Remarks by

Tony T. Brown, Director

Community Development Financial Institutions Fund (CDFI)

to the

18th Annual Training Conference of the National Community Capital Association

Marriott City Center
Oakland, California

November 1, 2002

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS (CDFI) FUND

FOR IMMEDIATE RELEASE
November 1, 2002

Contact: Bill Luecht
(202) 622-8042

Remarks by Tony T. Brown, Director
Community Development Financial Institutions Fund
U.S Department of the Treasury
to the
18th Annual Training Conference
of the
National Community Capital Association

Marriott City Center
Oakland, California

Good afternoon. Thank you, Mark, for the kind introduction. The theme for NCCA's 18th annual training conference, "Managing Change: The New CDFI Era," is quite appropriate for the CDFI Fund itself. It has been about 15 months since I joined the Fund and I can tell from your telephone calls and letters that the Fund is important to you and that you care about its direction, and the support from Congress and the Administration. I have been invited to share the Administration's vision for the Fund and our strategic initiatives and to give you an overview of what to expect in the next cycles of program funding and investments.

Well, we have had a busy year. Before I discuss our vision and change, I would like to highlight some key accomplishments this past year.

A year ago, at NCCA's annual conference in Memphis, I promised you that we would concentrate on operating efficiencies and I am very pleased to report several early successes:

- We talked about quicker award selections and award disbursements. We did it! All FY 2002 CDFI Program award selections decisions were made by July 30.
- We fast-tracked the closing and disbursement of TA awards: the first disbursement of a FY 2002 award occurred on August 26 (before the fiscal year was even over), and they are continuing.
- We fast-tracked the BEA award and disbursement process. August 1st was the date that BEA Assessment Period documentation was due. On August 29th, BEA awards were announced. And by September 30th, nearly 80% of the FY 2002 BEA awards were totally disbursed.
- We are speeding up the time it takes to close an award. 100 percent of the FY 2001 CDFI Program awards have been either closed and disbursed or are in the disbursement pipeline. The Fund's staff has completed their work in record time. Those FY 2001 awards that are not disbursed are primarily to awardees that are noncompliant with previous awards, are under review with their regulatory agency, or the CDFI is busy raising the required matching funds for their awards.

- Staff has completed work on about one-half of the FY 2002 Core awards; those awards are now in the closing and/or disbursement pipeline and our goal is to disburse 80% of these awards before year-end.

- While all of these accomplishments were achieved, the Fund also managed to design and implement the New Markets Tax Credit Program.

We have had a very busy year!

Now, let me talk vision and change.

As you know, our vision at the Fund is to have an America in which all people have adequate access to credit, capital, and affordable financial services. If you have been following our budget submissions and annual or accountability reports over the past several years, you will see a major revision when the FY 2004 budget is submitted. Nearly 20 goals and measures once defined what we do.

The Fund's new Performance Plan has one goal and four objectives, which state that our strategic focus is to "improve economic conditions in underserved areas through better access to capital and financial services." Our tools of delivery are certified community development financial institutions, regulated banks and thrifts and now, with the introduction of the New Markets Tax Credit Program, we can include certified community development entities.

The Fund's objectives for its investments are simple and clear:

1. A first objective is to increase financing to businesses and individuals desiring to start or expand businesses with low wealth, limited capital and that are located in underserved communities;

2. A second objective relates to affordable housing: we are committed to helping President Bush achieve his affordable housing agenda by funding CDFIs whose financing activities expand the supply and quality of housing units for underserved communities and populations; as well as increase homeownership rates among minority groups;

3. A third objective relates to access to financial services: with our fellow Treasury offices, we participate in the Administration's efforts in expanding access to affordable financial services to the unbanked, low-income persons and others in underserved communities, and in expanding financial literacy; and

4. Fourth: we continue to focus on our traditional goal of expanding the capacity of CDFIs to lend and provide financial services in our nation's distressed and underserved communities.

The current budgetary resources of the Fund are somewhat limited, so we have proposed to target our investments in the areas where community development financing activities are needed most.

