Collaborators or Competitors? Exploring the Relationships between Community Development Financial Institutions and Conventional Lenders in Small Business Finance

Geoff Smith
Woodstock Institute

Jennifer Newon
Woodstock Institute

Sean Zielenbach
Woodstock Institute

Sarah Duda
Woodstock Institute

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Abstract

This study examines the nature of the interaction of banks and community development financial institutions (CDFIs) with regard to small business lending. We examine the experience of six different CDFIs throughout the country. These are organizations that vary by size, corporate structure, and market. We explore the ways in which they both collaborate and compete with regulated lenders, and how changes in local and national market dynamics are affecting the CDFIs' activities. Our case studies are not necessarily representative of the CDFI industry overall, but they shed some insights into the factors that shape CDFIs' interactions with and responses to more- mainstream institutions. Our findings are therefore more descriptive than prescriptive, though we offer some suggestions for both CDFI practice and future research.

One of the key issues that emerges from the case studies is the idea of a continuum of credit where banks and CDFIs (typically non-depository loan funds) develop referral relationships that allow each to serve small businesses across the credit quality spectrum. Such collaborative relationships can be mutually beneficial for both CDFIs and mainstream institutions, but can also be problematic for CDFIs when mergers and acquisitions reduce the number financial institutions active in the local market and disrupt relationships. Problems can also arise for CDFIs if banks require CDFIs to improve a bank's bottom line as a condition of the CDFI receiving funding. The study also identifies a CDFI's source of lending capital as a key determinant of the nature the bank/CDFI relationship. In addition to competition for loans from aggressive, niche-oriented start-up banks, depository CDFIs also compete with larger banks for consumer and small business deposits, their key source of lending capital. The study also considers the current credit tightening and economic downturn. It examines both the opportunities for CDFI as banks become more restrictive in their small business lending, and the impact the economic downturn might have on CDFI underwriting policies.

Introduction

Substantial research has documented that minority-owned firms, firms in lower-income and predominantly minority communities, and firms in rural areas have difficulty accessing capital for small business development (see Cavalluzzo, Cavalluzzo and Wolken 1999; Immergluck 2002; National Community Reinvestment Coalition 2007). In particular, start-up firms and businesses owned by individuals with low levels of equity, limited collateral, damaged credit, and/or inexperience developing business plans often struggle to obtain affordable loans from mainstream financial institutions. The companies typically cannot satisfy the underwriting criteria of these lenders, and relatively few have the high-growth potential that would attract traditional venture capitalists. As a result, the businesses frequently have to rely on credit card financing and capital infusions from the owners' families and friends, sources that tend to limit the companies' prospects for growth.

In many lower-income markets, community development financial institutions (CDFIs) have become some of the leading providers of credit and investment capital to small and emerging businesses. While the volume of their lending still pales in comparison to that of regulated financial institutions, their borrowers have tended to differ from those served by more mainstream lenders. CDFIs frequently serve companies that require relatively small loans (often $100,000 or less) as well as considerable assistance in refining business plans, analyzing market opportunities, and implementing financial management procedures. In many cases, the CDFIs have worked in partnership with conventional lenders to serve these companies. Mainstream banks and thrifts have often provided the CDFIs with both operating and loan capital so the CDFIs can carry out their small business activities. For larger and more stable companies, conventional lenders may provide financing in partnership with CDFIs.

The nature of the relationship between CDFI small business lenders and conventional banks and thrifts depends on many factors, however. Local market characteristics certainly affect the interactions, as do the institutional structures of the CDFI and the underlying incentive(s) of the mainstream lenders. The state of the economy and the changes affecting the broader financial marketplace also play key roles. For example, pressures to generate greater returns have made banks much less willing in the past few years to provide CDFIs with equity-equivalent loans, patient and low-cost capital that had helped CDFIs expand their portfolios considerably.

Relatively few studies have looked critically at the roles of and relationships among CDFIs and mainstream lenders in financing historically under-served small businesses. The existing literature primarily focuses on the Community Reinvestment Act benefits available to banks from partnering with CDFIs, and not on the factors that might influence these relationships (see Cunningham 1999; Pinsky 2002). Our study is an effort to help fill that gap. We offer a preliminary analysis of the nature of bank-CDFI interaction with regard to small business lending. We examine the experience of six different CDFIs throughout the country, organizations that vary by size, corporate structure, and market. We explore the ways in which they both collaborate and compete with regulated lenders, and how changes in local and national market dynamics are affecting the CDFIs' activities. Our case studies are not necessarily representative of the CDFI industry overall, but they shed some insights into the factors that shape CDFIs' interactions with and responses to more mainstream institutions. Our findings are therefore more descriptive than prescriptive, though we offer some suggestions for both CDFI practice and future research.

Context

The limited track records and comparatively weak credit histories of many small businesses in lower-income markets make it important for these firms to develop more-personal relationships with prospective lenders. To the extent that the lender can feel comfortable with the company's management, business plan, and financial prospects, he or she may be more willing to offset and de-value more- traditional underwriting criteria when considering an application for financing. Such relationship-based lending has traditionally been more prevalent in smaller, more localized banks whose employees tend to be more closely attuned to the capacities of local businesses and the dynamics of the local market. Yet the past 15 years have seen a decline in the influence of such institutions, as the banking industry has undergone numerous mergers and acquisitions. The number of commercial banking institutions dropped by 26.8 percent from 1995 to 2007, resulting in fewer entities with a larger concentration of assets (Federal Deposit Insurance Corporation 2008a). In 2007, commercial banks with over $1 billion in assets controlled 89.1 percent of the country's banking assets, compared to 77 percent in 1995. At the same time, banks with less than $100 million in assets made up only 1.5 percent of national banking assets in 2007, down from 7 percent in 1995 (Federal Deposit Insurance Corporation 2008b).

One of the major ramifications of the merger and acquisition trend is that fewer small business lending decisions are made at the local level. In the interest of efficiency, banks increasingly concentrate many of their decision-making operations in their national or regional headquarters, not in the more decentralized branches. Most of Bank of America's lending decisions are made in Charlotte, for example, not in its thousands of branches throughout the country. To facilitate such centralized decision-making, conventional lenders increasingly rely on standardized risk assessment models. Such evaluations focus principally on borrower credit scores, equity, and collateral to quantify risk; they give comparatively little weight to more-qualitative information about the applicant and the peculiar characteristics of its market. By reducing the costs of underwriting, the automated process has made it more profitable for large banks to make smaller loans (Berger and Frame 2005). At the same time, the primacy of such an approach can make it much more difficult for businesses to obtain affordable financing if they do not have as strong a credit history, an equity base, or underlying collateral, even though they may have other compensating strengths (Immergluck and Smith 2001). With local loan officers less able to influence the ultimate lending decisions, prospective small business borrowers with more-marginal track records may well choose not to approach larger banks for capital, believing that the banks will deny them because of their financial characteristics (Berger and Udell 2002). Indeed, small business loan volumes tend to be lower in markets dominated by a small number of lenders (Laderman 2006).

The Role of CDFIs

The reduction in the number of smaller, more relationship-oriented banks and thrifts has created an opportunity for other lenders to fill the void. One result has been the explosive growth in the number of CDFIs in the past 15 years. Spurred in considerable part by the establishment of the federal CDFI Fund and the willingness of foundations to seed and support community development finance, the number of CDFIs more than tripled from the mid-1990s to the mid-2000s.

Given the increasing range of products and services that CDFIs offer, it is difficult to pin down an exact number of organizations that provide small business financing. There are three different types of CDFIs engaged in such lending.[1] Most entities are community development loan funds, self-regulated nonprofit or for-profit entities. These organizations collectively offer a wide range of products, from micro-loans of as little as $500 to home-based entrepreneurs to six-, seven-, and even eight-figure loans to companies looking to expand their physical facilities. A number of the loan funds, such as Coastal Enterprises, Kentucky Highlands, and the Bedford Stuyvesant Restoration Corporation, trace their origins to the War on Poverty and the initial community development corporation movement of the 1960s (Lehn, Rubin and Zielenbach 2004). In contrast, both community development banks and community development credit unions (CDCUs), some of which trace their roots as far back as the 1940s, are federally insured depository institutions. Depending on their focus and capital position, the insured depositories may offer a similar range of small business financial products as the loan funds.

CDCUs, for example, often specialize in micro-loans (under $35,000) as well as loans up to $100,000. Community development banks typically offer a fuller range of loan products, and frequently focus on larger commercial and industrial lending. As insured depositories, both types of institutions are subject to federal and state regulations to ensure their financial safety and soundness. Such oversight can lead to more conservative lending than might be typical of an unregulated loan fund; for example, regulators often discourage or prevent CDCUs and community development banks from making loans to poorly collateralized companies and making equity investments, fearing that the higher risk of loss associated with these transactions could jeopardize the lenders' solvency. Additionally, because these institutions typically have fewer assets and lower profit margins than community loan funds, they rarely have the liquidity to engage in riskier lending (Lehn, Rubin and Zielenbach 2004).

The different capital structures of the various CDFIs further shape their financing activities and influence their relationships with conventional lenders. As illustrated in Table 1, the vast majority of the capital for both community development banks and CDCUs comes from individual and commercial deposits: 88 and 85 percent, respectively (Coalition of Community

[11] We are not including community development venture capital funds in this discussion, as they typically provide equity and equity-like investments, not straight loans.

Development Financial Institutions 2007).[2] Another few percent comes from borrowed funds (including secondary capital), while the remainder constitutes equity and retained earnings. The banks and CDCUs have to compete with other insured depositories for deposits and other loan capital. They also have to remain self-sufficient, lest they incur sanctions from their regulators. Thus one would expect to see them compete on some level with conventional lenders for the more profitable small business loans.

