ABA Task Force Examines Rural America

By Jeff Plagge

Rural community banks have a lot at stake and a great deal of capital invested in the communities they serve. Assisting those communities in becoming rural development success stories is a strong interest of the bankers in those marketplaces. Finding innovative ways to get more credit and equity to those communities is part of that process.

This premise was the driving force behind the formation of the American Bankers Association Rural Economic Development Task Force (ABA Task Force), which held its first meeting in January 1994 in Des Moines, Iowa. The meeting launched a

See TASK FORCE, page 6

Fed Chairman Discusses Final CRA Regulation

Safe, Sound, and Profitable

Three factors—partnership, vision, and enlightened self-interest—have been in the regulators’ minds during the recent regulatory reform process for the Community Reinvestment Act. Preparing the new regulations has been a very difficult task. Various facets had to be carefully weighed and balanced in preparing the new regulations.

First was the President’s request that the agencies produce a more objective system which would include less process and paperwork burden for the financial industry and produce greater results for the community. There was the communities’ increased need for access to credit in all areas, including low- and moderate-income neighborhoods, and the needs of the financial industry to make safe, sound, and profitable loans.

Additionally, the regulators had to walk that fine line between trying to insure credit availability without falling into the trap of credit allocation. In essence there was partnership of interest in accommodating all these goals in the revised rules.

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INSIDE THIS ISSUE

- SBA lending can increase fee income and improve bank liquidity when guaranteed portions are sold in the secondary market
- Revolving loan fund meets minority business loan demand in nontraditional ways
- Four nonprofit organizations’ annual reports reviewed
- Surety bonds are frequently required of small contractors, but are sometimes hard to get
SBA Loans Can Be the Most Profitable Loans in Your Bank

Selling guaranteed portion of loan generates fee income and liquidity

By Kimberly A. Ludtke

A pproximately 3,000 banks in the United States enjoy benefits from selling the guaranteed portion of loans made under the Small Business Administration (SBA) 7(a) program. The liquidity provided by the secondary market frees the lenders’ capital to create subsequent small-business loans, giving small businesses greater access to the financial markets. Banks that sell the guaranteed portion of their SBA loans can service small-business borrowers profitably.

How the SBA Secondary Market Works

A lender that agrees to sell the guaranteed portion of its SBA loan to another party, usually a dealer, receives compensation for the guaranteed portion in the form of premium income, fee income, or a combination of both. The lender retains the unguaranteed portion and servicing responsibility. The lender is responsible for passing through the sold portions of principal and interest payments to the SBA-appointed fiscal and transfer agent (FTA) as long as the loan remains outstanding.

Most Lenders Choose to Maximize Premium Income

Most lenders who sell loans choose to increase their return by selling the guaranteed portion at the highest price, passing through the maximum amount of interest to the investor, and retaining the minimum servicing fee required by SBA (1%). The price usually includes a premium, the amount by which the guaranteed portion sells above its face (par) value.

For example, if the borrower pays interest of prime plus 2% (8% assuming a prime of 6%) and the lender retains 1% servicing fee, the lender passes through interest of prime plus 1% to the SBA’s fiscal and transfer agent (FTA). The FTA passes the pay-

Some Lenders Choose Annual Fee Income

Some lenders who sell the guaranteed portion of their SBA loans forgo some or all premium to build a portfolio that generates significant annual fee income. They sell the guaranteed portion at a lower premium or at no premium in return for passing through less interest to the investor. For example, if the borrower’s interest rate is prime plus 2%, the buyer might purchase interest of prime minus 1% at no premium, allowing the lender to retain a 3% servicing fee, instead of 1%.

