Community Development Financial Institutions Fund
U.S. Department of the Treasury

Community Development Financial Institutions Program
2004 Financial Assistance Component

Application Feedback

Part I: Overview of the Review Process
Part II: Characteristics of a "Good" Application

NOTE: Parts I and II below describe the review process that was used by the CDFI Fund under the Fiscal Year 2004 Financial Assistance round. The CDFI Fund reserves the right to modify this process in future funding rounds, consistent with requirements specified in the applicable Notice of Funds Availability (NOFA) and related application materials.

Part I. Overview of Review Process

A. Initial Review

Eligibility –Upon receipt of an application, Fund staff members reviewed all applications to determine that each one met all critical completeness requirements and eligibility standards as set forth in the NOFA. Key eligibility criteria included being certified as a CDFI (or having submitted an application indicating that the Applicant could be certified as a CDFI). Additionally, Applicants that were prior awardees of the Fund were reviewed to determine that:

- The Applicant was current on all required reporting to the Fund;
- The Applicant did not have a significant un-drawn balance on any award made prior to 2002; and
- The Applicant did not exceed the statutory funding caps.

Capital Need - For Applicants found to be eligible, staff reviewed each Application for capital need. This review evaluated the Capital Need charts and the related narratives.

- Applicants that had a "yes" answer on a Capital Need chart, or satisfactorily demonstrated capital need in the narrative, were forwarded for further review for those product types (Affordable Housing, Economic Development, Community Development Financial Services, and Other) for which capital need was shown. Applicants that demonstrated capital need for one but not all products within each product type were forwarded for further review for the whole product type.

- Applicants that demonstrated capital need for multiple product types were forwarded for further review for each product type for which they demonstrated capital need.

- Applicants that did not demonstrate any capital need (either in the Capital Need charts or in narrative) were rejected without further review.

Matching Funds – Fund staff reviewed matching funds documentation submitted. Staff determined the level of matching funds available in-hand or firmly committed. Additionally, for SECA/Category I Applicants, staff determined the level of matching funds likely to be raised. If needed, Applicants were contacted for clarifying information, but applicants were not able to submit documentation of additional matching funds received. The amount of matching funds available (plus to be raised, in the case of SECA Applicants) was used to determine the maximum award amount for that Applicant. If an Applicant did not demonstrate any eligible matching funds, the application was rejected without further review.

Substantive Review – Three reviewers independently reviewed and scored the business plan portion of each application that met the eligibility, Capital Need, and Matching Funds requirements. The reviewers included Fund staff, other Federal community development experts, and private-sector community development finance professionals. The Fund carefully screened each reviewer to identify and avoid any potential conflicts of interest with Applicants. The Fund provided reviewers with focused training to prepare them for the review process. The Fund also provided reviewers with guidelines to assist them in scoring each application.

- **Scoring** – To score each application, reviewers responded to a number of questions corresponding to the information requested in the application. Each item was rated good, satisfactory, or unsatisfactory and assigned a prescribed number of points. Applicants with multiple products received separate scores for each product.

- **Recommendations** – Each reviewer recommended a funding amount based on their scoring and evaluation of the application.

- **Scoring Anomalies** - A scoring anomaly was defined as a difference of 30 percent of available points (either for one or more sections, or in aggregate) between two or more reviewers. If a scoring anomaly occurred, the application was re-scored by another reviewer who had not previously reviewed the application, and the new score replaced the anomalous score if it was closer to the other two scores. If not, the original score remained as part of the aggregate score. The additional reviewer was selected consistent with the Conflict of Interest procedures.

B. Phase 2 Review and Award Selection

Ranking - Applicants that achieved the minimum passing score described below were ranked by their aggregate score for the Market Need and Community Development Performance (MNCDP) section. Each product type for which an Applicant applied received a separate score and ranking.

Minimum Passing Section Score by Applicant Category		
	Category I Applicants	**Categories II & III Applicants**
Financial Health & Viability	60 out of a possible 150	75 out of a possible 150
Management & Underwriting	60 out of a possible 150	75 out of a possible 150

Phase 2 Reviews - Highly ranked applicants were considered in Phase 2 review. Applications that advanced to Phase 2 were assigned to Fund Program staff for follow-up review, consistent with Conflict of Interest procedures. The follow-up reviewer sought to resolve any critical outstanding issues related to matching funds and issues raised by readers, and identified any critical information which would prevent the Applicant from carrying out the activities proposed in its application and/or effectively use CDFI Fund dollars. The Fund also consulted with an Applicant's regulator, if applicable.

- **Phase 2 Scoring** – The follow-up reviewer made any scoring adjustments justified by new information received. These score adjustments were then reviewed by a more senior staff person to ensure that the guidelines, policies and procedures were followed.