Table 1: Selected Characteristics of Small Business Oriented CDFIs, FY 2006

	CD Bank	**CD Credit Union**	**CD Loan Fund**
Organizational Type	Depository	Depository	Non-depository
Self-Sufficiency Requirement?	Yes	Yes	No
Capital Sources (as Share of Total Capital)			
• Equity / Net Assets	9.0%	10.6%	31.4%
• Loans	0.0%	2.3%	63.2%
• Equity-Like Loans	0.0%	0.0%	5.4%
• Shares / Deposits	88.4%	84.6%	0.0%
• Other	2.6%	2.5%	0.0%

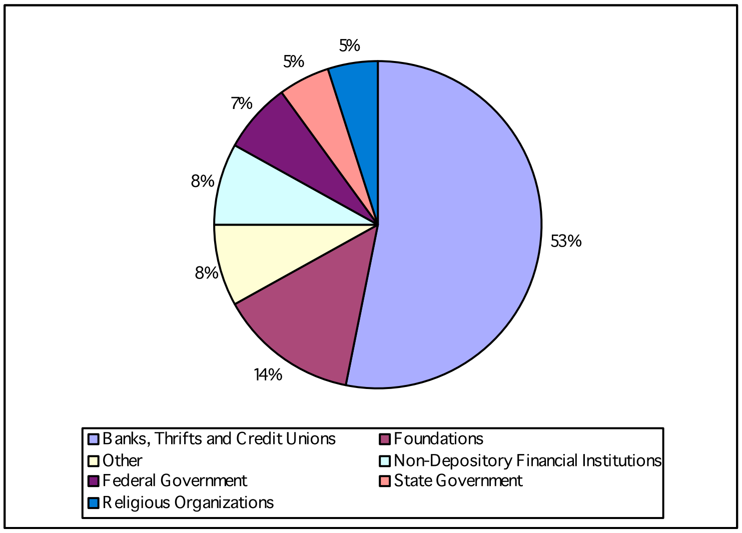
Source: Coalition of Community Development Financial Institutions 2007.

The vast majority of community development loan funds, on the other hand, do not have a self-sufficiency mandate. In fact, relatively few of the organizations, particularly those primarily engaged in small business financing, earn enough to cover all of their expenses. (The gap generally results from the technical assistance services that they offer current and potential borrowers.) A significant portion of both their operating and lending capital comes from public and philanthropic grants and below-market loans. Their strong net asset/equity positions—an average of 31.4 percent of total assets, according to the most recent CDFI Fund data—give them more flexibility to make higher-risk loans and devote resources to more-involved small business development activities.

As non-depositories, the loan funds generally do not compete with conventional lenders for capital. In fact, the CDFIs' primary source of loan capital has been mainstream financial institutions (see Figure 1). Both CDFI officials and mainstream lenders frequently see their institutions as complementing each other. Loan fund representatives frequently claim that they refer "bankable" borrowers to their conventional lending partners. In cases in which more-stable but not fully "bankable" businesses need a relatively large loan, the CDFIs and conventional lenders often finance the company together, with the CDFI's loan taking a second position to that of the bank.

[2] Included in the banks' deposits are those deposits made by governmental entities.

Figure 1: Sources of Capital for Community Development Loan Funds, FY 2006



Source: Coalition of Community Development Financial Institutions 2007.

Influence of *De Novo* Banks

Prior to the current credit crunch, the amount of conventional loan capital going into low- and moderate-income communities had increased substantially. The increase had been particularly noteworthy since the early 1990s, largely as a result of greater federal enforcement of the Community Reinvestment Act (CRA; Zinman 2002). While the growth□particularly in the sub-prime industry□made certain types of capital more accessible for traditionally under-served borrowers, it does not appear to have changed the small business lending dynamics significantly. Our conversations with leaders throughout the CDFI industry suggest that larger banks are still not competing for borrowers with CDFI small business lenders. (The dynamics are somewhat different on the residential lending side.) For the most part, the increased bank involvement in lower-income markets has contributed to greater financial support of CDFI small business lenders. Compelled by CRA to lend in these areas, conventional lenders acknowledge that CDFIs often can better serve certain types of borrowers, and have been willing to provide them with financial support to do so. Although most of the support results from CRA considerations, some appears to represent a longer-term marketing strategy on the part of the mainstream lenders. To the extent that the CDFI can help stabilize and grow the borrower's business, that company may "graduate" to a profitable banking relationship in the future.

The bank-CDFI dynamics may be changing somewhat with the recent growth of *de novo* financial institutions, however. As noted earlier, the spate of banking mergers and acquisitions has resulted in a decline in the number of small and mid-sized banks, particularly in certain markets. As part of the process, the merged institutions generally seek to streamline their operations and focus on their most profitable business lines. They consequently may devote fewer resources to certain market segments, including small businesses. The shift in focus, while potentially problematic for small business borrowers, creates an opportunity for other lenders, particularly those targeting specific under-tapped niches (Goldberg and White 1998). Between 2003 and 2007, 828 *de novos* opened throughout the country (Bradway 2007), with most opening in areas with high merger and acquisition activity (Flanigan 2006). Many have been able to take advantage of the skills and expertise of individuals who were laid off as part of a merger or acquisition.

Not surprisingly, the business models of *de novo* banks often focus on tapping into seemingly under-served markets. To generate earned income and satisfy their initial investors, *de novos* tend to be relatively aggressive small business lenders whose approach, in many ways, resembles that of CDFIs. The banks often focus on particular types of companies and/or certain sized businesses, using relationship-based lending and the loan officers' knowledge of the local markets and the cluster of small businesses to capture market share. In order to build their portfolios (so as to generate interest income), they may focus on newer or emerging markets in which more-established banks are not as active, as well as on somewhat higher-risk borrowers that other conventional lenders might shun (Flanigan 2006). In theory, then, *de novos* would be potential competitors for CDFI small business lenders. Yet while *de novos* might target certain under-tapped markets to help build their portfolios, they usually do not share the CDFIs' mission to serve economically distressed markets. Research in the Chicago region has shown that, compared to more-established banks, *de novos* have a smaller percentage of their offices in low- or moderate-income communities, and make a larger proportion of their small business loans to firms in higher-income areas (Immergluck and Smith 2001).

Effects of a Struggling Economy

The weak national (and, increasingly, global) economy, and the turmoil in the financial markets, have further complicated matters for CDFIs, conventional lenders, and small business borrowers. The decline in the stock market has negatively affected many foundations' endowments, which has and will likely continue to limit the funds they have available for community development. There are also signs of funder fatigue with CDFIs, as some of the major philanthropic supporters are in the process of re-thinking their community development and program-related investment strategies. Partly in response, there has been a steady drumbeat from the Opportunity Finance Network and others in the CDFI industry for loan funds to become more self-sufficient. One ramification is that CDFIs may find it necessary to make larger loans and work to serve and retain higher-performing clients, instead of "graduating" them to bank financing. In competitive banking markets, this could create circumstances where mainstream banks and CDFIs compete for the same types of clients.

At the same time, the combination of the weak economy and the turmoil in the credit markets has resulted in a general tightening of bank underwriting practices. According to recent reports, start-up and early-stage businesses, as well as smaller and less well-capitalized companies, have been encountering tighter lending standards when they apply for conventional financing, including increased collateral and equity requirements (Federal Reserve Board 2008a, 2008b; Goodman 2008). Large national banks such as JP Morgan Chase, Washington Mutual, PNC, and Wells Fargo have all grown more cautious with small business lending (Browning and Silver 2008; Aeppel 2008). The Federal Reserve Board's Senior Loan Officer Survey on Bank Lending Practices in April 2008 found that half of the loan officers had tightened their lending standards for commercial and industrial loans, up from 30 percent three months earlier. Eighty percent of the loan officers surveyed in April had applied stricter criteria to commercial real estate purchases, and half of the loan officers reported tightening lending to small businesses (Federal Reserve Board 2008b). The January 2008 survey had found that the cutbacks in small business lending even affected loans partially guaranteed by the federal government; indeed, funding for SBA 7(a) loans fell 14 percent between 2006 and 2007 (Federal Reserve Board 2008a).

The credit tightening on the part of many conventional lenders would seem to create additional opportunities for CDFIs. The organizations might well see more loan requests from higher-quality companies that now fall outside of the conventional lenders' more restrictive underwriting criteria. The overall pullback in the debt market is likely to slow the development of *de novos* and thus reduce a potential source of competition for CDFI small business lenders (Fajt 2008). On the other hand, the economic downturn affects the cash flow situation of many CDFI borrowers as well, and the decline in real estate values can negatively affect the CDFIs' underlying collateral position on their portfolios. Furthermore, the downturn appears to have depressed further the appetite of conventional lenders to provide CDFIs with equity-equivalent investments and other low-cost loans, which had been major contributors to the organizations' growth in the late 1990s and early 2000s. With less concessionary financing and more concerns with their existing portfolios, CDFIs may be less willing and able to take risks with objectively weaker business borrowers. Their need to find more-stable borrowers could put them in a position of competing more with mainstream banks for clients. This would presumably be more of an issue with the regulated CDFI small business lenders, given their need to assure the regulators of their financial soundness. Additionally, access to lending capital will continue to be a challenge for CDFIs, particularly as capital markets tighten.

Our study explores how selected CDFI small business lenders are grappling with these various factors. To what extent are they competing with conventional lenders for prospective borrowers? How has their relationship with the mainstream lenders changed as a result of the broader economic forces at play? To what extent do conditions in the particular markets in which they operate affect those relationships? What are the most significant challenges facing the CDFIs in the short to medium term, and how are they trying to address them? Our analysis is not necessarily representative of the experiences of CDFI small business lenders as a whole, but it sheds light on common issues that such entities are confronting.

Methodology

Our analysis relies on case studies of six separate CDFIs throughout the country. In selecting the six organizations, we first identified the 15 most active CDFI small business lenders that primarily serve urban or metropolitan markets. (We relied on the CDFI Fund's Community Investment Impact Survey [CIIS] and the CDFI Data Project [CDP] for the data.[3]) From these 15, we chose organizations that reflected a mix of organization type (community development banks, credit unions, and loan funds), market size, product offerings, and geography. We ultimately selected the following organizations: ACCION Texas (San Antonio, TX), Colorado Enterprise Fund (Denver, CO), Cooperative Business Assistance Corporation (Camden, NJ), Santa Cruz Community Credit Union (Santa Cruz, CA), Shorebank (Chicago, IL), and University National Bank (St. Paul, MN). These organizations' basic characteristics are outlined in Table 2.