With Loan Sales, Lenders Can Make Dollars Go Further

Ideally, a lender with loan demand and a high loan-to-deposit ratio would use sale proceeds to fund subsequent SBA-guaranteed loans. Table 1 shows this leverage effect. Keep in mind that a bank does not loan to the secondary market, so the benefit is multiplied due to the leverage effect. The lender with loan demand starts by selling one loan, uses the proceeds to make another loan, sells that loan, makes another loan, and so on. Table 1 shows that a commitment of $100,000 can generate $1 million in loans. The bank serves 13 customers, instead of just one. These customers use other services, open savings accounts, transfer money, etc. In the first year, the bank earns

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SBA: Helps service small business borrowers profitably

Continued from page 2

$71,000 (interest income, fee income, and premium on the sales) on the 13 loans, compared to $8,000 if it makes and holds one loan.

Lenders that sell for the maximum premium use the cash (principal and premium income) received at the point of sale for a number of purposes. In addition to making subsequent SBA-guaranteed loans, other purposes include funding a loss reserve, purchasing software to track sold and unsold portions of payments, and rewarding loan officers for making low-risk, profitable, marketable commercial loans.

Investing in SBA-guaranteed Loans

Some banks have weak loan demand or a low loan-to-deposit ratio. Others want to diversify their loan portfolios. Others need to improve their risk-based capital ratios. These institutions can purchase the SBA-guaranteed portions of individual loans to enhance their loan portfolios. Individual purchased SBA loans are accounted for as loans under regulatory accounting rules, giving the investor diversity, diffusion of premium risk, and flexibility in investment sizes.

Remember, the originator of the loan retains the unguaranteed portion and servicing responsibility. The investor receives one certificate, not the entire loan package. The investor does not perform credit analysis because the investor is unconditionally guaranteed by the full faith and credit of the United States government to receive principal and interest. The investor receives a monthly payment of principal and interest.

Because of the unconditional guarantee, the risk-based capital weighting to the investor is 0%. Loans and pools are available in a variety of maturities ranging from 7 to 25 years and a variety of interest rates ranging from prime minus 2.25% to prime plus 1.225%. About 90% of the secondary market is variable, that is, pegged to the prime rate, which tends to rise faster than it falls. In 1992, about 86% of variable-rate products had no caps or floors, which made SBA-guaranteed investments one of the only true floating-rate instruments. In addition, the frequent interest-rate reset dates (monthly or quarterly) give the investor stable prices and a handy asset/liability matching tool. Variable interest rates and stable prices are particularly important for bankers concerned with mark-to-market accounting issues.

A Vital Economic Stimulus

Lenders benefit from increased return by selling the SBA-guaranteed portions to the secondary market. The immediate liquidity provided by pool assemblers gives lenders a source of funds other than deposits.

Small businesses represent 99.67% of all U.S. firms, contribute 50% of the gross national product, and employ more than half of all workers in the United States, so every lender should know about the SBA-guaranteed 7(a) lending program and its secondary market. The SBA-guaranteed 7(a) lending program and secondary market fit lenders who are concerned with the quality of the loan portfolio, its riskiness, and bottom-line profitability.

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TABLE 1

A $100,000 Loan Commitment Can Generate $1 Million in Loans

<table>
<thead>
<tr>
<th>Number of Loans</th>
<th>Whole Loan</th>
<th>Retain 10% Unguaranteed</th>
<th>Sell 90% Guaranteed</th>
<th>Receive 6% Premium</th>
<th>8% Interest on Unguaranteed</th>
<th>Annual Fee of 1%</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>$100,000</td>
<td>$10,000</td>
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<td>$5,400</td>
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<td>85,860</td>
<td>5,152</td>
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<td>677</td>
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<td>12</td>
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<td>5,957</td>
<td>53,616</td>
<td>3,217</td>
<td>333</td>
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<td>6,152</td>
<td>55,367</td>
<td>3,422</td>
<td>333</td>
<td>376</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$1,000,000</td>
<td>$100,000</td>
<td>$900,000</td>
<td>$54,002</td>
<td>$8,333</td>
<td>$9,376</td>
</tr>
</tbody>
</table>
Greenspan: Avoid credit allocation

Continued from page 1

have been proven over the years of our experience since the law was enacted in 1977. CRA has helped financial institutions to discover new markets that may have been undeserved before.