- **Prior Awardee Review and Scoring** - Concurrently, the Fund reviewed each Applicant's reporting history with the Fund, if applicable. Applicants that were prior year awardees (with active awards or awards that terminated in calendar year 2003) that had a history of late reporting, late loan payments, and/or substantive non-compliance received point deductions. The Fund used only 2002 and 2003 reporting and compliance history to make these determinations.

    - "Substantive noncompliance" was defined as any failure to meet the terms of an Assistance Agreement that was deemed by the Fund as either:
        - An event of default of the awardee's Assistance Agreement or;
        - Negatively reflective on the awardee's ability to manage the activities identified in the application.

- Applicants that had late reports (in 2002 or 2003) had points deducted as a result of late submissions of their Semi-Annual, Annual, or Financial reports.

- Applicants with loans from the Fund lost points for each instance of a payment that was more than 30 days late or outstanding as late at the time of application.

Final Ranking - The final ranking of Applicants was based on the final aggregate score resulting from the Phase 2 review. Within each Programmatic Priority (as defined in the NOFA), Applicants were ranked by their MNCDP score. Applicants were funded in all four Programmatic Priorities.

- Applicants were selected for funding from both the Category I pool and the Categories II/III pool in equal proportions in rank order.

- However, some lower-ranked Applicants did not receive the full level of funding for which they were qualified, based on funding availability.

Part II. Characteristics of a "Good" Application

The highest score for any question was a score rated as "good." In order to receive a score in the "good" range, Applicants generally needed to demonstrate the characteristics described below.

A. Market Need and Community Development Performance

A-1. Market Need Analysis:

To be rated **Good**, an Applicant needed to demonstrate the following characteristics:

- A good understanding of its current and projected Target Market, including the individuals it seeks to serve and the market forces in the market.
- Products and services that closely address the needs and demand of the Target Market.
- A strong case that it is providing products or services not provided by other institutions serving that Target Market.
- A strong track record in its Target Market that is applicable to the needs and demands of the new Target Market, if the Applicant is expanding its Target Market.
- A strong track record serving its historic Target Market that is applicable to the successful deployment of the new product, if proposing a new product.

The following is an example of a "Good" Market Need and Community Development Performance Market Analysis narrative:

The Applicant is a community development loan fund committed to serving the financial needs of micro-enterprises. Using a step lending approach, the Applicant currently offers several different loan products, increasing the loan amounts available to borrowers as they grow and expand:

Product A, ranging from $1,000 to $5,000
Product B, ranging from $5,000 to $20,000
Product C, ranging from $20,000 to $50,000

The Applicant retained a consultant to conduct a market analysis of the micro-finance needs of its existing client base. The analysis identified a significant demand for micro-loans in the target market under $50,000, with very few providers focused on loans under $25,000. The analysis -- and later additional research conducted by the Applicant's staff -- determined an underserved market for debt financing. From the Applicant's experience with its borrowers, micro-enterprises may be able grow beyond the limits of Applicant's existing products, but may still have financing needs beneath the minimum loan requirements of banks and other CDFIs. A somewhat larger loan product is thus particularly needed by small businesses experiencing high growth, but which need patient capital to support this growth.

In response to this underserved market need, the Applicant plans to use the FA to support its B and C products. It is expected that many of the Applicant's existing borrowers will "graduate" to the larger loans.

A-2. Product Design and Strategy:

To be rated **<u>Good</u>**, the Applicant must have demonstrated that its products and services meet the needs and demands of potential customers in the Target Market, through features such as those listed below.

- Use of flexible underwriting;
- Extended or flexible terms;
- Products that differ from other providers serving the Target Market;
- Strategies for developing and testing products (for new products);
- Effective plans for marketing and delivering products and services to the Target Market;
- Coordinating with other providers serving the Target Market; and
- Coordinating with the existing economic and community development plans, housing development plans, and/or private sector resources within the Target Market.

All implementation strategies must have demonstrated that they were a good use of scarce public resources and likely to result in significant benefits to the Target Market. Additionally, Category III Applicants must have demonstrated a high level of leveraging of private sector dollars in the last three years.

A-3. Programmatic Priorities:
To receive Programmatic Priority points, Applicants must have demonstrated the following:

1) A strong level of historic and projected financing activities and other services in the Programmatic Priority markets, and;
2) A strong level of historic and projected community development impact indicators in Programmatic Priority markets.

B. Management and Underwriting

B-1. Management Controls:
To be rated **Good,** Applicants must have demonstrated management controls that included the following (as applicable):

- regular and timely portfolio reviews;
- methodologies for addressing delinquencies and defaults;
- loan charge-off policy that requires charge-offs not later than 120 days past due;
- methodology for structuring investments to manage risk and enhance likely returns that is appropriate for its product and Target Market served;
- underwriting/review criteria that lead to sound loans or investments and provide sufficient flexibility to address non-traditional loans/investments;
- appropriate methodology for addressing earnings benchmarks not met by portfolio companies;
- re-valuation of the equity investment portfolio at least annually using an appropriate valuation methodology;
- portfolio diversification and investment limits;
- methodologies for working with borrowers with no or blemished credit (while ensuring re-payment);
- consideration of borrowers/deals that are outside of the organization's underwriting standards;
- adequate internal controls over idle cash, checks and liquid assets;
- safeguards against conflicts of interest;
- reviews of internal and audited financial statements; and
- methodologies for determining liquidity reserves.

