

Strengthening Small & Emerging CDFIs

Capitalization: Raising Debt and Equity for CDFIs

Michael Swack
Carsey Institute at the University of New Hampshire

February 25, 2014



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NETWORK 

CDFI Fund's Capacity Building Initiative

- The Capacity Building Initiative will greatly expand technical assistance and training opportunities for Community Development Financial Institutions (CDFIs) nationwide and significantly boost the ability of CDFIs to deliver financial products and services to underserved communities.
- Industry-wide training will target key issues currently affecting CDFIs and the communities they serve.



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Strengthening Small and Emerging CDFIs Task Order

- **Goal:** Increase capacity of more than 70 CDFIs to strengthen financial sustainability and increase community impact.
- **Focus:** Business models that work to support sustainability and impact, understanding stages of organizational growth, and change management.
- **Approach:** Five trainings, five mentored cohorts, one-to-one technical assistance, virtual resource bank.
- **Results:** Each CDFI developed an Action Plan with implementation supported by mentored cohorts.

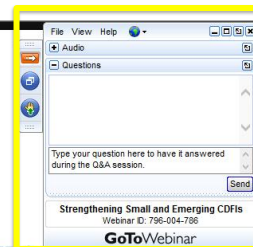


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Presenter



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Introductions

- Michael Swack
 - Professor at the University of New Hampshire where he has appointments at the Carsey Institute and at the Paul School of Business and Economics.
 - He has over 30 years of experience working in the fields of community development finance and community and economic development.
- You, the participants
 - Small and large CDFIs
 - Loan funds, credit unions, and banks



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Goals for the Session

- Determining your needs
- Identifying sources appropriate to your needs
- Understanding the pros and cons of various sources of capital
- Developing a basic capitalization plan



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Key Questions

- Is there a demand for your products?
- Are you capital constrained?
- How much are you trying to raise?
- Do you need debt or equity or both?
- What is your history of raising funds? Are your ratios in order? (Don't raise too much debt!)
- Do you need to raise reserves?
- What do investors look for before they invest?
- One size does not fit all – a capitalization strategy needs to fit your needs, and your particular situation.
- Do you have a plan?



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Plan for Raising Debt and Equity

- Goal: To raise \$5 million over the next 3 years to include 4.25 million in debt (blended rate of 2%) and \$750,000 in equity.
- Rationale for plan: (e.g., Increased demand for funds, new product development, geographic expansion, etc.)



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Potential Sources	Amount	Notes
Equity	\$750,000	
CDFI Fund	\$500,000	Are we certified? Application deadlines?
CDBG	\$100,000	Entitlement? Small Cities?
Local foundation (with PRI?)	\$100,000	Possible sources? Established relationships with staff or board?
Private gifts/donations	\$50,000	Any history with private donors? First steps?
Debt	\$4,250,000	
Long term (5 years or more)		
Bank pool		Any existing pools? Local history?
Insurance Companies		Any local companies?
Private Individuals		Is this a good idea? Costs? Securities laws? Interest among board members?
Program Related Investments		Research local foundations
Religious		Start with board members
Short term (less than 5 years)		
Need line of credit?		Do you have an existing line of credit? Is it sufficient to meet possible short-term needs?
Religious institutions		Start with board members
Universities or other institutional lenders?		
Sell loans?		How will this affect earnings?



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What are you raising money for?

- Affordable housing;
- Small business and microenterprise;
- Community services, such as child care, education, and health services;
- Livable-wage jobs for low-income individuals;
- Services to economically disadvantaged populations;
- Asset-building for low-income individuals;
- Sustainable development.

Your uses will dictate the type of money you need to raise.



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Sources of Capital – Private, Public and “Alternative”

- Banks
- Insurance Companies
- Pension Funds
- GSEs (e.g. Fannie Mae)
- Government – Federal and State (CDFI, CDBG, HOME, EDA)
- Foundations – Program Related Investments
- Religious Institutions, Universities, other “alternative” or mission related investors
- Private individuals



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Debt - Characteristics of Bank Lending

- I. Type of capital offered by banks = generally short-term, self-liquidating (fully-amortizing loans). Debt.
- II. Banks do not provide equity, subordinated debt or any other kind of patient money.
- III. Banks generally lend for the short-term so as not to get locked into set interest rates(short-term, lines of credit).



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Why Seek Banks ?

CDFIs seek bank partners for four primary reasons:

- 1) Liquidity—Almost all CDFI financing is non-conforming. As a result, productive CDFIs constantly face liquidity shortages.
- 2) Leverage—Because CDFIs seek to bring capital into underserved markets, many are willing to accept relatively higher risk to leverage more bank capital into a deal. CDFIs must use this limited capital strategically to encourage banks and other funders to participate.

Adapted from Mark Pinsky at <http://www.occ.gov/static/community-affairs/Summer-01.pdf>



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Why Seek Banks?

CDFIs seek bank partners for four primary reasons:

- 3) Access to technical financial expertise—CDFIs cannot afford to reinvent wheels, so they often rely on their bank partners' expertise. Many bankers enjoy the challenges of applying their professional talents to the non-traditional credit facilities that CDFIs often wrestle with.
- 3) Positioning CDFI borrowers for future bank relationships—CDFIs help season borrowers so that they can become traditional bank customers in the future. In some instances, CDFIs negotiate with banks up-front that the banks will ultimately purchase the CDFI's loans that are performing adequately.