Sound Business Opportunities

But what about the question of whether loans to low- and moderate-income borrowers have caused safety and soundness problems? To date there is very little hard data. A few studies suggest that the delinquency experience is not materially different. Aside from the issue of repayment, there is the issue of profitability. The more successful programs involve credit counseling and other activities that add to cost, and whether they are fully recovered is unclear. But on the broader question there is little or no evidence that banks' safety and soundness have been compromised, and often bankers report sound business opportunities.

We at the Federal Reserve have stressed the market aspect of CRA in the past and will continue to do so in the implementation of the new regulations. I think this is crucial. If CRA is perceived by banks as a tax or credit allocation, it will fail in the long run. Activities developed by banks to meet credit needs in low- and moderate-income neighborhoods should be well-planned and thoughtfully implemented within their overall business plan. Banks should not try to throw money at a problem or "just write the check"—that's not to anyone's advantage. The latter type of activity will not be sustainable over the long haul.

Banks are not philanthropic institutions. They are for-profit entities with obligations to their stockholders who require competitive rates of return, and are subject to a regulatory apparatus which protects their depositors from losses owing to unsound practices.

Meet the Test of the Market

This is surely evident to everyone, and I apologize for emphasizing what may seem to be obvious. But I think it bears repeating, for CRA must meet the test of the market if it is to provide the long-term benefits of revitalization that we all desire. It's worth reminding all of us—community groups, policy makers and even bankers—of this fact from time to time, since it's sometimes tempting to emphasize short-term benefits at the expense of long-term commitments.

CRA has had a unique strength in that it has not been a bureaucratic, Washington-driven program that substitutes "inside the beltway" decision-making by non-elected officials for the give and take of local community control. Yet in recent years, it has seemed clear that some greater direction from the regulators was needed, and we have tried to provide that guidance in the new regulations. But in doing so, we must be vigilant to avoid turning a flexible locally determined program into a "one size fits all" approach.

This was one of the most difficult issues that we tackled in the revision process—trying to maintain some flexibility, yet further quantifying what is required for good performance. Centrally directed credit allocation by administrative agencies would interfere

"... there is little or no evidence that banks’ safety and soundness have been compromised..."

See GREENSPAN, page 8.
Minority Loan Program Provides Non-traditional Financing in Jackson, MS

Extensive technical assistance helps qualify loan applicants

By Kimberly M. Walker

The Jackson/Hinds Minority Fund, Inc. (MinCap) is a non-profit organization which provides non-traditional financing and technical assistance to minority-owned businesses in Hinds County. The idea to establish a revolving loan fund arose from a community need to provide an alternative source of financing to those minority businesses that couldn't qualify for conventional loans. MinCap is presently targeting existing businesses; however, funds are also available for start-up enterprises.

MinCap has identified derogatory credit, inadequate collateral, and insufficient management skills as the major weaknesses that prevented many of these businesses from obtaining traditional financing. The organization made an effort to address these issues in developing its loan policy by allowing some flexibility in underwriting loans that have higher credit risk.

The organization initially received $2.35 million in funding from the following: the City of Jackson ($250,000); Hinds County ($250,000); State of Mississippi ($750,000); Metro Jackson Chamber of Commerce ($100,000); Bank of Mississippi ($50,000); Deposit Guaranty National Bank ($450,000); Trustmark National Bank ($450,000); Sunburst Bank ($50,000).

In addition to the initial funding, MinCap has recently been awarded a $74,000 administrative grant by the Levi Strauss Foundation. The grant covers a two-year period and will be used to hire a financial analyst, provide training for the staff and technical assistance for the clients.

Minority business owners are eligible to apply for loans from $5,000 to $100,000. The money may be used for contract or short term receivables, interim and inventory financing, start-up capital, term loans for equipment, working capital and real estate. These funds may also be used to guarantee loans made by the banks.

