled Loans to/Pooled Investments in CDFIs: in this model, there are likely two levels of eligibility criteria. First, the aggregating CDFI would have to meet the qualifications required to manage and make loans to other CDFIs. Separately, CBGP programmatic qualifications should also apply to the CDFIs receiving loans from the aggregator.*

In general, in addition to the criteria outlined above, both “pool” structures require the issuer/aggregator CDFI (or its designate) to show that they are experienced (or can acquire staff with experience or partner with experienced entities) in packaging loans and managing portfolios successfully.

(v) What penalties should be imposed in the event that a CDFI participating in the program ceases to be a certified CDFI? What remedies and cure periods should the CDFI Fund allow in the event of a lapse in CDFI certification?

Position: CDFIs that lose their certification while participating in a CBGP bond issue should be given 12 months to recertify. For asset-backed bond structures, there should follow a cure period wherein the issuer can “replace” the CDFI that lost their certification. Because of the complexity of bond issuances, these CDFIs should receive expedited consideration during the recertification process.

(b) Section 114A(a)(5) defines a master servicer as an entity approved by the Secretary in accordance with subparagraph (B) to oversee the activities of servicers, as provided in subsection (f)(4).

(i) Should the CDFI Fund require one servicer for all bonds and notes issued under the program?

Position: No, the Fund should not require only one servicer, but in the interest of keeping program costs as low as possible, the Fund may choose to limit the number of servicers used. Moreover, the Fund may decide a single servicer is the most cost

effective manner to administer the CBGP, but only if it can ensure maintenance of the necessary flexibility to accommodate the diversity of the CDFI industry.

(ii) Should the CDFI Fund require the master servicer and servicers to have a track record of providing similar services? How should the CDFI Fund evaluate the capabilities of prospective servicers and master servicers?

Position: Yes, servicers should be able to show a successful track record of managing the cash flow and performance of a portfolio of loan assets, as defined in 114(a)(5) and 114(f)(3).

The Fund should also develop and include a role for the "special servicing" of collections in the case of nonperforming loans that need restructuring and work out. Special Servicers could be appointed by the existing Servicers or the program administrator or one of the existing servicers could perform the duties of work out if qualified and agreed upon by the Fund.

(iii) Should the CDFI Fund pre-qualify servicers and make those groups known to CDFIs wishing to submit a capital distribution plan for consideration?

Position: We believe that CDFIs that originate loans financed with guaranteed bond proceeds are best positioned to service their own loans. Therefore, the notion of prequalifying all servicers is not necessary.

However, we do think the Fund could pre-qualify Master Servicers and make them known to CDFIs prior to submission of an application. As part of the underwriting process for a guaranteed bond issuance, all servicers should be certified as qualified to perform duties outlined in the capital distribution plan or application. However, the number of pre-qualified Master Servicers should not be fixed for the life of the program but potentially be a dynamic and growing universe of entities capable of assisting CDFIs implement the CBGP successfully.

(iv) Should a CDFI issuer be allowed to serve as its own servicer?

Position: CDFIs issuers should be allowed to serve as their own servicers. Again, we believe that one of the CDFI industry's strengths is their loan servicing capabilities. Patient, hands on attention paid to borrowers who may be struggling but who are still capable of meeting their debt obligations has contributed to the strong payment history of CDFIs over the past three decades.

(v) Should the master servicer be eligible to serve as a program administrator or servicer for a qualified issuer? If so, how should potential conflicts of interest be managed?

Position: There are certain responsibilities assigned to the program administrator which could be delegated to a third party, potentially the master servicer, the issuer, or the aggregator. The CDFI Fund or program administrator should maintain the right to replace the entity to which these responsibilities have been delegated to manage potential conflicts of interest.

(c) Section 114(a)(8) defines qualified issuers as a CDFI (or any entity designated to issue notes or bonds on behalf of such CDFI) that meets certain qualifications: (1) Have appropriate expertise, (2) have an acceptable capital distribution plan, and (3) be able to certify that the bond proceeds will be used for community development.