Beginning with the FY 2003 funding cycle, the CDFI Program and BEA Program may be revised in a number of important ways. Ideas that we, the Fund and Treasury, are considering including target funding to areas with the greatest need and requiring awardees to exercise enhanced accountability relative to financial assistance awards. If adopted, the changes will include:

- The Fund's CDFI Program resources will give funding priority to areas with the greatest needs (to be called "Hot Zones") for affordable housing production, low-income home ownership opportunities and job-creation activities.

- The Fund will use a "Growth Continuum" philosophy - as CDFIs grow in size and scale, the Fund will give more emphasis on the need for increased private sector funding along the way.

- A new BEA Program award formula would eliminate awards for CDFI bank transactions with other CDFI banks; we will continue to prioritize BEA awards for investments and support into CDFIs; development and service activities in the BEA program will be prioritized for loans in support of affordable housing production and small business loans, as well as deposit services for unbanked populations.

- A new performance rating system will rate CDFIs by their financial strength and their community development impact - PLUM (Performance/community development impact; Liquidity and overall financial condition; Underwriting/portfolio quality; and Management capacity).

- Baseline performance measures for the new plan would be set beginning in FY 2003 with better tools for tracking results and applied use of Fund program awards.

My telephone has been ringing off the hook regarding the Fund's Hot Zones proposal! The questions have been what are they and how will they influence the Fund's investment decisions. Let me answer each of these questions:

What are Hot Zones (HZs)?

- To target limited federal resources to areas of greatest need, the Fund will classify certain geographic units as "Hot Zones." For the FY 2003 funding round of the Financial Assistance Component of the CDFI Program, the Fund is considering giving underwriting priority to funding applicants serving Hot Zones. Hot Zones are a subset of Investment Areas. For the FY 2003 FA Component funding round, there will be two specific types of Hot Zones, as follows:

- <u>Economic Development Hot Zones (EDHZ)</u>: geographic areas with high unemployment and poverty rates:

  - EDHZs have been defined for metropolitan areas (urban) by census tracts and by counties for non-metropolitan areas (rural); and

  - A minimum population of 2,500 is required for all defined areas.

- **Housing Hot Zones**: geographic areas with high housing costs burdens (we have made provisions for homeownership and rental strategies):

  - Rental HZs are largely focused in areas with high poverty; and

- Homeownership HZs are set by high housing costs burdens.

Other key points:

- Hot Zones are a subset of Investment Areas, which means each such area must meet the 80 percent or less median income or 20% or more poverty thresholds;

- Most Native American Reservations and Trust Lands are HZs, as long as it otherwise meets Investment Area criteria - the population minimum will not matter for HZ consideration.

How will Hot Zones influence the Fund's Investment Decisions?

- Underwriting priority to CDFIs will largely be determined by the economic conditions of the target markets defined by CDFIs and the degree to which CDFIs produce financing activities within Hot Zones.
- Interagency affordable housing and economic development targets will be considered based on initiatives by other Federal agencies such as HUD, Commerce and SBA;
- CDFIs will be able to ask the Fund to consider other Federal community development initiatives based on a description of local data and independent research.

To date, we have certified 603 financial institutions as CDFIs across the country. The organizations we certify are engaged in a variety of activities.

We continue to certify and re-certify about 200 new CDFIs each year. Yet, it is not the number of CDFIs certified that is the goal. It is the fact that these CDFIs serve 98 percent of the nation's most distressed urban and rural communities.

These CDFIs, through compassion and community activism, have built a financial network that is dedicated to improving the lives of our most economically deprived communities and citizenry. The reach of this financial network is unprecedented and impressive.

The Fund views our partnership with CDFIs as a catalyst for vigorous community and economic development financing activity. The Fund is not a Federal regulator like the Office of the Comptroller of Currency, which regulates national banks. No, we do not regulate CDFIs. I like to refer to us as "determinators." The Fund is determined to see low income communities thrive.

We are determined to foster the growth of the CDFIs that invest in the neediest areas - Hot Zones - because this is where financial services can make the biggest difference in the lives of their customers.

We are determined to see partnerships between CDFIs and local communities strengthen and grow to achieve President Bush's vision of a prosperous America for all Americans.

The Fund is a lifeline and we are committed to our mission of expanded access to capital. We are committed to building the financial strength and capacity of this CDFI financial network so that you can do more to improve the lives of Americans.

We are determined to see this happen!