However, MinCap's goal is not only to provide greater access to financing for minority business owners, but also to educate these entrepreneurs on how to operate a successful business. MinCap is in the process of implementing an in-house technical assistance program to assist clients that have a specific need, including accounting, marketing, management counseling, data processing, feasibility analysis, and job costing. MinCap strongly believes that the quality of the technical assistance provided will directly affect the success of the businesses receiving financing. The technical assistance program will enhance the business owners' skills and improve the internal operations of the company.

In addition to providing direct financing, MinCap also sells participations to other organizations to leverage funds or minimize risk. These organizations presently include the City of Jackson Minority Loan Program; West Jackson Community Development Corporation; Central MS Planning & Development District; and local financial institutions.

In addition to accepting applications in February 1994, as of June 30, 1995, the board of directors had approved eleven loans totaling $755,397. The organizational goal for 1995 is to book $780,000 in new loans.

MinCap became the executive director of the Jackson / Hinds County Minority Fund, Inc., in Jackson, MS.
series of ideas that were later developed into a document called “New Tools for Commercial Banks in Rural America” that was released in November 1994. [A similar proposal entitled “The Rural Economic Development Partnership” was released jointly by the American Bankers Association and the Independent Bankers Association of America in May 1995.]

In approaching rural development, the ABA Task Force has focused on specific topics that we felt were unique to rural America. We specifically identified issues that affected community banks as they deal with the ongoing challenges of assisting their customers and marketplaces.

At a Rural Development conference I recently attended, someone made the statement, “How you look at things depends on how you look at things.” This statement really reflects my view of the challenges facing rural America.

Every community has a unique set of circumstances—different leadership, different ideas, different opportunities, and different approaches. Although general programs and incentives can be put together for rural America, one size does not fit all.

The ABA Task Force identified five priority areas and the problems associated with each (Ta-

See TASK FORCE, page 7

<table>
<thead>
<tr>
<th>ABA Rural Economic Development Task Force’s Top Five Priorities</th>
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<tbody>
<tr>
<td><strong>1. RURAL HOUSING</strong></td>
</tr>
<tr>
<td><strong>Problem(s)</strong></td>
</tr>
<tr>
<td>(a) Aging housing stock</td>
</tr>
<tr>
<td>(b) Lack of low- to moderate-income housing</td>
</tr>
<tr>
<td>(c) Lack of good rentals</td>
</tr>
<tr>
<td>(d) Lack and cost of new developments</td>
</tr>
<tr>
<td>(e) Lack of available or willing developers</td>
</tr>
</tbody>
</table>

| **2. MAIN STREET BUSINESS** |
| **Problem(s)** |
| (a) Aging business ownership |
| (b) Large chain store competition |
| (c) Lack of equity capital for buyout of existing businesses or for new start-ups |
| (d) Lack of cash flow for leveraged buyouts of existing businesses or leveraged start-up of new businesses |

| **3. RURAL INFRASTRUCTURE** |
| **Problem(s)** |
| (a) Deteriorating and outdated water and waste systems |
| (b) Difficulty of upgrading existing systems to meet environmental regulations |
| (c) Lack of adequate tax base to finance upgrades or replacements |

| **4. BUSINESS AND INDUSTRY** |
| **Problem(s)** |
| (a) Aging business ownership |
| (b) The intense capital needs for start-ups |
| (c) Lack of available equity capital |
| (d) Lack of adequate business planning and planning assistance available |

| **5. PRODUCTION AGRICULTURE** |
| **Problem(s)** |
| (a) Aging farmer and rancher population |
| (b) Lack of new producers willing to enter into production agriculture |
| (c) Fewer young people for transfer of existing operations |
| (d) Overall risk and low-margin nature of production agriculture and high capital needs |
Task Force: Target solutions that involve community banks

Continued from page 6

ble 1). All five of these areas have an enormous impact on whether a community can survive, compete, and prosper in the ever-changing structure of rural America. Many of the problems associated with Main Street Business, Business and Industry, and Production Agriculture are virtually identical. The aging population of rural America is having and will continue to have a dramatic impact on the future of rural communities.