(i) How should a CDFI demonstrate its expertise?

Position: If the issuer is a CDFI, the same criteria used to determine Eligible CDFIs in Section 4 (iv) should govern qualified bond issuers. At minimum, a qualified issuer should be a certified CDFI in good standing and can be for-profit or non-profit. The Fund should structure the CBGP application process in a manner that advantages applicants whose organizational activity aligns closely and consistently with eligible community and economic uses contained in 12 CFR part 1805.301. In cases where a bond issue is structured through a Single Purpose Entity (SPE), the Fund should apply these principles to the CDFIs participating in the bond issue under the SPE. CDFIs created expressly for the purpose of qualifying for the CBGP should not be eligible to participate in the program. As such, the Fund should use care in determining that applicants have a history of lending and investing for economic and community purposes and are motivated to do so for mission-related reasons only.

In evaluating newly-certified CDFIs, the Fund should consider:

- ***For CDFIs that are part of, or controlled by, another corporation(s), the other corporation(s) must also have a primary mission of community development;***
- ***Using mission and track record in low- income communities as the primary means to make decisions about the eligibility of these institutions;***
- ***Strategies and operations that align strongly with their community and economic development mission;***
- ***Effective deployment of operational and financing resources in pursuit of their mission;***
- ***Clear accountability to a low income market and a demonstrated history of working successfully in that market;***
- ***Accurate tracking of appropriate output data and continuously tracking outcome measurements.***

For the purposes of the CBGP, SPEs should not be considered “new entities,” since they are designates of existing CDFIs.

(ii) Are there any institutions that should be prohibited from serving as qualified issuers?

Position: The Fund should exercise good judgment in ensuring that qualified issuers represent the range of diversity in the CDFI industry and that no single issuer should dominate the CBGP. The Fund should not promulgate rules that prohibit any institution from serving as a qualified issuer.

The CDFI Fund’s programs have been less successful when important mission and accountability criteria have been given lower priority in its decision-making. For example, New Markets Tax Credit subsidies have been most successful when deployed through institutions with a strong track record in underserved communities, and strong mission screens for targeting deals.

(iii) Should the CDFI Fund establish minimum criteria for serving as a qualified issuer?

Position: If the issuer is a CDFI, the same criteria used to determine Eligible CDFIs in Section 4 (iv) should govern qualified bond issuers. If a CDFI designate is the issuer, then the CDFI that is sponsoring the bond and designated the issuer should meet these criteria. At minimum, a qualified issuer should be a certified CDFI in good standing and can be for-profit or non-profit. The Fund should structure the CBGP Application in a manner that advantages applicants whose organizational activity aligns closely and consistently with eligible community and economic uses contained in 12 CFR part 1805.301. In cases where a bond issue is structured through a Single Purpose Entity (SPE), the Fund should apply these principles to the CDFIs participating in the bond issue under the SPE. CDFIs created expressly for the purpose of qualifying for the CBGP should not be eligible to participate in the program. As such, the Fund should use care in determining that applicants have a history of lending and investing for economic and community purposes and are motivated to do so for mission-related reasons only.

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- ***Accurate tracking of appropriate output data and continuously tracking outcome measurements.***

For the purposes of the CBGP, SPEs should not be considered “new entities,” since they are designates of existing CDFIs.

(iv) Should the CDFI Fund set a minimum asset size for CDFI participation as a qualified issuer?

Position: The Fund should not apply minimum asset standards to CDFI participation as a qualified issuer nor as a participant in a pooled asset guaranteed bond.

(v) Should the CDFI Fund require the issuer to have a minimum net capital (real equity capital) and require a set amount of net capital be held for the term of the bond? If so, what is a reasonable level to require?

Position: The Fund should not require minimum net capital standards for CDFI participation as a qualified issuer nor as a participant in a pooled asset guaranteed

bond at the programmatic level. Required net asset levels should be determined based on the risk profile and structure of each bond application.