Table 2: Characteristics of Case Study CDFIs

	ACCION Texas	Colorado Enterprise Fund	Cooperative Business Assistance Corporation	Santa Cruz Community Credit Union	Shorebank	University Bank
Location	San Antonio, Texas	Denver, Colorado	Camden, New Jersey	Santa Cruz, California	Chicago, Illinois	St. Paul, Minnesota
CDFI Type	Loan Fund	Loan Fund	Loan Fund	Credit Union	Bank	Bank
Assets	$18,937,074	$4,000,000	$12,629,142	$58,000,000	$2,000,000,000	$117,000,000
Geography Served	Statewide	Statewide	Multi-County	Small Urban	Large Urban	Large Urban
Date Established	1994	1976	1987	1977	1973	1994

In conducting the case studies, we focused particularly on the ways in which CDFIs have responded to changes in their particular markets and in the nature of their relationships with mainstream small business lenders. To that end, we interviewed the CDFI directors and key small business lending staff members to understand the origins and products of the organizations, their relationship with mainstream lenders, and their perceptions of and responses to conditions in their markets. To obtain a broader perspective of the small business lending environments, we interviewed key officials from local small business development centers (SBDCs), community development corporations, and other smaller CDFIs active in the markets. These individuals shed light on the particular financial needs of the respective small business communities, and also provided a sense of the roles that the local lenders play in addressing those needs. We also interviewed conventional lenders who have both a significant presence in the selected small business markets—particularly in lower-income areas within those markets—as well as relationships with the selected CDFIs. We asked these lenders about the ways in which their institutions have tried to serve the needs of local companies, the products and outreach programs they use to serve businesses in low- and moderate-income communities, and their (and their

[3] CDFIs were eliminated from consideration if they reported originating fewer than 50 small business loans in the most recent year in either the CIIS or CDP datasets and did not serve an urban market.

institutions') relationship with CDFIs in the selected markets. When possible, we augmented the qualitative interview findings with more-quantitative data on the number, amount, and type of small business loans being made in the different communities.

ACCION Texas

Outside of the technology industry, budding entrepreneurs have frequently struggled to obtain the necessary capital to develop and expand their businesses. The problem has been particularly pronounced for immigrants who have limited or damaged credit histories, as they usually cannot meet the automated underwriting thresholds of mainstream banks. ACCION Texas was established in 1994 to help address the dilemma. Drawing upon successful international micro-lending programs, the San Antonio-based organization focused on providing small loans to budding entrepreneurs that generally cannot obtain the needed financing from mainstream sources. Through its 12 offices throughout the state, ACCION now makes between 80 and 90 loans each month for upwards of $1 million (collectively).

ACCION lends to both start-ups and existing businesses, and primarily works with relatively unsophisticated borrowers who do not keep good financial records and consequently cannot quantify their success to a mainstream bank. Most of ACCION's borrowers are minority-owned businesses, and about half of these businesses are owned by women. The typical borrower has a credit score of 570—well below the usual threshold for conventional lenders—and ACCION lends to individuals with scores as low as 500. The organization makes loans of as little as $500 and caps its lending at $50,000. Eighty percent of its loans are under $35,000, and an average loan is in the $15,000 to $20,000 range. Virtually all of the loans go toward working capital, inventory, or the purchase of equipment. Most ACCION borrowers take out multiple loans from the organization in a "step borrowing" process; once they successfully repay a smaller loan they become eligible for a larger one.

In many ways, ACCION operates much more like a for-profit bank than a traditional nonprofit CDFI. Financial self-sufficiency is a distinct organizational goal. (ACCION currently covers about 70 percent of its costs internally, well above the average for CDFI micro-lenders.) The organization offers comparatively little technical assistance to actual and prospective borrowers, generally referring individuals in need of help in structuring their business plans, for example, to a small business development center or other business counseling entity. ACCION has developed its own automated credit scoring model—based on data it has collected from its borrowers over the past 13 years—and uses it to make decisions on loan applications within 24 hours of receiving them. The model represents a deliberate attempt both to increase the organization's loan volume and to decrease its transaction costs, thus maximizing its financial return. It takes into account both demographic and financial variables, including the business owner's length of time at his or her current residence, homeownership status, debt-to-income ratio, credit score, and expenses.[4] Approved loans are subsequently priced for risk, with more-

[4] If the automated credit scoring model rejects a loan, the applicant is referred to a loan officer to determine what is lacking in the application. In some cases, loan officers are able to approve the loan after consulting with the applicant; the individual may not have presented some information properly in the application, for example. In most cases, though, the loan officers refer the individual to third-party agencies for help in improving his or her application.

marginal borrowers receiving higher interest rates (up to the high teens) and smaller loans. Only those borrowers with credit scores of at least 600 are eligible for the maximum $50,000 loan. ACCION requires that all of its loans be fully collateralized or otherwise supported by tangible assets. Borrowers lacking sufficient collateral must pay a non-refundable fee equal to 5 percent of the loan that goes directly into ACCION's loan loss reserve. To generate additional earned revenue, ACCION currently underwrites loans for three other CDFIs using its credit scoring model. It also services their micro-loan portfolios. ACCION hopes to increase the number of CDFIs to which it sells such services to 15 within the next five years.

For the most part, ACCION encounters little competition from conventional lenders. Few regulated lenders are interested in making small loans to high-risk business borrowers, particularly without the benefit of a SBA guarantee. They are interested, however, in building relationships with ACCION in the hopes of capturing the CDFI's small business borrowers once they grow beyond ACCION's ability to serve them. ACCION's initial capitalization in 1994 consisted of a total of $125,000 in zero-interest loans from four separate banks. It continues to receive both operating support and low-interest loan capital from conventional institutions, especially those that are more-recent entrants into the San Antonio and Texas markets. Capital One, for example, recently moved into the Texas market when it acquired a large local bank, and has been assiduously working to establish a formal referral process with ACCION, so that it can help its customers who cannot meet the bank's underwriting standards, while simultaneously being a go-to lender for ACCION graduates. Its support of ACCION□both financial and through its officers' service on the governing board and loan committee□is geared toward establishing a mutually beneficial "continuum of credit." Wachovia and Washington Mutual have taken similar approaches. As newer players in the Texas market, they are working both to steal customers from other banks and to develop new customers from under-served and emerging markets. Working through ACCION becomes a logical strategy.

While most banks actively seek to partner with ACCION, Executive Director Janie Barrera notes two exceptions. These are Innovative Bank and Superior Financial Group, both of which are based in California and have actively marketed $5,000 to $15,000 SBA-backed loans to start-ups and home-based businesses. These institutions do not take small business deposits, and they do not offer any business development services. Prospective borrowers fill out a streamlined application online and pay a $500 application fee. Loan approvals are based almost entirely on the individuals' credit scores, as applicants are not required to provide prior tax returns or information on their business plans. Innovative and Superior market their products nationally through seminars at local small business development centers, chambers of commerce, and community development corporations. Sue Malone, Superior's President of Small Business Strategies, who previously worked for Innovative Bank, claims that she has originated 20,000 such loans in the past five years.

While Innovative and Superior appear to have found a niche in the micro-business market, it is not clear how much of a threat they represent to an organization such as ACCION. Malone views CDFIs not as competitors, but rather as partners that serve a different segment of the small business market, specifically individuals and companies that cannot meet the bank's underwriting threshold. Barrera concurs, at least to a point, believing that the institutions are unwilling to go as low on the credit score ladder as ACCION is willing. Like many banks that have specialized in higher-risk markets, Innovative and Superior have not yet survived an extended economic downturn. The general weakness in the business environment has already caused a similar small business lender, Business Loan Express, to curtail its lending, and there is some indication that Innovative Bank itself has cut back significantly as it struggles to deal with under-performing assets.

The most challenging issue for ACCION continues to be obtaining adequate loan capital. The organization disperses nearly 100 percent of its available funds every month, with repayments generally covering new requests. Yet in December 2007, ACCION had in excess of $200,000 in new loan requests it could not meet because of a lack of loan capital. The problem has multiple causes. Bank mergers tend to reduce the amount invested in the CDFI; the merged institution typically makes only half as much in grants and loans to the organization as the previous institutions had made separately. Merger activity in Texas has reduced the number of banks that might invest in ACCION. Banks also appear to have changed the way they approach loans to the organization. According to both Barrera and some of the organization's investors, banks no longer view ACCION as a charity, but more as a financial institution with a bottom line. They consequently underwrite loans to ACCION as they would to any financial institution. Banks want an economic return on their investment, not simply CRA credit or a tax write-off; they need ACCION to demonstrate how the loan will benefit the bank as well as the CDFI. The changing environment has led ACCION to expand its own capital outreach efforts. For example, it purchased a share in (and received a seat on the board of) the for-profit Texas Mezzanine Fund (TMF), a multi-bank CDFI that provides both residential and small business loans throughout the state. ACCION has received a $250,000 loan from TMF, but hopes that its involvement with the organization will create new partnership opportunities with TMF's investor banks.

Colorado Enterprise Fund

As in Texas, emerging businesses in Colorado frequently struggle to obtain financing from mainstream lenders. Banks in the Denver and Front Range areas are extremely reluctant to make micro-loans, particularly to start-ups and other companies with limited collateral, limited equity, and/or owners with personal credit issues. The interest that could be earned on the small loans simply is not worth the underwriting effort, and the resulting loan-to-value ratios would exceed those with which the lenders (and their regulators) are comfortable.

