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BANKING'S ROLE IN BUSINESS-COMMUNITY PARTNERSHIPS

Remarks by

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I have been asked today to address the topic of "Business in League with Communities" in the context of the community reinvestment obligations of financial institutions. This is an extremely timely topic, for several reasons.

On one level, the topic is especially appropriate here in the Midwest, where everywhere we see evidence of extraordinary efforts by business, government and community organizations to work together to respond to the havoc wreaked by the recent floods. As President Keehn has indicated, lenders can play important roles in partnership efforts to help rebuild affected areas. I understand that some efforts already are underway and some of the hardest hit areas are on their way to what we hope will be a full and lasting recovery, though this will take time.

But on a broader plane, the concept of business and community partnerships extends far beyond our national instinct to pull together in crisis situations and goes much deeper than our tradition of support for neighbors in tough times.

The types of business-community relationships I want to talk about today are more fundamental and should outlast any temporary community <u>esprit de corps</u> that is manifested in response to emergencies. My focus today then is on the community development process and the many roles banks can play in it.

Even in normal times, we often lose sight of how our day-to-day economic life is conducted at the local level. I believe that in most places, basic economic activities, those that contribute to the long-term economic health and growth of our communities, have almost always been a reflection of the capacity of businesses -- including financial institutions -- and their communities to work together.

Sometimes these cooperative efforts are simply an outgrowth of that rather mundane government function of providing public facilities. From the days of the Erie Canal to development of our modern interstate highway system, it has long been recognized that strategic development of public facilities helps stimulate private investment. At the local level, we all understand the importance of such things as streets and roads, or water and sewer systems that support private development and investment in housing, in downtown development and neighborhood revitalization, in industrial facilities and small business growth. That's the old concept of community-business partnerships, and it continues to be necessary today.

But over the years, new, more direct and sophisticated types of partnerships involving public-private financing arrangements, joint ventures, use of special tax incentives and other techniques, such as those being presented here at this workshop, have become the focus of the community development process.

Whatever the particular techniques, the process has often been referred to as "economic development," "community development", or "community investment." Use of any of these terms implies that there is a concerted effort by both the public and private sectors to make something happen. Usually these efforts are in response to concerns about local economic conditions, concerns that generate ideas about how to leverage resources and share risks to address them. Often the focus is on support for business expansion and attraction to provide employment opportunities, or how to ensure development or rehabilitation of affordable housing.

Well, how do financial institutions fit into this newer concept of community development? After many years considering this topic, and dealing with reinvestment issues both as a banker and a regulator, I have concluded that financial institutions can fit in virtually any way and anywhere they want to.

But it does depend on certain circumstances. It depends on the nature and extent of the needs in the community. It depends on the capacity and willingness of local government to make commitments to address those needs. It depends on the extent to which public and private resources are available. It depends on whether local businesses, developers or nonprofit development groups are actively participating by committing capital. It depends on executive leadership in both the public and private

sectors. And of course, it most certainly depends on the size, financial health and capacity of the bank or thrift itself. Which is to say ... banking's role in community development often depends on actions and commitments from others.

This is <u>not</u> to say, however, that banks and thrifts are necessarily always <u>dependent</u> on others in the community development process. Under the right circumstances, financial institutions can play leading roles in small business development and affordable housing programs.

What then are these possible roles? I think that for our purposes here today, I want to cover two primary ways banks and thrifts can participate as effective partners in the community development process -- as lenders, and as investors.

Despite increasing specialization in the financial services industry, the vast majority of banks and thrifts are, first and foremost, lenders. They help leverage capital in the community by extending credit, and by managing credit and interest rate risks, for profit.

Consequently, the primary way financial institutions participate in community development is still through lending, though there are many ways to lend. Typically, banks and thrifts can provide home mortgage, home improvement, housing

construction, commercial property and a variety of business loans that are useful in community development and revitalization. These types of loans are certainly not unusual and are just an extension of conventional banking activity.

Of course as lenders, banks and thrifts usually wait for credit demands from home owners and buyers, developers and small businesses who, in turn, provide down payments or business capital that will support lending.

But there's the rub. Many borrowers or communities in need of affordable housing, neighborhood revitalization programs and business development efforts, either do not have the capital that would enable them or their projects to qualify for conventional credit, or do not have incomes sufficient to carry loans at market rates, terms and conditions. Put simply, there are significant capital or income gaps that must be addressed.

Consequently, as lenders, financial institutions may need to depart from traditional standards to ensure that appropriate and affordable financing can be provided for community development projects. Often this means joining in public/private partnerships to underwrite economic activities that neither banks nor the public sector can do alone. By using techniques such as government loan guarantees, interest rate subsidies from a variety of sources or blended-rate loans with participation from

both public and private lenders, banks can make secure, profitable loans, while sharing costs and risks. That's the crux of the new community development process.