Adapted from Mark Pinsky at <http://www.occ.gov/static/community-affairs/Summer-01.pdf>



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Bank Related Programs

Goldman Sachs

CDFI Small Business Financing Initiative with Opportunity Finance Network
see:

- <http://www2.goldmansachs.com/citizenship/10000-small-businesses/index.html>

Deutsche Bank

New CDFI Partners Program: Low-interest loan capital, in amounts from \$250,000 to \$500,000, with a range of interest rates, maturities, and subordination. See:

- http://www.fundconsulting.com/docs/RFP--Deutsche_Bank_New_CDFI_Partners_Program.pdf



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Financing Vehicles and Tools

- Bonds (State and Federal)
- Loan Sales
 - Community Reinvestment Fund <http://www.crfusa.com/Pages/Default.aspx>
 - Impact Community Capital <http://www.impactcapital.net/index.html>
 - Community Development Trust <http://www.cdt.biz/whatwedo.htm>
- Loan Participations and Pools (Georgia, Florida and NH examples)
- Credit Enhancements



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“Alternative” Sources of Debt

- Program Related Investments from Foundations
- Institutional sources such as religious organizations, universities, and private individuals
- Government Sources



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Program Related Investments

Program-related investments are loans originated by charitable foundations in which:

- The primary purpose is to accomplish one or more of the foundation's exempt purposes,
- Production of income or appreciation of property is not a significant purpose, and
- Influencing legislation or taking part in political campaigns on behalf of candidates is not a purpose.



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PRI

The following are some typical examples of program-related investments:

- Low-interest or interest-free loans to needy students
- High-risk investments in nonprofit low-income housing projects
- Low-interest loans to small businesses owned by members of economically disadvantaged groups, where commercial funds at reasonable interest rates are not readily available
- Investments in businesses in deteriorated urban areas under a plan to improve the economy of the area by providing employment or training for unemployed residents
- Investments in nonprofit organizations combating community deterioration



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Federal Government Programs

- CDFI Fund (see CDFI.gov)
- Community Advantage – SBA 7A program opened up for CDFIs
- SBA Micro lending
- USDA – business lending and equity programs (Judy Canales USDA)
- Bond Guarantee Program (CDFI Fund)
- Healthy Foods Financing Initiative (CDFI Fund)



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Raising Equity

- Investors
 - Are you eligible?
- Grants
 - What are the sources?
- Secondary Capital – EQ2
 - What is it? Do you qualify? Sources?



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EQ2

- Capital product for CDFIs and their investors;
- A financial tool that allows CDFIs to strengthen their capital;
- Structures, and leverages additional debt capital;
- A general obligation of the CDFI that is not secured by any of the CDFI's assets;
- Fully subordinated to the right of repayment of all of the CDFI's other creditors;
- Carries an interest rate that is not tied to any income received by the CDFI;
- Has a rolling term and therefore an indeterminate maturity.



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CARS*

- Rates CDFI financial strength and impact performance;
- Provides bird's-eye view into how investors underwrite and assess CDFI risk;
- Promotes a CDFI's commitment to transparency and rigorous performance standards;
- Simplifies due diligence process for investors;
- Investors currently more interested in whether CDFI is rated than the actual ratings.



*Comprehensive Ratings for CDFI Investments - see <http://www.carsratingsystem.net/>

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What is Your Plan?

- What are your goals?
- What are your most appropriate sources of debt?
- What are your most appropriate sources of equity?
- What is a reasonable timeline?



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QUESTIONS?



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Strengthening Small and Emerging CDFIs Webinar Series

Upcoming Webinars

- 
 - **Leading Organizational Change**
 - Pam Porter, Opportunity Finance Network

- 
 - **How Should the Board of Directors Evolve as your CDFI Grows?**
 - Adina Abramowitz, Consulting for Change
 - Recommended Attendees: Board Members and CEOs/Executive Directors of CDFIs


Past webinars are uploaded to [The CDFI Fund's Virtual Resource Bank](#).



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CDFI Fund's Virtual Resource Bank



www.cdfifund.gov/what_we_do/Strengthening_Small_and_Emerging_CDFIs_Resource_Bank.asp

- WHO WE ARE
- WHAT WE DO
- IMPACT WE MAKE
- NEWS & EVENTS
- HOW TO APPLY

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

UNITED STATES DEPARTMENT OF THE TREASURY

Strengthening Small and Emerging CDFIs Resource Bank

The resources for this topic can be found below. To view all of our available Resource Banks, click [here](#).

I. Training Curriculum:

- Models for Growth – What Works
- The Logic Model as an Outcome-Based Project Management Framework
- The Four Stages of Organizational Growth
- Business Model: External Environment
- Managing and Negotiating Change
- CDFI Action Plan
- Leading Organizational Change

II. Training Webinars:

- Coming Soon

III. Additional Resources:

- Analysis of the CDFI Industry Landscape
- CDFI Operations
- Tools for Greater Community Development Impact



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