The nonprofit Colorado Enterprise Fund (CEF) was created in 1976 in order to help emerging companies and entrepreneurs that could not obtain financing from traditional sources. Headquartered in Denver, CEF serves the entire state, though the bulk of its activity takes place in the Front Range Urban Corridor (the area east of the Rockies stretching from the Wyoming boarder to Pueblo). The organization offers loans ranging in size from $1,000 to $250,000, with an average of $30,000. CEF focuses on traditionally under-served businesses, particularly those owned by women, ethnic minorities, and low-income individuals. It will lend to virtually any type of non-"sin" business (no bars or liquor stores), but tries to target companies with the potential to create significant numbers of jobs. Micro-enterprises comprise 88 percent of its borrowers, and CEF consequently relies heavily on capital from the SBA micro-loan program. The CDFI augments its core lending efforts with management consulting and training services, including a "Bizworks" education program, and has developed special lending initiatives for childcare facilities and teen entrepreneurs.

CEF is primarily a cash flow lender, with the business's collateral taking secondary importance. For loans under $35,000 (i.e., most of its loans), CEF uses an internal rating system similar to that of ACCION Texas's to guide its decision-making. Like ACCION, CEF developed its model based on its historical experience. It also incorporated underwriting practices set forth in the early 2000s by the Opportunity Finance Network. CEF's system focuses on eight criteria that include assessments of company cash flow and collateral as well as the owner's credit history. The approach has enabled the organization to respond to applicants generally within a few days. For loans greater than $35,000, CEF staff members conduct more-thorough analyses of the prospective borrower, paying closer attention to the underlying collateral as well as both the historical and projected cash flow and related financial information. These larger loans require the approval of CEF's loan committee, and that typically adds up to 10 days to the approval process. Most of the larger loans serve as gap financing for companies and are in junior position relative to conventional bank loans to the company; without CEF's participation in the transaction, the company would not be able to access any bank financing. The organization continues to augment its lending with business and financial management counseling.

Like ACCION Texas, CEF benefits from a generally collaborative relationship with conventional lenders active in the Front Range market. Banks continue to provide the organization with both operating and loan capital, including three equity-like investments in the past year alone. The banks derive distinct non-CRA benefits from the CEF relationship as well. They are able to refer to CEF existing small business depositors who could not meet their loan standards, thus enabling the companies to obtain their needed financing while retaining them as depositors and potential future customers. CEF frequently refers its borrowers to its partner banks for deposit services, as well as for loans once the companies have developed enough to be "bankable." As noted earlier, CEF also will lend in partnership with mainstream banks on larger deals that the banks are unwilling to make themselves.

There is little overlap between the banks' and CEF's borrowers. Up to two-thirds of CEF's borrowers come to the organization from area banks; most of these companies are "pre-bankable," in that they lack the credit history, collateral position, and/or capital needed to meet the banks' underwriting criteria. Because CEF's interest rates tend to be higher than those of the banks, it is more advantageous for "bank-able" borrowers to go to conventional institutions for financing. On occasion, CEF will finance a "bank-able" borrower that had previously received a smaller loan from the organization and prefers the CEF relationship. It is more common for CEF to receive applications from businesses that could qualify for a bank loan, in which cases the organization typically refers those companies directly to one of its partner banks. The organization has not reported any competition of note from a regulated institution, including *de novos* in the Front Range.

CEF's partnerships with conventional lenders periodically have been affected by changes in the local financial markets. In the early 2000s, for example, Colorado's economy and real estate market was attractive to speculators looking either to acquire existing banks or to form new banks. Although these new banks rarely competed directly with CEF for borrowers, they frequently lured away loan and CRA officers from CEF's bank partners. The turnover disrupted some of CEF's relationships with these institutions, in terms of both borrower referrals and capital support.

Capital remains the critical challenge for CEF. As a way of helping to increase its self-sufficiency (and thus its net asset base), CEF has been trying to make larger loans□typically those in the $70,000 to $100,000 range. Larger loans require less maintenance per dollar, and the borrowers tend to be more stable. Yet these deals fall outside the SBA micro-loan program, which has traditionally been CEF's primary source of loan capital. The need for more-flexible capital may well become even more pronounced with conventional lenders' movement toward increasingly conservative small business underwriting standards. Sharon King, the Director of the Boulder Small Business Development Corporation, explained that banks now have much stricter credit score requirements, place more importance on collateral, and are more aggressively calling lines of credit. CEF Executive Director Ceyl Prinster anticipates an emerging demand for more flexible lenders willing to address financing gaps through innovative, relationship-based underwriting, and already notes an uptick in the number of bank referrals that the organization has received.

Cooperative Business Assistance Corporation

Based in Camden (NJ), the nonprofit Cooperative Business Assistance Corporation (CBAC) has been providing financial assistance to small and emerging businesses in the six-county southern New Jersey region since 1987. The region consists of Philadelphia suburbs, one of the most economically distressed cities in the country (Camden), Atlantic City, the largely unpopulated Pine Barrens area, and some of the state's more productive agricultural land. While New Jersey overall has the highest population density in the country and thus qualifies as one of the more economically vibrant states, its southern region has long been comparatively weak economically. CBAC works to promote and sustain development in the region by supporting companies with a good likelihood of future growth.

Much of CBAC's market lies within the Philadelphia-Camden-Wilmington metropolitan statistical area (MSA), the country's fifth largest. Although the area is generally well served by conventional banks, many of its small businesses cannot meet the lenders' underwriting standards. These prospective borrowers frequently have low credit scores, little equity or collateral, and little history of banking with a mainstream financial institution. Gary Rago, the Regional Director for the New Jersey Small Business Development Corporation, also notes the dearth of lenders who can devote the time and resources to work with entrepreneurs who can communicate their business ideas but lack the skill sets required to translate their visions into feasible, bankable plans. One of the biggest challenges the SBDC encounters, for instance, is its clients' inability to communicate to lenders a budget for their business ideas. Such small businesses comprise a significant portion of CBAC's portfolio. The CDFI targets most of its services to entrepreneurs and companies that cannot obtain financing from conventional bank sources. Many of these borrowers need smaller loans than are profitable for mainstream lenders, do not meet the banks' credit or collateral standards, and/or need considerable technical assistance in order to use credit effectively.

CBAC tailors its financing to meet the particular needs of its borrowers. For start-ups, which constitute about 20 percent of CBAC's portfolio, it makes micro-loans of as little as $1,000. In Atlantic City and Camden, it will offer working capital, inventory, and equipment purchase loans of up to $150,000 with five-year terms and fixed interest rates. For businesses based in these cities that have been in operation for at least two years, CBAC will make fixed asset loans of up to $500,000. These notes are primarily designed to finance the acquisition, construction, or renovation of commercial real estate. They carry 15-year terms and fixed interest rates that are determined on a case-by-case basis. Camden companies can also obtain emergency loans of up to $6,000 to address unforeseen building repair issues and short-term financial catastrophes. The typical CBAC small business borrower receives a $15,000 loan with a maturity that may extend for up to six years. CBAC generally underwrites based on a company's positive cash flow, but will make exceptions for businesses with strong management and compelling business plans. It requires that all small business owners sign for their loans and take full personal responsibility for them.

The CDFI views itself ultimately as a gap lender, one that will work with comparatively marginal companies to help them reach a position where they can qualify for straight bank financing. It therefore considers more-conventional lenders to be its partners, not competitors. According to Executive Director Mike Diemer, if one of the bankers on CBAC's loan review committee thought that his or her institution could finance a deal that was being reviewed, the deal would be taken off the table and referred to that bank. CBAC operates its loan funds in collaboration with eight mainstream lenders; it uses borrowed funds from the banks to lend in particular areas, and it lends in partnership with those banks to companies that require larger loans than CBAC can provide on its own. (CBAC's loans take a subordinate position to those of the banks.) It also offers a loan guarantee program in Camden and Atlantic City, through which it purchases a certificate of deposit in the originating bank for up to 40 percent of the loan amount (or $75,000, whichever is less). The guarantees can extend for up to 10 years, and are intended to help nascent small businesses establish relationships with mainstream banks.

The relationship with CBAC has numerous benefits for the banks. CBAC helps the conventional lenders build a presence in low-income, under-served markets. The banks can take advantage of the CDFI's underwriting and its knowledge of the Camden, Atlantic City, and other south Jersey small business environments to make loans that boost their CRA ratings. By making the loans through CBAC, the banks also avoid having to put higher-risk loans on their own books. CBAC not only helps generate potential future small business customers for the banks, but it also enables banks to keep some of their current customers. CBAC's bank partners have periodically referred existing small business depositors to CBAC for loans; the companies could not meet the individual bank's underwriting criteria, and rather than risk the business taking its deposits to another institution that might look more favorably upon its request, the banks have recommended that it approach CBAC for financing.

Not surprisingly, CBAC's focus on higher-risk borrowers and its emphasis on technical assistance provision prevent it from covering its costs internally. The organization is not self-sufficient and does not believe that such a goal is realistic. Achieving self-sufficiency would likely require that CBAC either cut back its business counseling services considerably, charge higher rates on its loans, charge its partner banks higher fees for loan participations, and/or focus its lending on more-stable businesses that need larger loans. Each of these options would limit the organization's ability to serve the weaker, nascent companies that it has long targeted, however. Another option would be to raise enough capital to increase its loan volume and thus the overall size of its portfolio, but that appears unlikely in light of the uncertainty in the capital markets and CBAC's limited staff. The organization will therefore continue to rely on grants and very low-cost capital to make ends meet. CBAC receives operating support from its bank partners, through Community Development Block Grant allocations, and from occasional foundation grants. In addition to lending capital for its micro-loan program, it receives grant money from the SBA to help cover the costs of its small business counseling programs. It has received grant and other low-cost capital from the federal CDFI Fund and Economic Development Administration, and it has a contract with the New Jersey Economic Development Authority for a Hispanic/Latino business mentoring initiative.