As with most situations, identifying the problems is a much easier task than finding solutions. Again we worked to specifically target solutions that we felt would assist community banks in working through some of these challenges.

The five solutions that we specifically targeted were:

1. Greater utilization and flexibility of the secondary market;
2. Greater access to equity capital;
3. Greater access to specialized expertise;
4. More attention to the intergenerational transfer issue; and
5. Development of new sources of lendable funds for rural and community banks.

Secondary Markets

If Congress is willing to change the Federal Agricultural Mortgage Corporation (Farmer Mac) so that it can be a more useful tool for community banks, it would become a powerful resource. The availability of longer-term credit provides more stability to the farm sector by reducing some of the interest rate risks associated with farm loans.

Farmer Mac’s activities could be broadened to include the ability to authorize rural development lending. This broadened authority would bring additional liquidity to rural banks and also bring outside capital into rural areas that could be disbursed through the vast network of community banks.

Lastly, we need to make sure that the Small Business Administration remains a viable partner with rural banks and find ways to get all rural banks to use SBA to help them revitalize their communities.

Equity Capital

Additional access to equity capital is a more difficult issue. Many small businesses, especially those in rural areas, just don’t have the volume of business to support the cash flow of a debt leveraged operation. Therefore, finding equity capital or equity partners becomes more of an issue. With cutbacks in federal and state programs, the best potential sources are private equity partners.

In other words, facilitating partnerships within a community or within a region is necessary to assist in the transfer of existing businesses and to help new ones get started. Many potential business owners just don’t have the capital it takes to buy an existing operation or to start a new one and still keep the business in a positive cash flow and profitable position.

Intergenerational Transfers

Sometimes the only viable and interested buyer of an existing business or farming operation is a family member. Yet many programs specifically exclude family members from accessing funding in order to buy out a family business. Oversight on this issue is certainly important, and caution is understandable; but when family members may be the most viable buyers of the business, you can see the dilemma that is created.

If it is important to keep the business functional for the community, we need to find a way to increase the flexibility of the SBA, FMHA and other programs to assist with the intergenerational transfer of businesses in rural communities. It is equally important to provide good oversight of these loan programs in order to avoid any potential abuses.

New Loan Sources

The last and certainly the most controversial part of the ABA Task Force solutions calls for the re-configuring of the Farm Credit System to allow for access to wholesale funding by rural and community banks. This re-configuration would be modeled after the Federal Home Loan Bank System. Community

See TASK FORCE, page 8
Federal Reserve Principles for CRA Reform

Federal Reserve Governor Lawrence B. Lindsey, in his testimony before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Banking and Financial Services, U.S. House of Representatives, on March 8, 1995, offered the Federal Reserve's perspective on the Community Reinvestment Act. These eight principles were contained in his testimony.

1. CRA has had a beneficial effect on many communities and institutions.
2. We will not endorse any reform approach—no matter how well intentioned—that results in credit allocation.
3. We must be cautious to avoid unintended consequences that harm others, such as undermining the efforts of minority-owned financial institutions or non-profit organizations.
4. We must retain examiner judgment to deal with unforeseen problems.
5. We must recognize the uniqueness of small institutions and the disproportionate burden they bear from any regulation, CRA or otherwise.
6. Any increased data reporting must be carefully scrutinized and justified.
7. Safe harbor proposals have generally provided protection to too many “barely satisfactory” institutions and too few institutions when limited to only those rated “outstanding.”
8. We do not support anything other than safe, sound, and profitable lending.

For a complete copy of Governor Lindsey's testimony, please call Dianne Rawls at 404/589-7307.