B-2. Management Team
To be rated **Good**, Applicants must have demonstrated the following.

- An appropriate level of qualified human resources available to implement the Comprehensive Business Plan, including maintaining financial soundness and compliance with an Assistance Agreement. An appropriate level of resources includes:
  - an organization head who dedicates the appropriate level of time given the Applicant's activities and stage of development;
  - sufficient qualified staff (or other human resources); and
  - organizational roles and responsibilities that are clearly described and appropriate for the Applicant's current and proposed activities.

- A board of directors with the ability to effectively serve the Applicant and be responsive to the issues of the Target Market. The board (and advisory board, if applicable) should demonstrate ability to considerably strengthen the Applicant through all of the following:
  - fundraising and capitalization skills;
  - involvement in determining policies
  - clear and appropriate roles and responsibilities of board working committees, including fiscal and management oversight; and
  - otherwise complementing the skills and experience of Management Team in the areas of Target Market knowledge, community development, community development finance, and underwriting.

B-3. Portfolio Quality:

To be rated **Good**, Applicants must have demonstrated that they met the following Minimum Prudent Standards (MPS), as applicable.

Loan Portfolio Quality

	Non-Regulated Entities *Historic: 3-Yr Average*				**Insured Credit Unions (ICU)** *Historic: Last completed FY*	**Insured Depository Institutions (IDI)** (includes Depository Institutions Holding Companies) *Historic: Last completed FY*
	Affordable Housing-First Lien	*Affordable Housing-Subordinate Lien*	*Business*	*Micro & Consumer Loans*		
Portfolio-At-Risk (PAR)	<=3.00%	<=6.00%	<=9.00%	<=11.00%	Delinquent Loans/Total Loans ≤ 3.5.0%	Non current Loans & Leases/Total Loans & Leases <= 2.0%
Annual Net Loan Loss Ratio	<=1%	<=3%	<=5%	<=9%	Net Charge offs/Average Loans ≤ 0.75%.	Net Loss/Avg Total Loans & Leases <=0.5%
Loan Loss Reserves (LLR) Or Provision for losses	.5PAR <= LLR <=1.5PAR	.5PAR <= LLR <=1.5PAR	.5PAR <= LLR <=1.5PAR	.5PAR <= LLR <=1.5PAR	Comparing FY02 and FY03, Applicant's dollar amount of provision for loan losses changed by at least the same percentage and direction as the change in the dollar amount of delinquent loans.	Loans & Leases Allowance/Total Loans & Leases >= 0.5PAR

B-4. Equity Investment Portfolio

To be rated Good, Applicants must have demonstrated the following:

- The Percentage Change in Portfolio Value is not less than -15% (negative fifteen percent).
- The portfolio was valued by a party other than the Applicant or an Affiliate.
- The Applicant's Actual Rate of Return was at least 70 percent of the Projected Rate of Return.

C. Financial Health & Viability

To be rated **Good**, Applicants must have demonstrated that they met the following Minimum Prudent Standards (MPS), as applicable, for the last three years, and project to meet them for the next three years.

	Non-Regulated Entities	**Insured Credit Unions (ICU)**	**Insured Depository Institutions (IDI) & Depository Institutions Holding Companies (DIHC)**
	Historic: 3-Yr Average *Projected: 3-Yr Average*	*Historic: Last completed FY* *Projected-3-Yr Average*	*Historic: Last completed FY* *Projected-3-Yr Average*
Capital	Non Profit: Net Assets/ Total Assets ≥ 25%	Net Worth/Total Assets ≥ 6%	Tier 1 Leverage Capital >= 8%
	For Profit: Shareholders Equity/ Total Assets ≥ 25%)		
Deployment	Deployment Ratio ≥ 50%	Total Loans/Total Shares ≥ 60%	Total Loans/Total Deposits >= 65%
Earnings	Net Income ≥ $0	Return on Average Assets ≥ 0.75%	Net Operating Income/Average Assets >= 0.65%
Self-sufficiency	Self-Sufficiency Ratio, Non-Profit: ≥ 40%	N/A	N/A
	Self-Sufficiency Ratio, For-Profit: ≥ 70%		
Capital Liquidity	Current Ratio ≥ 1.0	**Asset-Liability Management**: Investments w/ maturity or re-pricing period of less than 1 yr /Total Investments ≥ 46%	**Asset Liability Management**: Net Non Core Funding Dependence <=21%
Operating Liquidity	Operating Liquidity Ratio ≥1.0	N/A	N/A