CBAC is well positioned to take advantage of the problems affecting many conventional lenders, though it likely will have to raise additional capital in the next couple of years. Rago explains that many small business borrowers have used their residences as collateral for their loans, and declining real estate values could result in banks re-setting rates to account for the reduced collateral. Such scenarios could push borrowers who had been marginally "bankable" toward more character-oriented lenders such as the CDFI. Similarly, officials at CBAC's partner banks note both the general credit tightening on the part of mainstream lenders and the higher business operating costs resulting from increases in the price of oil and other raw materials. These factors may well make it more difficult for less-established companies to satisfy the banks' automated credit scoring thresholds. The officials also see potential servicing opportunities for CBAC, as banks will perceive a need for greater monitoring of their small business portfolios.

Santa Cruz Community Credit Union

Santa Cruz County, located about 50 miles south of San Jose (CA), has essentially two different markets. The northern part of the county contains its namesake city, home to a University of California branch and the National Surfer Hall of Fame. Residents tend to be relatively affluent, with many commuting over the mountains to work in Silicon Valley. Concern for the environment runs strong, and many residents have consistently pushed back against proposed development. The southern part of the county tends to be much more agricultural in orientation and comparatively poorer. The area surrounding Watsonville has long been one of the major strawberry producing regions in the country and has long been home to a large migrant worker population. While the Santa Cruz area tends to be predominantly non-Hispanic, the Watsonville area has a substantial Latino population.

Frustrated with the seeming unwillingness of mainstream banks to serve the needs of lower-income communities in the county, a group of Santa Cruz housing and consumer advocates founded the Santa Cruz Community Credit Union (SCCCU) in 1977. Even as banks have become more active in such markets as a result of CRA and other motivations, the basic operating premise of the credit union has remained the same. Members contend that the conventional banking system is fundamentally flawed and that community-controlled capital is essential to meet the financial needs of the county's poorer residents and communities.

According to officials at the county's small business development center, access to financing continues to prove problematic for many low-margin service businesses such as childcare centers, as well as for emerging minority-owned businesses. Latino-owned companies in the Watsonville area have particular difficulties obtaining such capital. These businesses frequently have relatively weak or limited credit histories, limited management experience, thin capital bases, and limited collateral. At the same time, they generally require small amounts of credit. SCCCU has always targeted these types of companies. The credit union provides a wide range of options, including equipment and vehicle loans, commercial real estate financing, working capital loans and lines of credit, SBA 7(a) loan guarantees, and business credit cards. The vast majority of its loans are less than $50,000, and about 19 percent qualify as micro-loans (under $25,000). Among its specialized product areas are childcare, solar energy, and energy efficiency, each of which was developed in response to voids in the market. SCCCU also targets agricultural businesses, arts and cultural nonprofits, and business cooperatives. As of March 31, 2008, the credit union had 56 small business loans totaling $10.1 million in its portfolio.[5]

The credit union has succeeded in serving these companies through classic relationship lending. Loan officers will take the time to make loans as small as $5,000, working closely with the business owner to understand his or her plan and evaluate its likelihood of success. They typically handle all phases of the lending process, not involving other departments or lenders, which allows them to develop better relationships with the individual owners. SCCCU primarily lends against cash flow, requiring debt service coverage ratios of 1.15 or more. But if the prospective borrower does not have the historical profitability to demonstrate such coverage capacity, the credit union will accept projections and assess their reasonableness. For these borrowers and for those with insufficient collateral, SCCCU will use SBA or other loan guarantee products to support the loans, provided that the business plan seems realistic and that some likely social benefit will ensue.

The credit union's emphasis on relationship lending has become increasingly important with the disappearance of many of the locally chartered banks in the county. In 2003, Union Bank of California acquired Monterrey Bay Bank. In 2004, Greater Bay Bank bought the Santa Cruz-based Coast Commercial Bank, which had been instrumental in helping the city recover after the 1989 Loma Prieta earthquake; Greater Bay Bank subsequently merged with Wells Fargo. In 2006, RaboBank acquired the Community Bank of Central California, a Salinas-based institution that had been active in the southern part of Santa Cruz County. Although the acquiring banks have actively solicited small businesses, the general sense among both SBDC and credit union officials is that none has been willing to focus as much on the community relationships that their acquired banks had developed. Wells Fargo, for example, is seen as noticeably less responsive to local small business needs.

One response to the changing market dynamics has been the emergence of two Santa Cruz-based *de novo* institutions: Santa Cruz County Bank (established in 2004) and Lighthouse Bank (created in 2007). Both are reasonably well capitalized for their age ($168.6 million and $33.8 million in total assets, respectively, as of March 31, 2008) and have been aggressive lenders in the small business marketplace. Collectively, the two institutions had $9.3 million in small business loans on their books at the end of the first quarter, in addition to $26.4 million in commercial real estate notes.[6] Many of the loan officers at these institutions had worked at other local banks prior to the banks' acquisition, and they brought their knowledge of the local small business market and their relationships to the start-up institutions. With the emergence of these *de novo* banks, SCCCU officials believe that there are no longer unmet small business needs in the Santa Cruz and northern Monterrey County market.

[5] Based on the credit union's 5300 report filed with the National Credit Union Administration; see http://reports.ncua.gov/data/cureports/index.cfm

[6] Based on data from the Uniform Bank Performance Reports (UBPR), available at http://www.ffiec.gov/ubpr.htm

Aside from occasional joint efforts to provide financial literacy training to area residents, SCCCU and other area financial institutions tend to be competitors with regard to both their deposit and small business customers. Many (if not most) of the credit union's members could easily have their basic financial needs met by conventional institutions; in fact, many members also have accounts with some of the larger banks. Those both within and outside the credit union acknowledge that SCCCU's major appeal to more-affluent depositors with a choice of institutions is one of social mission and customer service. This commitment to the community continues to set the credit union apart from the other institutions in the area and represents a key competitive advantage. SCCCU also has relatively little competition from other lenders on its small, high-touch business loans. "Many of our borrowers are unsophisticated small business owners that do not know what is available or how to go about obtaining capital," explains Loan Officer Randy Johnson. "Our mission is to assist these borrowers by educating them as to what services are available and how to tap into them." For the most part, the banks are unwilling to put the time and resources into underwriting these higher-risk borrowers on transactions unlikely to generate much (if any) profit.

For somewhat larger business loans, SCCCU encounters much stiffer competition. Both it and the *de novos* have emphasized relationship-based lending and frequently compete for the same customers. Credit union lenders report that SCCCU's borrowers are "constantly solicited" by mainstream banks, and that commercial banks have "numerous sales people with substantial sales goals on the street at all times soliciting business [and] entire departments dedicated to products" the credit union offers. Santa Cruz County Bank in particular has been "overly aggressive" in this regard. The larger banks can often better the credit union on price, they have a greater ability to bundle loan products and small business services, and they have much higher lending limits than SCCCU. Such characteristics prove advantageous to some of the credit union's existing small business customers as they grow. Furthermore, the banks' branch networks tend to be much more visible that that of the credit union, which has only two branches (in Santa Cruz and Watsonville).

In addition to developing the childcare and environmental product offerings described earlier, SCCCU has taken other steps to increase its attractiveness to potential borrowers. It now offers a "Quick Cash" line of credit of up to $25,000 that uses flexible underwriting standards, features a short application process, and offers rapid approval turnaround. The credit union has recently begun to offer 24-hour loans both on-line and over the phone. SCCCU remains at somewhat of a disadvantage, though, as it does not have the resources to match the banks in technological capacity. It is also subject to regulatory lending limits based on its relatively small size.

Credit union officials believe that the general trend among conventional lenders toward credit tightening may create some additional business opportunities. Officials at $8 billion Rabobank, for example, stated that troubles in the housing market could impact small business owners' personal credit scores. Since many individuals pledge their homes as collateral for their business loans, declining real estate values could undermine the existing collateral value and force the borrowers to come up with additional sources to restore it. That would likely tighten the underwriting criteria on smaller business deals generally. Other CDFIs active in the greater Santa Cruz area have already seen increased demand for their products as bank credit has become more restrictive. The aggressive lending on the part of the *de novos* could also ultimately benefit the credit union, if either a) enough of the loans default and raise safety and soundness concerns among the banks' regulators, or b) if the *de novos'* success causes them to be acquired by larger institutions with less interest in a relationship-based approach to small business finance. Yet SCCCU itself can be only so flexible in its underwriting and take on so much risk without raising concerns among its own regulators.

Shorebank

Shorebank is widely credited as being the first community development bank in the United States. Founded in Chicago in 1973 as South Shore Bank, the institution emerged as a response to the financial disinvestment that was occurring place in the city's lower-income neighborhoods. A group of local activists mobilized enough capital to purchase a mainstream bank branch in the city's South Shore neighborhood that was scheduled for consolidation. They obtained a new charter and focused on providing loans and financial services designed to help stabilize and ultimately revitalize South Shore.[7] The bank's success in pursuing its dual mission attracted considerable attention among policy-makers□ Bill and Hillary Clinton's interest in the model helped provide the impetus for the federal CDFI Fund□ and also spurred efforts to replicate the bank elsewhere in the country. Shorebank now has 12 branches in the Chicago area, Cleveland, and Detroit, and non-bank affiliates in Michigan's Upper Peninsula and the Pacific Northwest. With over $2 billion in assets, Shorebank is one of the largest CDFIs in the country. We are limiting our study to the bank's efforts in the greater Chicago market.

A full service bank, Shorebank offers deposit services, residential mortgages, and consumer loans in addition to its small business products. It has four full-service branches on Chicago's south side, one on the far north side of the city, and two in western Cook County (the result of its recent acquisition of Greater Chicago Bank). The bank's historical small business focus has been on companies and neighborhoods traditionally under-served by mainstream lenders. In particular, Shorebank has targeted minority-owned businesses, franchises, churches, small to mid-sized nonprofits, and childcare centers. It initially concentrated principally on activities designed to help develop South Shore and the surrounding communities, but has since broadened its scope to include socially responsible banking and investing. Vickie Battle, Shorebank's Director of Business Banking, stresses that the bank lends throughout the Chicago region but places the most emphasis on lending in the neighborhoods surrounding its branches.