(vi) Should qualified issuers be required to obtain an independent, third-party credit rating from a major rating agency?

Position: Qualified issuers should not be required to obtain a credit rating from a major third-party rating agency. The major third-party ratings industry is not familiar with the CDFI industry and we are highly skeptical of their ability to accurately rate bonds issued by CDFIs. The history of third-party ratings agencies shows that newly rated industries aren't rated appropriately. At best, third-party raters would apply non-comparable criteria to CDFI investment portfolios, likely resulting in bonds ratings that do not reflect the true risk of the bond investment.

As part of its efforts to support the work of CDFIs, the Fund should take a gradual approach to moving the community development finance industry towards the ultimate goal being rated by major third-party rating agencies. As part of this effort, the Fund may want to consider utilizing existing CDFI ratings tools, such as CARS™, or a partnership between CARS™ and a major third-party rating agency. This partnership could eventually lead to bond issues being rated by major third-party raters on a "look-back basis." Bonds rated on a "look-back basis" could then be sold to private investors.

5. Capital Distribution Plan

(a) Section 114A(a)(8)(B)(ii)(II) states that a qualified issuer shall provide to the Secretary: (aa) an acceptable statement of the proposed sources and uses of the funds and (bb) a capital distribution plan that meets the requirements of subsection (c)(1). The CDFI Fund seeks comments relating to the capital distribution plan requirement, specifically:

- (i) What elements should be required in an acceptable statement of proposed sources and uses of the funds? How should the CDFI Fund measure acceptability?
- (ii) What elements should be required in a capital distribution plan? Are there examples of such plans, Federal or otherwise, upon which the CDFI Fund should model the CDFI Bond Guarantee Program's capital distribution plan requirements and application materials?
- (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?

Position: The requirements of a Capital Distribution Plan should depend on the bond structure proposed. In general, applicants should be able to demonstrate an intended pipeline of underlying assets and cash flow projections that illustrate the ability to service the guaranteed bond based on the expected terms and conditions of the assets in the pipeline.

(iv) 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?

Position: No, the CDFI Fund should not set minimum underwriting criteria for end-borrowers. CDFIs specialize in understanding risk in markets that are outside of the financial and economic mainstream, with a remarkable record of success and minimal losses and delinquencies. The Fund should rely on this unique experience by continuing to allow CDFIs to make the best decisions regarding the needs of their community.

6. Accountability of Qualified Issuers

(a) The CDFI Fund welcomes comments on how to monitor the use of proceeds and financial performance of qualified issuers, particularly with respect to the following questions:

(a) What tests should the CDFI Fund use to evaluate if 90 percent of bond proceeds have been invested in qualified loans? Should reports be required from the qualified issuer more frequently than on an annual basis?

Position: All risk share, credit and liquidity reserves should count as deployed assets for purposes of the 90% deployment test. In addition, all revolving loan fund facilities (such as working capital lines of credit for small businesses or real estate developers) should be counted as deployed assets for purposes of this test. Lastly, closed loan facilities (legally binding commitments to lend) should count as deployed assets, not outstanding balances. As explained in Section 2(C) in conjunction with the mechanics of the relending account, we don't believe the 90% deployment provision should be interpreted to deny small businesses and construction projects the short term capital they need to create new jobs or lead to imprudent guaranteed bond structures due to the failure to include risk mitigation reserves.

To enable maximum responsiveness to borrower needs and provide maximum flexibility in managing liquidity and asset-liability matching, the 90% deployment test should not be applied more frequently than once per year.

(c) What types of tests should the CDFI Fund use to evaluate satisfaction of the low-income or rural requirement set forth in Section 114A(a)(2)?

Position: The CDFI Fund should use a definition of low-income geographies based on Metropolitan Statistical Area rather than census tract. Applicants to the program should be allowed to target low-income populations as well as low-income geographies.

