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Bank of America's Strategic Approach to Investing in CDFIs

by Bob Bidal, *Senior Vice President, Bank of America*

Vista Las Flores Affordable Housing
This 28-unit affordable housing was financed through the Low Income Housing Fund (LIHF) in California. A joint venture of the Wakeland Housing and Development Corporation and the San Diego Interfaith Housing Foundation is providing affordable rental housing for families.

Community Development Financial Institutions (CDFIs) play an important role in our communities. They also play in important role at Bank of America. While CDFIs are an effective way for financial institutions to channel capital to communities in need of development, they can also be strategically approached as an effective tool for investors.

CDFIs provide grassroots funding to borrowers that traditional banks may not have the resources to reach. They differ from conventional financial institutions in that they focus on a community development mission as well as their own profitability. The loans they make often require extensive staff time per transaction plus provision of technical assistance to help borrowers use funds effectively. CDFIs are uniquely positioned to bring together loan capital with the technical assistance that is crucial to successful lending in this arena. They also are eligible to access public and grant sources to fund the assistance.

Bank of America has a long history of investing in CDFIs and created a formal CDFI program in 1996. At year-end 2001, the company had 98 relationships with CDFIs, representing 135 investments with nearly $190 million in funds committed or outstanding. CDFI loans and deposits are delivered through market-based Community Development Lenders along with a variety of other community development banking products and other banking services. There is a centralized staff to provide administrative support for underwriting, closing and monitoring CDFI products.

As with any investment, banks need to strategically partner with CDFIs. Fundamental to a successful strategy is the precept that loans must be repaid and that not every application will qualify for approval. Banks are facing more limits on equity, and only when loans are repaid can the flow of capital continue to circulate, creating stronger, more effective CDFIs and bringing sustainability to their endeavors. With the right approach, banks can ensure that CDFI investments will make good business sense as well as a positive impact in underserved communities.

We have found three key assessments for an effective CDFI investment strategy. First, assess the market context within which a CDFI operates. Second, assess the CDFI's capacity to succeed. Third, assess the opportunity to interact with the CDFI on more than one level — to partner in activities such as affordable housing or workforce development. All are key to ensuring sustainability. (Please see the National Community Capital Association's CDFI peer group and key ratio analysis in the electronic article "Growing Opportunities in Bank CDFI Partnerships.")

Assessing market context

At the outset, a bank must recognize that there are certain advantages and disadvantages to using a particular CDFI vehicle based on market context. For example, when neighborhood residents need access to basic financial services such as checking and savings accounts, a community development credit union may be an appropriate market alternative. We place insured deposits in community development credit unions to increase their liquidity and capacity to serve the unbanked. Community development credit unions vary considerably. Some are faith-based, such as the TBC Federal Credit Union in Richmond, VA. Others may serve particular ethnic groups, such as *Cooperativa Communitaria Latina de Credito*, the Latino Community Credit Union in Durham, NC.

When there is an entrepreneurial culture in a community and limited employment opportunities, a microenterprise fund — such as ACCION Texas, headquartered in San Antonio — might be the best vehicle to address the community's needs. When the need for capital is more broadly based, a community development loan fund such as the New Mexico Community Development Loan Fund might be the appropriate mechanism. We typically make loans with terms of up to ten years to such lenders.

Assessing capacity for success

As a result of the extensive staff time and technical assistance required to make the loans, in-kind or financial support is often needed to help a CDFI cover transaction costs and become self-sustaining. An objective assessment of such needs and a plan for helping the CDFI meet them should be part of a bank's evaluation of the CDFI.

CDFIs must follow sound business principles to succeed. How well they do so can be a good indicator of their potential for success. Key factors that banks should look for include:

- **Clear Strategy**. Is the CDFI's strategy well articulated and understood both by CDFI personnel and the community?
- **Strong Management**. Does the CDFI have strong staff leadership and an actively involved board?
- **Market Driven**. Does the CDFI respond to the evolving needs of the market?
- **Appropriate Financial Structure**. Does the CDFI have the right mix of grants, interest income and other revenue to sustain business objectives?
- **Balanced Success Measures**. A commitment to community development isn't enough. An appropriate balance between mission and successful lending is all-important.
- **Distinct Credit Culture**. Does the CDFI have a clear approach to lending, with appropriate credit policies and procedures in place?
- **Risk Management**. The CDFI must have policies in place to manage the key drivers of the business: portfolio mix, adequate reserves, interest rate spread and asset/liability management.

Partnering on other levels

While it may not be feasible in every case, looking for ways to expand a relationship should always be part of a bank's CDFI investment strategy. In addition to providing capital, banks can provide other mutually beneficial services, such as treasury management and other depository services. This partnership should yield referrals and create opportunities for close teamwork on loan and development projects.

To illustrate, we've developed a relationship with the Low Income Housing Fund (LIHF) that transcends conventional CDFI investing. LIHF was founded in 1984 to address the housing needs of low- and moderate-income families and communities. In 1996, Bank of America made a $1 million CDFI loan to capitalize a revolving fund for loans to be made in the bank's market areas. Based on the success of this initial loan, we were able to make another loan of $5 million in January 2001. In addition, we placed a $5 million deposit with the CDFI, qualified by the state of California through the California Organized Investment Network for an investor tax credit. The combination of a Bank Enterprise Award (BEA) received on this loan (see below) and the tax credit enabled us to make the loan on more favorable terms than would otherwise have been possible.

We've also worked closely with LIHF to develop affordable housing. In November 2001, the Wakeland Housing and Development Corporation and the San Diego Interfaith Housing Foundation opened Vista Las Flores (see photo above), a 28-unit affordable housing project. LIHF provided the soft-cost financing that is often difficult to obtain for such projects: technical assistance and a $150,000 predevelopment loan funded from the revolving loan fund. Bank of America, in turn, provided the construction financing for the project through its Community Development Banking group. Financial teamwork brought the project to fruition.

BEA and CRA: Under the CDFI Fund's Bank Enterprise Award (BEA) program, banks can apply for federal awards for qualified investing in certified CDFIs and for making other specific types of community development investments. We've used BEA to build a firm foundation and a safety net under our CDFI program. Since below market returns on CDFI investments are typical, the BEA program awards can either augment return or can help to fund loan loss reserves. "The BEA program has been critical to our success in leveraging capital for deployment as CDFI investments," says Mary Schultz, CDFI investment manager at Bank of America. CDFI investments can also earn CRA credit for banks as indirect investments where few direct investment opportunities may exist. (Please see the sidebar about the BEA program in"Bank Enterprise Awards and New Markets Tax Credits: Two Tools to Increase the Flow of Private Capital in Targeted Markets.")

What is the key to our success? We've adhered to a clear strategy, worked with effective partners, and leveraged resources. As a result, we've been able to create affordable housing, employment opportunities, community facilities — and a sustainable program. Although our available capital for CDFI investment is currently oversubscribed, we hope to do more lending as loans are repaid and more funds are allocated to our program.

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