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[7] For a more detailed discussion of Shorebank's mission and origins, see Richard P. Taub. 1994. *Community Capitalism*. Cambridge, MA; Harvard Business School Press.

Shorebank's small business loans tend to be larger than those of the other CDFIs in our study. In 2005, for example, the bank's average small business loan in the Chicago area was $228,000. Shorebank continues to target smaller companies as well, however. Forty-six percent of its loans in 2005 were under $100,000, and the average of those loans was $61,000. The bank recently divided its commercial and industrial lending division into two parts. One focuses on larger companies in need of larger loans, while the community lending component works with customers seeking loans of under $250,000 and with companies generating less than $1 million in annual revenues. The bank has always augmented its lending with efforts to help increase its current and prospective borrowers' management and operational capacities. One such vehicle was the affiliated Shorebank Neighborhood Institute, which provided a range of business development services in addition to micro-loans and energy financing. With the recent dissolution of Shorebank Neighborhood Institute as a separate entity, the bank either offers those services itself or (more frequently) refers individuals and organizations to its small business development partners in its communities.

Chicago has long been a major financial center with a strong tradition of community activism. Organizations such as the National Training and Information Center, the Woodstock Institute, The Woodlawn Organization, and others were instrumental in calling attention to discriminatory lending practices with regard to minorities and low-income communities, and have been steady advocates on behalf of legislation such as the CRA and the Home Mortgage Disclosure Act. They have continued to monitor banks' lending activity in the region's lower-income markets and have not shied away from publicly calling certain institutions to task for weaker performance. In addition, Chicago's size and ethnic diversity have contributed to the formation of numerous new institutions seeking to exploit perceived niches in the marketplace; 41 of the locally chartered banks active in 2007 had been formed since 2000 (Federal Deposit Insurance Corporation 2008c). As a result, Chicago is one of the most competitive small business banking cities in the country. Lenders routinely compete for small business loans, even (and especially) in the region's poorer communities.

Shorebank consequently faces competition from both more-established and *de novo* banks with regard to both deposits and small business financing. Like most banks, Shorebank's primary source of capital is deposits. Yet most of the bank's branches are located in low-income communities with weak deposit bases. Complicating matters further has been the branch building boom throughout the city, with larger banks increasing their branch presence in lower-income and minority communities. For example, since 2003, large national banks and thrifts such as JP Morgan Chase, Bank of America, Washington Mutual, Citibank, National City, and Fifth Third have all opened up new branches in communities where Shorebank branches are located. Shorebank has sought to market its social mission orientation to prospective depositors outside of its geographic footprints□it has frequently advertised in the *New Yorker* magazine, for example□ but such efforts come with a price. The bank's cost of funds tends to be higher than that of its larger competitors, often closer to the five-year Treasury note than to the London Interbank Offered Rate. As a result, Shorebank frequently loses out on deals to other banks if the determining factor is the price of the loan. Bank officials acknowledge the need to invest more significantly in technology in the near future in order to attract more deposits from small business owners; building the deposit base is critical for potential cross-selling opportunities.

In light of these constraints, Shorebank has necessarily focused both on its ability to develop relationships with customers and on the development of certain lending niches such as franchises and smaller and medium-sized nonprofits. Additionally, Shorebank has actively worked to fill gaps in lending to churches, other faith-based businesses, and child care centers. Unlike many of its larger competitors, the bank offers flexible underwriting that does not rely heavily on credit scoring. Shorebank's reorganization of its small business lending division represents one effort to capitalize on its strength in relationship-based lending, and the bank continues to be an active originator of SBA-guaranteed loans. Its franchise lending model has been successful enough that other lenders are seeking to copy it, and Shorebank has recently seen increased competition in lending to franchises.[8] At the same time, Shorebank still struggles to lend to independent retail establishments in its targeted communities. Part of the reason stems from the relatively weak commercial presence in neighborhoods such as Austin, Bronzeville, and Chatham. Part also reflects the bank's difficulty in lending to suburban businesses and to out-of-area businesses with urban locations. In many cases these firms are less interested in Shorebank's social mission and relationship lending focus, and more intent on securing loans with favorable pricing and on using sophisticated cash management services offered by larger banks.

It is too early to tell how the tightening credit markets will affect Shorebank. Loan officers at the bank have not seen any changes in the demand for larger commercial loans, and, at the time of the interviews, the bank had not noticed any substantial deterioration of its portfolio performance. The bank has seen some increase in the number of small business applicants, with newer applicants appearing to be somewhat more creditworthy than existing customers. Such a trend would suggest that Shorebank stands to benefit from a credit shortage in the small business marketplace.

University National Bank

Based in St. Paul (MN), University National Bank (UNB) was originally chartered as Summit National Bank of St. Paul in 1962. The bank changed its name in 1995 and made a conscious effort to focus more on the financial needs of lower-income Twin Cities communities. It received federal certification as a CDFI in 2001, the first insured depository in Minnesota to receive that designation. It offers a full range of banking and financial services to its customers, including consumer and business deposit services, residential and consumer loans, and

[8] Lending to franchises generally poses less risk than lending to independent small businesses, as there is often some financial backing provided to the franchise by the underlying company (McDonald's, for instance).

commercial loan products. One of the bank's larger and more innovative programs is Houses to Homes, which provides financing for the acquisition and revitalization of blighted residential spaces. Seventy percent or more of UNB's loans regularly target projects and borrowers in economically distressed neighborhoods.

Like many other urban markets, the Twin Cities have experienced considerable consolidation in the financial industry. Whereas locally chartered institutions held 60 percent of the area's deposits in 2003, they held only 29 percent by 2007 (Federal Deposit Insurance Corporation 2008c). The increased market share of larger regional and national banks seems to have had negative ramifications for emerging small businesses, particularly those operating in low-income Minneapolis and St. Paul neighborhoods. Iric Nathanson, the Financial Resources Coordinator of the Metropolitan Consortium of Community Developers, notes that the larger banks have not been as consistently active in reaching out to such companies, and their emphasis on automated credit scoring has made it difficult for less established businesses to obtain the capital necessary to grow. Both he and Tene Wells, the President of Women Venture, a small business development organization based in St. Paul, report that the problem is most pronounced for start-up businesses, companies owned by recent immigrants, and firms with low levels of equity or collateral. Larger lenders appear noticeably less interested in making smaller loans to such companies and are unwilling to devote the time and resources to work closely with prospective borrowers that require more assistance with the lending and application process.

UNB has consistently taken a different tack, aggressively seeking out and assisting small businesses whose growth could help build and sustain the economic vitality of the local community. Whereas larger banks tend to rely on more-quantitative criteria when assessing loan applications, UNB emphasizes a relationship-based approach. To develop and enhance their understanding of local needs and issues, loan officers are required to make 500 or more calls each year to non-bank customers and to participate as board members of local nonprofit organizations. The idea is that the lenders are able to develop more- detailed knowledge of the ways in local organizations work with individuals and companies that may well become bank borrowers. These relationships help UNB source potential loans as well as to assist emerging companies so that they can use capital most effectively. For example, loan officers make the effort to understand the individual businesses that come to them for financing, frequently referring potential loan applicants first to entities such as Women Venture for help in formulating their business plans and marketing strategies.

These local partnerships, in conjunction with the lenders' understanding of the applicants' business model, allow for greater flexibility in underwriting. In addition to the underlying business fundamentals (likely cash flow, collateral, and the like), loan officers evaluate the character of the borrower him or herself□assessments that are influenced by those of the local partners with which the applicant and loan officer have mutual relationships. In effect, the loan officer can become the borrower's advocate within the bank, helping to convince loan committee members of the likelihood of success even though the "hard" numbers may not suggest such an outcome. Because of this approach, UNB has made small business micro-loans of as little as $2,000. (The bank understandably does not engage in many of these transactions, as loans under $10,000 tend not to be profitable.) None of this is to suggest that UNB is making loans that would put its safety or soundness at risk, however; the bank uses guarantee programs to shore up its collateral position when necessary. For example, UNB received a $1 million loan from the city of St. Paul through its Neighborhood Lending Partnership, a program that guarantees loans made for companies operating in economically distressed communities to acquire and rehabilitate real estate and business equipment in these markets.

Although its community development orientation sets it apart from other regulated financial institutions in the market, UNB does not enjoy an uncontested niche. As a federally insured depository, it competes with more-established banks, *de novos*, and larger credit unions for deposits. UNB is at a disadvantage because it has only one branch (in St. Paul), but it has invested heavily in technology to allow more on-line banking throughout its service area. It has specifically targeted socially-minded individuals, local businesses, faith-based organizations, and other CDFIs—both within and outside the Twin Cities—for deposits in its Socially Responsible Deposit Fund. The deposits earn competitive interest rates and are earmarked for community development loans in particularly economically challenged neighborhoods in Minneapolis and St. Paul.

UNB offers a range of small business loan products, including term loans, commercial real estate loans, working capital lines of credit, and business credit cards. It encounters relatively little competition for its very small transactions, as they are not very profitable for anyone. It faces much stiffer competition, especially from larger national and regional banks, for larger commercial and industrial loans. UNB's relatively small size ($117.6 million in total assets as of June 30, 2008) limits how much it can realistically lend to any single project. The larger banks can also often beat UNB on price, although UNB tends to have an edge when the deals require more-complex underwriting and place a premium on local and interpersonal relationships.

The strongest competition on much of UNB's small business activities comes from the region's *de novo* banks, however. The extensive merger and acquisition activity that has taken place in the past 15 years among the region's financial institutions has created an opportunity for more relationship- and niche-based lenders. Nearly one quarter of all of the banks with local charters in 2007 had been established in 2000 or later (Federal Deposit Insurance Corporation 2008c). Although they do not share UNB's social mission, these emerging banks highlight customer and borrower interaction as differentiating them from their more established counterparts. In some cases, UNB will lend in partnership with these institutions, usually in cases in which the requested loan is too large for a single small bank to make comfortably. Yet in many cases in the past couple of years, UNB has lost potential borrowers to the *de novos* as the banks sought to grow their portfolios as quickly as possible.