The CDFI Fund should use the US Department of Agriculture's definition of rural areas as defined in 7 CFR Part 3550, which defines rural area as:

(1) Open country which is not part of or associated with an urban area.

(2) Any town, village, city, or place, including the immediate adjacent densely settled area, which is not part of or associated with an urban area and which:

(i) Has a population not in excess of 10,000 if it is rural in character, or

(ii) Has a population in excess of 10,000 but not in excess of 20,000, is not contained within a Metropolitan Statistical Area, and has a serious lack of mortgage credit for low- and moderate-income households as determined by the Secretary of Agriculture and the Secretary of HUD.

(3) An area classified as a rural area prior to October 1, 1990, (even if within a Metropolitan Statistical Area), with a population exceeding 10,000, but not in excess of 25,000, which is rural in character, and has a serious lack of mortgage credit for low- and moderate-income families.

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

(e) What specific industry standards for impact measures (businesses financed, units of affordable housing developed, etc.) should the CDFI Fund adopt for evaluating and monitoring loans financed or refinanced with proceeds of the guaranteed notes or bonds?

Position: The CDFI Bond Guarantee Program can be an effective vehicle to track the substantive community and economic development impact of CDFIs. In particular, we believe that the CBGP represents an opportunity to move away from reliance on transaction-level data towards more comprehensive indicators of economic development.

Investment in a CDFI begins a chain of activity that ultimately finances small businesses, affordable housing, commercial development, and economic growth. The CDFI Fund should monitor/collect impact data as capital reaches end-borrowers. In cases where bond proceeds are utilized to refinance debt at the CDFI level, the Fund should enforce requirements to reinvest the funds according to section 108(b) of the CDFI Fund authorizing statute.

The following data points may be collected from participants in the CBGP. This small number of data points, self-reported by CDFIs, will provide a snapshot of CBGP activities and the impact it is making. The Fund should also consider other ways of reporting women and minority-owned businesses, such as husband/wife joint ownership.

- ***Total Financing Outstanding***
- ***Number of loans made***
- ***Direct Financing Outstanding for Businesses \$***
- ***Direct Financing Outstanding for Housing \$***
- ***Direct Financing Outstanding for Microenterprise \$***
- ***Direct Financing Outstanding for Other \$***
- ***Direct Financing Outstanding that meet the basic credit needs of Low- and moderate-income households \$***
- ***Direct Financing Outstanding for Community Facilities \$***
- ***Direct Financing Outstanding, Total Reported \$***
- ***Total Number of Housing Units Created or Preserved/Renovated in Fiscal Year (Projects developed by CDFI or organization financed #)***
- ***Total Number of Businesses Financed in Fiscal Year***
- ***Percent of Clients located in Major Urban areas % per Fiscal Year***
- ***Percent of Clients located in Minor Urban areas % per Fiscal Year***
- ***Percent of Clients located in rural areas % per Fiscal Year***

- *Percent of female Clients % per Fiscal Year*
- *Percent of clients served with low to moderate household income % per Fiscal Year*
- *Percent of Clients self-identified as a racial/ethnic minority % per Fiscal Year, if permitted by law*
- *Jobs created (direct, indirect, and construction)*
- *Jobs retained (direct, indirect, and construction)*
- *Estimated interest savings, where applicable*
- *CBGP dollars deployed to end-borrowers*
- *Total project financing involved (including leveraged financing related to the project or business being financed)*

In those structures where CDFIs are direct recipients of bond proceeds, this impact data should be required from the point at which a CDFI makes a loan/investment to an end-borrower. For bond structures where end borrowers are the direct recipients of bond proceeds, this impact data should be required at the point of receipt of bond proceeds. This data should be collected on a prospective basis until actual data can be collected and reported on a look back basis.

These data are available from most if not all CDFIs and provide the information necessary to provide a general picture of the scope, activities, diversity, and outcomes of the CBGP. These data points also paint a picture of economic growth and community development over short- and long-term periods of time, as opposed to the "snapshot" portraits provided by transaction-level data collection.