The Fund's underwriting guidelines have not kept pace with the growth and sophistication of the CDFI industry. We have historically underwritten a SECA Component award in a manner that is somewhat similar to how we underwrite a Core Component award. Further, we underwrite CDFIs with less than $5 million in assets in a manner that is somewhat the same as how we underwrite a CDFI with $50 million in assets. We need to make more of a distinction in our analysis of CDFIs with multiple loan funds. The FY 2003 NOFAs, as currently being considered, would incorporate significant changes. Let me explain some key changes you may see in the FY 2003 funding rounds.

Technical Assistance Programs:

- Awards will be made available on a first come, first review basis. The TA NOFAs will cover the 2003 and 2004 fiscal years (assuming funds are available in the second year). As I promised last year, if we are serious about building capacity, then technical assistance funds should be made available throughout the year as long as dollars are available. To wait annually between funding rounds did not allow us to provide assistance when you may have needed it most.

- Two tools will distinguish our target efforts to expand the capacity of CDFIs in general and institutions serving our Native American, Alaska Native and Native Hawaiian populations in particular: the TA Component and the Native American CDFI Development Program.

- To obtain TA awards, institutions will need to meet a minimum threshold score of 60 points (out of 100). Applicants that score above 60 points will be funded. If they do not score above 60 points, they may reconsider their applications and reapply. There will be no waiting period.

- We do warn you, however, the Fund is its busiest during the period from February through September, so you may see a slow down in response time during that period. Therefore, if you are looking for a TA award, we urge you to get your applications in early in the calendar year or again after September 2003. The last time the Fund tried this approach for TA awards, about 2/3 of all applications were received in the last month the TA window was open, which defeated the purpose of getting TA awards out on an expedited, as-ready basis. Therefore, the Fund reserves the right to decrease the amount remaining available if applications are not received at a reasonable rate.

Financial Assistance Programs:

- We are shifting the definition of our Financial Assistance Component away from the asset size of CDFIs. In the FY 2002 funding rounds, there will no longer be a Core or SECA Component to the CDFI Program.

- Our investments in CDFIs are for creating demonstrable community development impact: defined this year through homeownership opportunities, employment-generating opportunities, and expanding the availability of financial services to the "unbanked" population.

- The Fund will include in its underwriting review an expectation that larger CDFIs will demonstrate their degree of leverage of Fund resources. Financial Assistance funding for larger institutions will be limited to specific purposes such as funding loan loss reserves, credit enhancements for warehouse lines of credits, investments to fund innovative product development or expansion, or program initiatives in Hot Zones.

- We expect the FA Component to remain very competitive, especially in this upcoming year of decreased resources.

- Starting with the FY 2003 award round, FA Component assistance agreements will require award recipients to account separately for the use of funds received as Financial Assistance. This is a recommendation from the Treasury's Office of the Inspector General following its audit of the Fund's post-award process this year.

Other Programs

Bank Enterprise Award:

- In the past five years, the BEA Program has successfully leveraged over $5 billion in lending and investment in Distressed Communities and to CDFIs. Notwithstanding this significant investment, the Fund has concluded that it could more effectively achieve its vision and strategic objectives and those of the Department, if the BEA Program targeted awards to "asset-building" activities such as homeownership, small business lending and savings products.

- The Fund also seeks to simplify certain aspects of the BEA Program in order to achieve greater operating efficiencies.

Secondary Market Study:

- As you know, the Fund's programs are designed to attract direct private sector investment in CDFIs and distressed communities. Another way the CDFI Fund might stimulate greater private sector investment in CDFIs is by exploring whether it is feasible to promote the development of a secondary market for CDFI loans. Through such a market, CDFIs could replenish their supply of capital by selling loans on their books, thereby converting working assets to liquid assets with which it can make new loans. Raising capital by selling portions of a loan portfolio could become a critical new capital source for CDFIs.

- The Fund has contracted with a firm to conduct a study on the feasibility of developing a secondary market for community development finance loans. The first phase of this study is a survey, which many of you will be receiving in the next two weeks. I ask that each of you take the time to complete this survey, whether or not you are interested in selling loans on the secondary market today.

- This is very much a forward-looking study, and one that I consider to represent a critical new direction for the CDFI industry. I want to assure you that the survey does not duplicate the questions asked in the FY 2001 Annual Survey administered by the Fund and the CDFI Data Project; rather the two surveys are designed to complement each other.