How serious and consistent the competition for small business loans will be remains to be seen. At this point, UNB officials are not especially concerned. The larger, more established banks periodically come in and aggressively try to capture a significant portion of the small business market in lower-income areas, but rarely maintain a long-term commitment to that market. The *de novos* might be more serious competitors because of their focus on relationship lending, but they have yet to make it through an extended downturn in the business cycle. UNB believes that the types of loans that the *de novos* have made could cause some real problems. According to Bank President David Reiling and holding company Vice President Nikki Foster, the *de novos* have not adequately priced their loans relative to their underlying risk. For example, they have loaned at below-prime rates to companies in business for less than a year and possessing shaky collateral. Comparing the underwriting to that of subprime housing lenders, Reiling contends that the *de novos* will end up with a substantial proportion of bad loans on their books within the next year or so. To the extent that those banks have to devote more resources to cleaning up their portfolios, UNB should benefit. The CDFI proactively worked to restructure and/or write off many of its problem loans over the past 18 months, so it should have a cushion to be more aggressive in the small business arena. Reiling also anticipates potentially being able to hire some of the experienced commercial lenders away from *de novos* that experience portfolio problems, particularly if those banks have not yet reached profitability and are forced to consolidate.

Discussion

What emerges from the case studies is the idea of a continuum of credit. There remains a subset of small businesses that do not have the experience, financial structure, and/or credit history to obtain financing from conventional banks. These entities (or individuals, in the case of very small companies) frequently need a fair amount of assistance in developing a business plan, better targeting their market, and generally improving their management and financial structures in order to become viable bank borrowers. Such work requires much more intensive, relationship-based underwriting and technical assistance provision than conventional lenders are willing to provide. *De novo* institutions tend to be more oriented toward relationship-based lending, and will target certain companies that more-established banks have shunned, but they too are generally unwilling to engage in significant lending to fledgling companies, especially those needing comparatively small loans. CDFIs, particularly nonprofit loan funds, thus become the primary providers of credit for these businesses. The organizations' explicit focus on community economic development and lending to under-served populations, coupled with their ability to attract funding from a wide range of public and philanthropic sources, virtually demands that they target such companies.

The Community Reinvestment Act requires that banks lend and invest throughout their service areas. The mandate has contributed to heightened competition for "bankable" borrowers in low-income communities. Not surprisingly, more established, "bankable" small businesses can often play off multiple lenders when looking for larger loans (those of $100,000 or more). Yet direct financing is only one manifestation of the competition. Banks work diligently to attract small businesses as depositors. Not only do the deposits help increase the bank's low-cost capital base, they also offer the opportunity for current and future cross-selling opportunities□some of the major sources of bank revenue. Banks have therefore worked closely with CDFI small business loan funds to help build and sustain a base of customers. They frequently refer depositors who cannot qualify for bank financing to CDFIs that specialize in working with less sophisticated small businesses; the company can address its immediate financing needs while remaining a bank customer. Mainstream banks regularly provide these CDFIs with low-interest loan and investment capital, operating grants, and technical assistance in the form of board and loan committee members as well as training in lending and underwriting. Not only do the banks receive CRA loan and investment credit for their CDFI-related work, but they also frequently are able to partner with the CDFIs in making direct loans to more stable small businesses in need of larger capital amounts. Underlying the bank-CDFI relationship is an assumption that the CDFI will refer stronger, more "bankable" borrowers to the bank in the future□often after those companies have built their credit history with the CDFI.

Such collaborative relationships do not come without costs to the CDFIs, however. ACCION's Janie Barrera and others noted the bank partners' increasing emphasis on ensuring that their grants and investments in CDFIs ultimately improve the banks' bottom line in some way. For example, banks increasingly require financial returns from CDFIs on their capital investments into the organizations, as well as formal referral agreements from the CDFIs. In exchange for lending and operating capital, the banks want to ensure that the CDFI sends them “bankable” CDFI “graduates” for small business lending services. In some cases, the banks’ capital carries requirements for a seat (or seats) on the CDFI’s board of directors. These conditions could limit the CDFIs’ abilities to work with a variety of financial institutions and maximize funding opportunities. Yet thus far, the benefits of the bank relationships appear to outweigh the costs.

It is important to note the fundamental differences in the relationships between banks and CDFI loan funds and those between banks and CDFI-insured depositories. While the former tend to be much more collaborative in nature, the latter are generally more competitive. As regulated institutions, community development banks and credit unions inherently have less flexibility in their lending; they cannot take on as much risk as a loan fund might, because of regulator concerns about financial soundness and stability. Thus while they may engage in some lending to small businesses deemed too costly or risky by both established and *de novo* institutions, they need to supplement those transactions with loans to more-stable companies, many of which need (and can support) larger loans. This latter lending often places the CDFI depositories in direct competition with more conventional lenders looking to carve out their own niche in the particular local market (the typical *de novo* strategy), expand their existing activities, and/or satisfy both CRA and internal lending benchmarks.[9]

The competition affects not just lending, but also the institutions’ deposit bases. The CDFI depositories in this study, as well as others into which we have insights, typically seek to exploit their emphasis on relationship-based lending and financial services, their flexibility in addressing customer needs, their in-depth knowledge of the local market, their community development mission, and the technical assistance they are willing to provide to attract both borrowers and depositors. Unfortunately, many of those characteristics (except for the community development mission) also apply to non-CDFI community banks and credit unions. Although these institutions’ relationship-based lending generally focuses on larger loans to relatively established firms, *de novos* are often willing to target smaller, stable businesses in lower-income markets that need more moderately sized loans□in effect, some of the CDFIs’ actual or potential customers. One has to wonder whether the CDFI deposit bases are ultimately limited to particular subsets of low-income individuals and communities, as well as certain socially-minded investors, many of whom field multiple requests for their social investments.

Thus far, the relatively small size of the CDFI depositories□even Shorebank pales in comparison to a typical regional bank□has limited their competitiveness in attracting capital and making larger loans. Larger banks frequently invest more heavily in technology, which enables them to

[9] It is not uncommon, however, for CDFI depositories to lend in partnership with conventional banks to companies that require larger loans than either of the participating institutions is willing to make by itself. Conventional lenders may also support or co-sponsor financial literacy outreach efforts with community development banks and credit unions.

offer sophisticated cash management services and automated consumer loans in addition to basic checking and savings accounts. They tend to have more-extensive branch networks, which gives them a broader range of potential depositors; by comparison, CDFI depositories typically have at most a handful of branches. As basic deposit accounts pay low interest rates, the larger banks often have a lower cost of funds, which enables them to offer more-favorable pricing on their loans. The CDFI banks and credit unions often cannot compete effectively on price, so they have to rely more on identifying niches where their expertise and "high-touch" approach prove advantageous. It should also be noted that the competitive pricing offered by conventional banks usually does not apply to many of the smaller, fledgling companies the CDFIs are more likely to serve, as such companies typically do not meet the banks' underwriting criteria.

How the credit tightening associated with the weak economy will affect the CDFI-bank relationships remains to be seen. On one hand, stricter bank underwriting standards may well drive formerly "bank-able" borrowers toward CDFIs, as declines in real estate values undermine the underlying worth of the borrowers' collateral. On the other hand, the pressures of a weaker economy affect the CDFIs as well. Organizations throughout the industry, be they residential or commercial lenders, are experiencing more problems with their own portfolios as a result of falling real estate values and general market contractions. It is quite possible that CDFIs will have to tighten their own underwriting standards in response, which could limit their lending to some of their previous small business markets.

A potentially more problematic issue for the CDFIs is that of loan capital. In order to meet the potential increase in demand for financing, as well as to expand their bases of borrowers generally, the organizations need to be able to build their loan pools. To continue offering affordable pricing and technical assistance to higher-risk borrowers, they need a fair amount of low-cost capital. Yet the sources of such capital are nowhere near as plentiful as they were in the late 1990s and early 2000s. Until recently, the federal CDFI Fund's budget was less than half of what it had been at the turn of the decade, and financial assistance awards to CDFIs have been capped at up to 75 percent below what was requested. Some of the foundations that had been most supportive of the CDFI industry□the Ford and MacArthur Foundations, for example□have cut back their grant-making and program-related investing to CDFIs. Similarly, banks have sharply curtailed the amount of equity-like investments they make in CDFIs, opting instead for term loans with rates that are closer to what the market bears. The continuing consolidation of the banking industry has also reduced the number of potential sources of CDFI capital.

One response to the shortage of low-cost capital has been for CDFIs to try to become more self-sufficient, so that they are less reliant on operating grants and can use outside support to build their loan funds. Community development banks and credit unions have always had to break even or generate a profit in order to satisfy their regulators, but most small business loan funds have been fortunate to cover 75 percent of their operating costs with earned revenues. For example, in FY 2006, the average microenterprise loan fund was able to cover 47 percent of its operating costs with earned revenues (Coalition of Community Development Financial Institutions 2007). ACCION's approach has been to automate as much of its lending as possible and focus on loan volume as a way to compensate for the relatively small amount of income it can generate from an individual loan. In the process, it has effectively minimized the amount of "high-touch" technical assistance it provides borrowers. The Colorado Enterprise Fund has actively sought to make larger loans (in the $70,000 to $100,000 range), with the intent of using the greater interest and fee income generated by such deals to subsidize its less lucrative micro-lending. Yet such an approach threatens at some point to bring the CDFI into more-direct competition with conventional banks, a showdown in which the banks have distinct advantages in their ability to price loans and offer accompanying financial services. Both ACCION's and CEF's strategies also run the risk of taking the CDFIs away from those fledgling small businesses that the organizations were initially designed to serve; it is another example of the tension between the financial bottom line and the attainment of social mission goals.