We also recommend that the Fund collect off-balance-sheet information to fully understand the assets managed by CDFIs, and because pooled bond structures will involve off-balance sheet Single Purpose Entities. A question might be: Please report your CDFI's off-balance sheet financing outstanding as it relates to the CBGP. This would include any financing that is not shown on your audit. Examples could be CBGP loans held in a separate entity, as well as loans you service for other financial institutions that are on their books.

(f) Should achievement of some standards or outcome measures be mandatory?

Position: Achievement of some standards or outcome measures should not be mandatory. Measurement of impact is a complex undertaking, and the extent of impact varies considerably from community to community and from transaction type to transaction type. It is inadvisable to apply an impact standard a priori across a program as diverse as the CBGP.

(g) Are the approval criteria for qualified issuers as listed in Section 114A(a)(8)(B) adequate? If not, what else should be included?

Position: In addition to the approval criteria mentioned in this Section, the Fund should incorporate the entity eligibility criteria cited in the answer to 4(a)(iv) of this document.

7. Prohibited Uses

(a) Section 114A(b)(5) provides certain prohibitions on use of funds including, "political activities, lobbying, outreach, counseling services, or travel expenses." The CDFI Fund encourages comments and suggestions germane to prohibited uses established in the Act, specifically as to whether there are other prohibited uses that the CDFI Fund should include.

Position: No additional prohibitions are suggested.

8. Servicing of Transactions

(a) Section 114A(f) states that, in general, to maximize efficiencies and minimize cost and interest rates, loans made under this section may be serviced by qualified program administrators, bond servicers, and a master servicer. This section further outlines the duties of the program administrator, servicers, and the master servicer. Comments regarding the servicing of transactions are welcome, specifically:

(i) The Act lists certain duties of a program administrator. Should there be other requirements?

(ii) The duties of a program administrator suggest that the CDFI Fund will serve as the program administrator for all issuances. Should the CDFI Fund require that each qualified issuer have a designated program administrator as suggested in section 114A(a)(7)?

Position: While some of the duties listed in the Act relating to program administrator may be appropriate for the CDFI Fund, others are not necessarily. For example, bond packaging is better left to the issuer or its designate (aggregator) and certain compliance monitoring is better performed by a servicer or the issuer (or its designate/aggregator). Therefore, we recommend that each Bond Guarantee applicant propose the responsibilities of each party to the transaction based on the specifics of the proposed structure and use of proceeds. That way, the CDFI Fund could act as program administrator for a particular guaranteed bond, but delegate certain responsibilities to other parties.

(iii) If so, should the servicer be eligible to serve as a program administrator for a qualified issuer?

Position: In cases where the CDFI Fund delegates certain program administrative duties to a third party, said third party should be able to serve as a servicer.

(iv) Who should be responsible for resolving troubled loans?

Position: In the case of troubled loans in the pool backing the guaranteed bond, a special servicer could be appointed. However, the guarantor should make this determination only after concluding that the originator (if serving the role of servicer)/issuer/aggregator is no longer competent or able to resolve the troubled situation.

(v) On what basis should servicers be compensated?

Position: The compensation should be market-based and determined on an application by application basis. Generally speaking, the basis should be either (a) a percentage of assets or (b) the number of loans in the pool that is backing the

guaranteed bond. It is difficult to set this requirement a priori because the servicing complexity of different kinds of bond structures will vary.

(vi) Are there any duties not listed that should be included in sections 114A(f)(2) through 114A(f)(4)? Are there any prohibitions or limitations that should be applied?

Position: The duties of “aggregation” should be included in these sections. Duties of an aggregator include: (a) creating the framework for an asset pool, (b) identifying and originating the loans that will go into the asset pool, (c) developing projections that will support repayment of the bond and (d) managing the asset pool through the maturity of the bond. These duties could be performed by a qualified issuer, or the qualified issuer could simply be a conduit designated by a qualified CDFI and the conduit could be managed by a third-party aggregator. The aggregator does not necessarily have to be a CDFI but must work at the behest of qualified CDFIs, and would have to be qualified to perform the duties outlined herein.