For example, to help meet the need for longer term small business loans in their communities, some banks have become specialists in making SBA guaranteed loans. The guarantee allows the institution to make longer term loans, making payments more affordable to the small business borrower, while reducing credit risk to the lender. The federal guarantee also enables lenders to readily sell the loans in what has become a mature and active secondary market, thereby replenishing loan funds for re-use at the local level. The result for institutions that are not afraid to tackle a new product that helps their customers has been increased loan volume, reduced risks and increased liquidity. Most importantly, these loans help create economic value in the community and stimulate employment.

Another technique that facilitates community development lending is the use of interest rate subsidies to reduce costs to borrowers and help them qualify for loans that might not be approved at market rates. Interest rate subsidies for loans originated by an institution are sometimes available from federal programs, such as HUD's Community Development Block Grant or HOME programs, which are managed by local and state governments.

An increasing number of states also have developed their own subsidized loan programs that work through, or in tandem with private financial institutions. Right here in Iowa, for example, the state's Department of Economic Development has several programs that provide both financial and technical assistance to emerging or expanding small businesses. One is the Community Economic Betterment Account, which helps fill the gap in financing small businesses through the provision of supplementary loans, forgivable loans, grants and other equity substitutions. These loans and equity financing are used in conjunction with bank loans to provide the right mix of financing needed by a particular business. The program also provides interest rate buydowns on commercial loans made by banks and others. The program emphasizes job creation.

In a few cases, financial subsidies are even provided through deposits. For example, here in Iowa, the State Treasurer's Office offers several "linked deposit" programs that support below-market rate small business and agricultural loans. Below-market rate deposits are placed with banks which, in turn, use them to match fund lower rate loans, with a spread over the deposit rate. This approach provides two unique, highly targeted programs through participating Iowa banks. One is targeted for minority- and women-owned small businesses and provides below-market rate financing for a variety of business purposes. The other is an especially unique program focused on helping

diversify Iowa's rural economy and increasing employment. It offers linked deposits as incentives for banks to fund below-market rate loans for horticultural and agricultural projects that involve products not typically found on Iowa farms. I understand that, thanks in part to this program, Iowa is now home to ostrich, llama, and emu farms, and grows crops that include special mushrooms and hydroponic tomatoes.

Whatever the source of the interest rate subsidies, they help reduce debt payments, thereby improving the affordability of credit for borrowers.

Although participation in government-assisted credit programs may, in some cases, result in increased paperwork and costs, lenders have found that offering and extending these types of loans is profitable. Government loan guarantees and interest rate subsidies provide effective avenues to help lenders originate loans that otherwise might not be made within their communities. They help stimulate economic activity and promote economic growth and diversification in the community at large and in low- and moderate-income areas. Most important, they let lenders be lenders, focusing on the business they know best, but in ways specifically designed to help special sectors of their communities.

Perhaps one example, using a multitude of financing sources, best illustrates the community development financing process. In Memphis, Texas, a small community of about 2,500, the First National Bank of Amarillo combined resources with the Panhandle Regional Planning Commission, the City of Memphis, Texas, and the Texas Department of Commerce to finance the expansion of a plumbing firm's operations. The $2.0 million project, involving re-use of a vacant foundry, was financed by $800,000 in equity from the company, a $750,000 loan from the bank, a $300,000 second position loan from the City's revolving loan fund, and $200,000 from the Texas Capital Fund.

Another increasingly effective approach that focuses on lending for community development is the formation of multi-lender consortia, including small and minority business loan pools or housing partnerships.

Consortia are especially useful for financial institutions which may not make specialized housing or small business loans directly, but would like to support the community development process. They also help spread the risks, especially for smaller banks.

Effective consortia can be formed on a statewide, regional multi-county or local level. Formation of statewide multi-lender consortium organizations in Massachusetts, Indiana, California,

Washington and many other states reflects the growing interest in this approach.

But consortia can be particularly useful at the local level. For example, in Fillmore County, Minnesota, thirteen smaller banks have formed the Bankers Loan Network, a county-wide effort creating a $1.2 million fund for economic development. The fund enables these smaller institutions to pool resources in a way that allows origination of larger economic development loans than any of the institutions could provide acting alone. The fund targets manufacturing and distribution businesses, companies that will help diversify the local economy and businesses owned by minorities and women.

In Milwaukee, Wisconsin, the Lincoln Fund, a multi-bank neighborhood loan pool, provides a variety of types of financing for businesses located in the Lincoln Avenue neighborhood of the city. By providing loans as small as $5,000, the fund helps to stabilize and preserve the economic viability of the neighborhood. Two smaller commercial banks, a savings bank and the Wisconsin Community Capital Corporation, are participants. Since 1991, the Fund has provided financial assistance to eleven business which have added 95 jobs to the neighborhood.