Our analysis is admittedly exploratory in nature. We do not claim that the six organizations that we have studied are necessarily representative of CDFI small business lenders, nor are they necessarily typical of community development loan funds, banks, or credit unions. Our case studies also address only a few components of the organizations and their markets, and they do not delve into more-complicated questions of institutional impact or borrower viability. Based on the commonalities in our findings and our experience with numerous other CDFIs, however, we contend that the general trends we have highlighted are fairly typical of the interactions and relationships between conventional and CDFI small business lenders. Operating from that premise, we offer the following suggestions for both future research and potential policy-making.

First, there needs to be more in-depth, primarily quantitative research about the specific differences in the borrowers served by CDFI small business loan funds, CDFI depositories, *de novo* banks, and more established banks. At this point, we cannot distinguish, except in general terms, among the typical borrowers served by each type of institution, and how those characteristics differ across markets. We also do not know as much as we need about the distinctions in loan products offered to these borrowers. To what extent are community development and conventional banks competing for the same types of borrowers? To what extent are conventional lenders more competitive on pricing? Answering these and related questions requires a more complete set of data than is currently available on a CDFI industry-wide level, as well as currently proprietary information from conventional and *de novo* lenders. Realistically, such a study (or series of studies) is most feasible within a particular market with sufficient small business activity on the part of both CDFIs and conventional lenders. With the help of the bank regulators and the individual CDFIs, researchers could obtain the necessary transaction-level data, including information on borrower credit score, credit history, collateral, and other key underwriting information. Such an analysis would help us understand whether and to what extent CDFIs truly are serving otherwise "unbankable" individuals and could provide an important guide to policy-makers.

Second, similar research needs to track the relative impact of CDFI small business lenders on their borrowers. Controlling for borrower size, loan amount, borrower/business track record, and the like, how well do CDFI-supported companies fare relative to those served by more-conventional lenders? What is the survival rate of CDFI-supported small businesses after five years? To what extent do the companies experience notable growth in their revenues and net worth? Do companies that receive substantial technical assistance from CDFIs fare better than similar companies that do not? In short, is there evidence that CDFIs help bring about more positive social outcomes than a typical conventional lender? Again, such information would prove helpful in assessing the value of the CDFI small business approach.

Third, assuming that there is a distinct subset of small business borrowers that CDFIs serve, and that CDFI engagement with these entrepreneurs and companies results in tangible benefits to the companies and the local marketplace, additional low-cost capital must be made available to help the CDFIs expand their operations. Policy-makers need to understand that CDFI small business loan funds are unlikely to become self-sufficient if they continue to offer extensive technical assistance while targeting generally “unbankable” borrowers. If the policy-makers deem such activities important, they have to be willing to subsidize both the CDFIs’ operations and their capital pools. One strategy would be to increase the amount of capital made available through entities such as the CDFI Fund and similar state programs. Another might be to designate certain pools of capital for such uses as part of federal, regional, and/or state economic development efforts.

Author Biographies

Geoff Smith is Vice President at Woodstock Institute. He has conducted research and written analyses of housing and community development topics including mortgage lending policy, housing market trends, small business finance, financial institution regulation, access to banking services, and general community reinvestment policy. He has authored and co-authored numerous Woodstock publications and co-authored research published in journals including Housing Policy Debate, Urban Affairs Review, and the Journal of Developmental Entrepreneurship. He has testified on predatory lending issues and community reinvestment policy at hearings held by the U.S. House Financial Services Committee, the Federal Reserve Board, the State of Illinois Department of Financial and Professional Regulation, and the Chicago City Council. Geoff has a B.A. in Geography from the University of Illinois at Urbana-Champaign and an M.S. in Geography from the University of Wisconsin-Madison.

Sean Zeilenbach has been working on issues related to economic development and development finance for the past 20 years. He spent four years at the U.S. Treasury's Community Development Financial Institutions (CDFI) Fund, where he developed a model for underwriting CDFIs, created a framework for assessing the economic and social impacts of these organizations, and was integrally involved with the design and development of the New Markets Tax Credit (NMTC) program. He had previously coordinated fundraising efforts for the Chicago office of the Local Initiative Support Corporation (LISC). He currently consults for a number of community development groups throughout the country on issues of strategic planning, impact measurement, and program / product development. He works closely with both for-profit and nonprofit community development entities in the design and evaluation of their NMTC programs, as well as in the refinement of successful allocation applications. He also consults with the Urban Institute team charged with evaluating the overall impact of the NMTC. Mr. Zielenbach has a Bachelor's degree from Princeton and a doctorate from Northwestern. He is a Senior Consultant with the Chicago-based Woodstock Institute, an organization that works to promote private reinvestment in low-income communities throughout the country. He also operates his own consulting practice and is a member of multiple community development advisory boards.

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Appendix A: Case Study Informants

Camden / CBAC

- Mike Diemer, Executive Director CBAC
- Tom Kelly, Senior Vice President of Small Business Banking and Consumer and Mortgage Lending Sun National Bank
- Joseph Tredinnick, Regional Vice President, Commerce Bank
- Gary Rago, Regional Director, New Jersey SBDC

Chicago / Shorebank

- Vickie Battle, Senior Vice President, Director of Business Banking, Shorebank
- Kaushik Shah, Vice President – Senior Loan Officer, Shorebank
- Curt Roechley, Director of Hull House, sponsored by Uptown SBDC
- Kelly Mizuer, former Business Finance Specialist, Women's Business Development Center
- Calvin Holmes, Executive Director, Chicago Community Loan Fund

Denver / Colorado Enterprise Fund

- Ceyl Prinster, Executive Director of Colorado Enterprise Fund

- Brett Haigler, President of Guaranty Bank and Trust
- Sharon King, Director of Boulder SBDC
- William Stiewig and Shelly Marquez, Loan Officer and Vice President of Community Development at Wells Fargo

San Antonio / ACCION

- Janie Barrera, President and CEO of ACCION Texas
- Sue Malone, President of Strategies for Small Business, Superior Financial
- Daniel Delehanty, Vice President of Economic & Community Development, Capital One
- Al Salgado, Regional Director San Antonio SBDC

Santa Cruz / SCCCU

- Sheila Schat, Director of Community Outreach and Marketing, SCCCU
- Randy Johnson, Loan Officer, SCCCU
- Theresa Thomae, Director of Santa Cruz SBDC
- Karen Nuno, Vice President and Government Guaranteed Loan Manager, RaboBank
- Carol Cook, Wendy Franscioni and Herb Aarons, Loan Officers and President of Cal Coastal

Twin Cities / University National Bank

- David Reiling and Nikki Foster, CEO and AVP of Sunrise Community Banks
- Iric Nathanson, Financial Resources Coordinator of The Metropolitan Consortium of Community Development
- Tene Wells, President, Women Venture
- Rachel Peterson, Executive Vice President and Chief Lending Officer, Bridgewater Bank

Appendix B: Interview Questions

Questions for CDFIs:

Lending Market

- How does your institution define its target market?
- Do thresholds for borrowers exist (i.e. age of business, size of business, experience of business owner, etc)?
- Have changes in the regional banking industry affected your institution's lending behavior? If so, how?

Loan Products

- What small business loan products does your institution offer?
- How are the products and services offered by your institution different from those offered by mainstream lenders in your target market?
- Describe the underwriting criteria for your small business loan products.
- What target market needs are you trying to address / addressing with the current product offerings?
- Do unmet needs remain in your target market? If so, why?

- Have you developed new products for your target market(s)? What factors drove this innovation?

Relationships With Mainstream Banks

- Have the markets targeted by your institution begun to overlap with those of mainstream banks? In what way? If so, why?
- Have efforts to grow to scale or reach some level of self-sufficiency caused your institution to be in more direct competition with mainstream lenders for larger or higher-performing borrowers?
- Does your institution have current borrowers that could be served by mainstream banks? Do you target such borrowers for certain loan products?
- In what ways has your institution collaborated with mainstream banks?
- Has your institution noticed mainstream lenders being more active in your target market(s)? How has your institution responded?

Questions for Mainstream Banks:

Target Market

- What is your bank's small business lending strategy?
- Does the bank have a specific strategy for CRA small business lending? If so, how does it differ from the bank's overall small business lending strategy?
- Do thresholds for borrowers exist (i.e. age of business, size of business, experience of business owner, etc)?
- Have changes in the regional banking industry caused the bank to reach out to new markets? If so, how?
- Who does the bank see as its primary competition in this market?
- Who serves businesses the bank does not serve?

Lending Products

- What small business loan products does the bank offer?
- Are there specific products tailored to reach more difficult to serve markets?
- What is the target market for these product offerings?
- How does the bank market these products?
- Describe the underwriting criteria for the bank's small business loan products.
- Has the bank developed new products for difficult to serve markets? What factors drove this innovation?

Relationships with CDFIs

- Has the bank noticed any overlap in its markets and those targeted by local CDFIs? In what way? When did the overlap begin? What drove it?
- In what ways does the bank collaborate with CDFIs?
- Could the bank serve the borrowers targeted by local CDFIs? If yes, why isn't the bank taking the CDFIs' business? If no, why not?
- What does the bank see as the role of CDFIs?
- In what ways, if any, has the bank's small business lending behavior been influenced by CDFI lending?
- Does the bank actively seek business owners who utilize CDFI products?
- Do CDFI products at all influence bank product development?

Questions for Key Informants:

- What do you see as the relationship between CDFIs and mainstream banks in the regional lending markets?
- How do the products and services offered by CDFIs differ from those offered by mainstream lenders?
- How responsive are CDFIs and mainstream banks to the needs of business owners in underserved markets?
- In what ways has CDFI small business lending influenced lending by mainstream financial institutions? In what ways have banks' activities changed the approach of CDFIs?
- Have certain CDFI products or services have bigger impacts than others?
- Have the markets targeted by CDFI and mainstream institutions begun to converge? If yes, what factors have been driving these changes?
- Have efforts of individual CDFIs and the CDFI industry to grow to scale changed the relationship between CDFIs and mainstream financial institutions?