9. General Compliance

The CDFI Fund welcomes comments on general compliance issues related to monitoring the guarantee portfolio, particularly with respect to the following questions:

- (i) What types of compliance measures should be required by the CDFI Fund? Should the CDFI Fund mandate specific reports to be collected and reviewed by the servicer and ultimately the master servicer? If so, please provide examples.
- (ii) The Act states that “repayment shall be made on that portion of bonds or notes necessary to bring the bonds or notes that remain outstanding after such repayment into compliance with the 90 percent requirement of paragraph (1).” How should the CDFI Fund enforce this requirement?
- (iii) What penalties should the CDFI Fund impose if a qualified issuer is deemed noncompliant?
- (iv) The Act provides that the qualified issuer pay a fee of 10 basis points annually. What penalties should be imposed for failure to comply?

Position: Compliance measures under the CBGP should consist of “bright line” tests that are distinct from impact/outcome measurements. Along with the prohibitions on use of funds in 114A(b)(5) and the 90 percent deployment requirement in 114(A)(c)(1):

- ***All CDFIs participating in a bond issue at the Direct Issuer or Single Purpose Entity/ collaborative level should submit financial reports annually to the Fund at the end of the CDFI’s fiscal year.***
- ***In cases where a Single Purpose Entity will be the bond issuer, compliance measures should be applied to participating CDFIs as a whole—not on an individual basis.***
- ***In the event of non-compliance of a qualified issuer, there should be a cure period of at least 90 days.***
- ***If the Fund must enforce repayment of the bond due to expiry of all cure periods associated with failure to meet the 90 percent requirement, it should do so in a way that preserves the remaining outstanding of the bond at its original terms (e.g., same coupon, same remaining term, etc.) and releases a proportional amount of risk share or other credit reserves to maintain the original risk profile of the guaranteed bond.***

- *The Secretary of Treasury should reserve the right to permit extensions of the cure period, based on facts and circumstances, upon reasonable request.*
- *The 10bps administration fee should be priced into the bond issuance.*

10. General Comments

The CDFI Fund is also interested in receiving any general comments and suggestions regarding the structure of the CDFI Bond Guarantee Program that are not addressed above.

Position: The presence of the Federal Financing Bank as the sole investor of CDFI guaranteed bonds has many benefits in the beginning years of the CBGP. However, neither the Act nor the Request for Public Comments mentions any proscribed role of the FFB. Not much is known about the FFB and as such the industry is unable to make comments about the role of the FFB for CBGP. We strongly request that if the FFB has rules, requirements, structures or constraints that could affect how the CBGP will work, that the industry be allowed to learn how the FFB works and have input regarding their role and the opportunity to make public comment.

August 11, 2011

CDFI Bond Program

Guiding Principles for Design & Implementation

Introduction

The CDFI Bond Program established by Section 1134 of the Small Business Jobs Act of 2010 is meant to encourage creation of a new type of security that would provide access to responsible financing for disadvantaged communities at meaningful volumes, affordable cost, and long terms. If successful, this Program could dramatically improve access; recapitalize CDFI balance sheets, improving profitability and financial stability; and help banks and other mainstream financial institutions increase their financing in partnership with CDFIs for the benefit of low-income and low-wealth communities. As a result, the number of jobs created and maintained, the supply of quality, affordable housing, and access to vital community facilities and services all would increase. In short, the CDFI Bond Program would give CDFIs, which are playing an increasingly central role to a wide range of financing strategies, access to a reliable supply of capital with a term and cost structure that has never before been available.

To help ensure that the program is designed and implemented consistent with congressional intent and in the best interests of the people and communities that CDFIs serve, Opportunity Finance Network, recommends that this set of principles serve as the foundation for the CDFI Bond Program. Developed with the undersigned CDFIs, these principles rest on decades of CDFI experience in accessing and deploying capital with good financial and social results. At the same time, they incorporate the CDFI industry's experiences leveraging public investments to public purposes.