While lending remains the primary way banks and thrifts participate in community development, a second role for institutions is as an equity investor. Community development investment authority granted to financial institutions enables them to take an ownership position in real estate or business ventures by investing equity capital. Such investments must provide direct benefits to low- and moderate-income persons by providing housing, jobs or services.

But equity investments allow institutions to expand the roles they can play in the community development process. Using this special authority, banks, thrifts and bank holding companies can buy, rehabilitate and sell properties, or provide supplemental equity or special debt investments that help make projects or business ventures feasible. Rather than waiting for developers, businesses, or nonprofit development groups to commit resources, institutions can use the equity investment option to become catalysts for the revitalization of economically distressed areas, or fill capital gaps making the participation of others possible.

There are four primary ways in which institutions utilize community development equity investment authority. First, the bank or bank holding company can establish a wholly owned, *de novo* community development corporation, or "CDC," as a stand-alone subsidiary. Usually, the institution capitalizes the CDC

with an initial equity contribution and may provide loans or lines of credit to fund the CDC's investments and lending. The CDC then becomes the vehicle that makes debt and equity investments in a variety of community development projects.

One example is Commonwealth Bancshares Community Development Corporation, which operates in a number of small communities in North Central Pennsylvania. In addition to affordable housing investment, part of the CDC's mission is to help revitalize economically depressed downtown areas of those communities and serve as a catalyst for other economic development projects that help create employment opportunities. The CDC has made a $98,000 investment in a new office building in Williamsport, Pennsylvania, triggering bank financing for a 40,000 square foot, commercial complex. It was also a limited partner in a newly constructed small manufacturing plant that will help a business expand and in the process create 30 jobs. Additionally, the CDC is a limited partner in a seed capital fund, operating out of State College, Pennsylvania, which is investing in small, start-up businesses.

A second approach, one that is increasingly popular, is participation in a multi-investor, consortium CDC or equity pool that, in turn, invests in one or more community development projects and business ventures. Sometimes called multi-bank or nonbank CDCs, these CDCs pool the investments of a number of

financial institutions or others, allowing them to share community development expertise, resources and risks.

A third approach used by banks and holding companies is investment in limited partnerships formed to invest in one or more community development projects. Investments in limited partnerships that finance low-income housing projects has become increasingly popular and some institutions have invested in economic development limited partnerships.

Finally, some institutions have made direct equity investments in a single-purpose community development project or business venture, alone or jointly with others.

Lending and investment are just two of the ways banks can support business/community partnerships. But they are powerful tools and, when used effectively, can dramatically change the economic prospects of lower income and economically distressed communities.

You've heard a lot about community development during this conference. Whether it's in the areas of rural development, low- and moderate-income housing construction or rehabilitation or small business and commercial revitalization financing, there are many paths to successful community development for financial institutions of all sizes. Some involve working with local

government, others require partnerships with nonprofit development groups and still others involve private developers, small businesses and other for-profit groups. And many of these paths require working together with all of these participants.

None of these paths makes much sense, however, unless the activity can be undertaken on a profitable basis. As members of the business community, banks certainly can choose to give money away for good causes. And, no doubt, we all consider the production of affordable housing and the creation of jobs in economically distressed communities to be good causes. But as financial institutions, and especially as lenders, banks must be capable of participating in community development on a profitable basis, if these activities are to be sustained.

I believe that it has been amply demonstrated around the country that community development can be profitable if, like other bank functions, it is done well. One thing we've learned over the last decade is that it does no good to throw money at a program if that program is not well thought out. The financial package must be designed to meet the requirements of the project while at the same time providing reasonable assurance of repayment.

Perhaps it's surprising that I've been talking for some time about banking's various roles in community development, and have

not mentioned the Community Reinvestment Act, even once. That was planned.

Unfortunately, community development financing is still perceived by some bankers as just "CRA lending" or one of a number of forms of unprofitable endeavors required to keep an institution in good standing with its regulator and community. In discussing community development as a legitimate line of business, I hope I've helped dispel that misperception.

I know that many of you are interested in recent news about possible changes in CRA and, as President Keehn indicated, the agencies are in the midst of the process that could reshape how CRA is administered. The only thing I can say for sure is that a lot of ideas are on the table. We hope to be publishing a proposal for public comment before the first of the year.

But let me conclude today by advising all of you not to worry too much about precisely how CRA might change. Keep your eyes on the ball-- that is, keep focused on how your institutions can best support economic and community development where you do business.

Those banks that make community development an ongoing line of business are and supported by management with sufficient bank resources and expert staff will reap the economic rewards in

terms of growth in their communities and increased profitability for their institutions. Given the direct relationship of community development to CRA's aims, those same institutions should also score well on any CRA test, no matter how the regulations or law might change.

Remember that an economically vital and growing community is a better place for the banks that serve that community to operate. Community investment in the final analysis is just plain common sense good business.

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