E-Government Initiatives:

- The Fund achieved 100 percent electronic application submission in the 2002 NMTC Program round, and we hope to achieve that same outcome with the CDFI Program's FA Component application.
- For the TA Components, we hope to have an electronic application form available later this fiscal year. In the interim, we will accept paper applications.
- In order to determine where Hot Zones are located and what portion of your Investment Areas may be in designated Hot Zones, the Fund's Help Desk is currently being enhanced to provide this capability.
- In 2003, the Fund is considering collecting loan-level data from its CDFI awardees, asking for information such as the loan amount, the borrower address, the purpose of the loan, and the community development impact. We expect to use this information to geo-code your loans so that we can identify how much lending is occurring in Hot Zones and other high-distress areas, and the community development impacts related to that lending.
- Loan level data may also be used to create a sharper picture of industry performance, which will help with CDFI Program underwriting and to track CDFI Program awardees' compliance with production expectations that may be described in their assistance agreements.
- To minimize reporting burdens, the Fund will develop a system for you to easily export the loan-level data from your portfolio and other management information systems and submit it to the Fund. New software may also be developed to help you collect and store the data the Fund requires so that your annual data submissions are automated to the fullest extent possible.
- Our goals include reducing the paperwork burden of tracking impact; providing consistency in reporting among all CDFIs; and obtaining near-real time data so that we can more accurately report the impact our CDFI financial network is having in America's distressed communities.

In January 2002, we stated our plans to introduce a new performance rating system called PLUM. One goal of PLUM is to help the Fund establish a series of financial soundness covenants and deployment ratios based on composite evaluations of CDFIs. For every dollar invested into a CDFI, we desire to be able to articulate a required rate of impact.

Let me give you an example:

Prior awardees know that our staff evaluated your comprehensive business plans and then negotiated output measures for your assistance agreements. For FY 2002 awards, that has been drastically minimized. We are proposing to do away with the negotiated step in 2003. Instead, we will rely on your production projections and we will include that information in the assistance agreement, instead of performance measures, as you know them. Further, our PLUM analyses will be used to determine if the level of dollars requested will result in a measure of impact consistent with the size of the CDFI, its products and target market conditions.

In order that additional data can be collected for the Fund's analyses, indicators within the four components of PLUM will be incorporated into the FY 2003 funding application. These indicators should be transparent to the applicant as the measures build upon evaluation factors previously included in the Fund's applications for financial assistance. Going forward, data collection for PLUM analyses will be collected electronically through the annual reporting process, which includes the annual survey process.

As I have stated to you before, the Fund needs to know and be able to articulate the key variables for managing a successful community development finance program. Our funding programs are highly competitive and have been over-subscribed. We are at the point where our database of over six years of CDFI financial and performance data should help drive the development of meaningful financial soundness covenants and performance goals.

Our Compliance Monitoring and Evaluation program will begin to take on a more sophisticated approach. Our goal is to measure compliance based on performance and capacity to reach distressed markets, not merely on your performance to a five-year business plan that can be outdated after a few years.

Conclusion

The Fund is initiating a great number of changes. These changes reflect the organizational maturity of the Fund and of the CDFI industry. These changes reflect the commitment of the Bush administration to invest in programs that improve our nation's communities. The Fund has to modify its reporting to comply with these new standards set by the President's Management Agenda. This is not a political agenda.

In remarks to community and business leaders across the country, President Bush acknowledges the role of community-based organizations in helping to eliminate pockets of despair. President Bush believes in the work we do to improve America. He knows that we must work hard and that there is plenty of work to do. And he knows that we can eliminate poverty and despair with love, compassion and decency.

CDFIs are excellent vehicles to better connect our nation's distressed and underserved markets with resources needed to increase economic health. We can achieve these changes and fulfill the goals described with your help. The Fund is committed to building these changes in full collaboration with the industry. CDFIs are very important in our nation's efforts to improve the well being of all Americans. Yes, we are all challenged with "Managing Change." However, together, we must acknowledge that the "New CDFI Era" starts with the actions we make today.

Thank you so much for your attention. At this time, I would like to hear some thoughts and comments from you, as I understand that we have time for a Q & A period.