This program reflects the CDFI Fund's CDFI financial assistance program model, a unique federal financing program that makes flexible equity and debt investments in CDFIs based on business strategies and financial performance. In a proven and scalable approach, this model enables CDFIs to respond quickly and creatively to changing market conditions, as they have proved able to do for more than 30 years. As the enabling legislation amends the Riegle Community Development and Regulatory Improvement Act of 1994 (12 U.S.C. 4701 et seq.), which established the CDFI Fund, it is fitting that this Program be administered by the CDFI Fund.

The CDFI Bond Program should increase the ability of CDFIs to provide financing that benefits low-income and low-wealth people and places. Under the Program, new investors will purchase, hold and trade CDFI bonds based on the 100% US Treasury guarantee provided in the statute, enabling CDFIs to access capital markets directly. In this way, the CDFI Bond Program opens a door to billions of dollars of new capital in support of community development. Through the CDFI Bond Program, CDFIs can expand their capital sources, leveraging decades of pioneering investments by private foundations, banks, the government, and others.

The CDFI Bond Program should enhance existing federal community development and community development finance policies, not replace them or compete with them. This program does not obviate the need for the Community Reinvestment Act nor is it a suitable substitute for affordable housing finance that government-sponsored enterprises provide. This is a CDFI financing program for CDFIs that CDFIs must be able to access at reasonable cost and with minimal complications to deliver affordable and responsible financing to low-income and low-wealth people and places.



To these ends, the CDFI Bond Program should:

I. Fit the full range of CDFI financing strategies, including new uses of proceeds made possible by the long-term capital the Bond Program provides. CDFIs are uniquely qualified to find customized financing solutions to challenging market conditions and demands. The CDFI Bond Program should encourage and support this key innovation role.

A. Eligible Bond Proceeds must include:

1. All loan and investment types (amortizing, bullet, working capital, construction, secondary capital investments etc.) and financing segments (business, multi-family and single family housing, real estate, etc.) as long as they meet the definition of community or economic development as defined in the statute, i.e., same definition used in the Riegle Community Development and Regulatory Improvement Act of 1994, which created the CDFI Fund (Eligible Loans)
2. Eligible Loans to CDFIs or Eligible Loans originated, managed or controlled by CDFIs to end borrowers
3. Purchase or origination of Eligible Loans
4. Refinance of existing Eligible Loans
5. Eligible Loans to for-profit and non-profit borrowers, alike
6. Replacement of existing financing for Eligible Loans

B. Use of the Guarantee must be consistent with the Use of Eligible Bond Proceeds:

1. The Guarantee should guarantee Eligible Loans whether made to CDFIs or originated, managed, or controlled by CDFIs to end borrowers.
2. Once a Guarantee is issued for a qualifying purpose, it should be irrevocable so long as the CDFI or its designee qualified issuer (as defined in the statute) is duly certified by the CDFI Fund.

For the sake of this principle, loans originated by non-CDFIs should be Eligible Loans only if the issuing CDFI or its designee determines that it is Eligible and if that CDFI controls the use of proceeds.

II. Rely on CDFIs to ensure the public purpose impact of the program is met. Under the Riegle Act, CDFIs are required to use their resources for specific public purposes.

- A. Participating CDFIs must certify that the use of proceeds benefits the communities and targeted populations served by CDFIs.



- B. Issuers must be established CDFIs, single purpose entities controlled by CDFIs created expressly for the purposes of a bond issue under the Program, or Bond Authorities designated by a CDFI.
- C. Issuers must be held accountable for creating positive impact on affected communities. To ensure efficient and cost effective bond issuance, investors must be able to rely on CDFI certification of eligible public purpose uses of funds as a “safe harbor” from future regulatory and/or legal action.

III. Encourage a variety of financial structures that are responsive to the needs of the target communities. The immediate needs of underserved markets as well as the long-term sustainability of CDFIs and the CDFI Bond Program require that CDFIs are able to create structures appropriate to their financing strategies based on market conditions and needs. Constraining the range of structures would inadvertently benefit some markets and disadvantage others.

While no one structure should dominate, the CDFI Bond Program must be flexible enough to accommodate:

- A. Aggregation of loans from various originators (directly or indirectly) and single originators (direct or indirect)
- B. General recourse to individual CDFI(s) and limited, asset-based recourse to a pool of Eligible Loans
- C. Eligible Loans originated by a wide array of qualified CDFIs including rural, Native American, small, large, and from all 50 states.
- D. Secondary Market transactions

IV. Be based on CDFI assessments of risk. CDFIs specialize in understanding risk in markets that are outside the financial and economic mainstream. They have a remarkable record of success at serving those markets with minimal losses and delinquencies. The CDFI Bond Program can and should rely on this unique expertise.

- A. The process and criteria for underwriting should be market driven not government-prescribed.
- B. Underwriting criteria and individual bond structures (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 not on a generic, one-size-fits-all set of requirements.

V. Increase in material ways CDFI access to new investors and sources of capital. CDFIs have grown steadily for the last 30 years without substantial access to capital markets. The CDFI Bond Program has potential to open important growth opportunities for investors and CDFIs.

- A. Bonds should appeal to new classes of investors and as broad a set of investors as possible.
- B. Bonds should not have restrictions or requirements that make them ineligible for major investor classes, e.g., pension funds, insurance companies, mutual funds, etc.



- VI. Make participation efficient for CDFIs and investors.** The structures of bonds are inherently complex. The design and implementation of the CDFI Bond Program should minimize costs that might price products out of reach of the markets they are intended to serve. CDFIs serve opportunity markets that have very little tolerance for additional transaction costs or fees added to interest margins.
- A. The Program should screen applicants using standard, transparent criteria. The allocation of bond authority and use of the guarantee must be straightforward and must not impede rapid and responsible implementation.
 - B. The form, structure, and function of the federal guarantee should be straightforward, efficient, and clear to ensure that investors purchase, hold, and trade the bonds based on the guarantee not the underlying CDFI credit risk or the risk of the Eligible Loans.
 - C. The program should be cost effective for CDFIs to structure and manage.
 - D. Issuers should be selected based on their proposed strategy for deploying bond proceeds and their historical track record in meeting the needs of their targeted communities as opposed to a broad, generic measure of impact.
- VII. Should not incorporate government requirements that restrict the effective use of the Program or issuance of individual Bonds.** For example, regulations meant for very large banks were applied with significant adverse consequences to CDFIs participating in the Community Development Capital Initiative (CDCI). This constrained both CDCI and CDFIs and, so, the markets they were trying to serve.
- VIII. Produce Results in CDFI markets.** The opportunity markets that CDFIs serve are distinct from conventional markets in multiple ways. First and foremost, they are profitable but not profit-maximizing. That is why CDFIs, and not other financial institutions, serve them. Second, they are constrained by adverse economic factors such as exceptionally high unemployment, poor housing stock, and limited services. That is why public investment in opportunity markets through CDFIs is sound policy. Third, they are breeding grounds of innovation and opportunity led by talented, entrepreneurial residents. Finding and fostering those innovations and opportunities is what CDFIs do best.
- A. The CDFI Bond Program should be designed and implemented as a vehicle for CDFIs to access new sources of low cost, long-term debt to strengthen and sustain their financing strategies.
 - B. Oversight and evaluation should be performance-based. CDFIs participating in the CDFI Bond Program have an obligation to their customers, their investors, the federal government, and taxpayers to produce the best possible balance of impact and financial returns, consistent with the purpose of the Program.



- C. Performance evaluation should be outcome-based. No two CDFI-based bond issues will produce the same results. CDFIs should be held accountable to the outcomes and impact that they propose to produce under the Program.

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