Greenspan: CRA feedback still needed

Continued from page 4

with the flow of credit, and runs the great risk of misallocating funds and underserving some of the unique and critical needs of localities. I don't think you'll find any argument on this point from any of the agencies, but it will be important for all of us, in implementing the new regulations, to remain alert to the risk of de facto credit allocation that is not sanctioned by the Congress, at the same time we are disavowing any such intention.

This brings me to the issue of implementation of the new rule. In a sense the work is just beginning. There will be difficult steps in developing training for the agencies, lenders, and community groups and in successfully implementing the new rules. We are committed to do this on an interagency basis to insure maximum consistency both within and among the various regulatory agencies in the examination process. Since much of this will be new to everyone, we will be looking for, and paying close attention to, feedback from the lenders, community organizations and other interested parties on our progress. With everyone working together, we think that this will continue to be important to sound community development.

Task Force: ABA Solutions

Continued from page 7

banks would be able to purchase wholesale funds of varying maturities from the Farm Credit District Banks to meet the needs of their customers. The Farm Credit System Associations would continue to lend money to agriculture as they have done in the past with no change in their authority.

The community banking network is vast and provides over 84 percent of all credit to small businesses in rural America. Finding ways to use this network of banks to an even larger degree meets the ultimate goal of getting more credit to rural communities. Allowing banks to access wholesale funding from the Farm Credit System, as they can currently do from the Federal Home Loan Bank System, brings new funds of varying maturities to rural America and gives farmers, consumers, and businesses more flexible credit products that better meet their needs. It is a partnership that has great potential.

Rural America is getting some long needed attention, but attention by itself will not solve the problems. We need to facilitate new partnerships, communicate success stories, and streamline existing programs to fit the needs of rural America and find new resources that fill the gaps. Working together we can make a difference.
Taking Note of Annual Reports

The theme of Local Initiatives Support Corporation's (LISC) 1994 Annual Report is *The Hidden Good News: Something is Working*. Through the use of expressive photographs and narratives, the report highlights the development projects initiated by LISC through its work in communities across the country. Established by the Ford Foundation in 1979, LISC is the nation's largest community development support organization that provides financing and technical assistance to nonprofit CDCs in more than 60 cities across the nation. At year-end 1994, LISC had assets totaling $261.3 million, which included an increase of approximately 26 percent in both contributions receivable and investments from 1993. LISC made $25.2 million in loans directly to CDCs (and CDC-sponsored projects) and also to its affiliate, National Equity Fund, for affordable housing and commercial development. In addition, LISC's grant activity for 1994 included $12.1 million in new commitments and $11.3 million in disbursements on commitments.

Atlanta Neighborhood Development Partnership, Inc.: Bringing Home the Dream, 1993-94 Annual Report, marks the third year of operation for this non-profit community development corporation. ANDP's stated mission is two-fold: to revitalize Atlanta's neighborhoods by rehabilitating and constructing affordable single- and multi-family housing and, (2) to serve as an intermediary to support neighborhood-based CDCs in metropolitan Atlanta by providing financial and technical assistance to them. The annual report indicates that ANDP supports a network of 15 CDCs serving 19 low- and moderate-income neighborhoods. At the end of its fiscal year of June 30, 1994, ANDP reported assets totaling $15.47 million, which included an increase of over $6.1 million in grants receivable from 1993. During the fiscal year 1993-94, ANDP awarded $958,962 in grants to local CDCs. Loans to community development corporations for land acquisition and development of low- to moderate-income housing units totaled $1.01 million (less a $50,000 loan loss reserve), which is a 3.8 percent increase from the prior year.

The Central Florida Community Reinvestment Corporation (CFCRC) 1994-1995 Annual Report details the affordable housing developments that have been funded through the loan consortium established by this not-for-profit corporation. CFCRC was created by financial institutions in Central Florida to facilitate the development of multi-family housing to serve low- to moderate-income residents in Orange County, which has since been expanded to include Seminole and Brevard Counties. In 1994, the CFCRC closed $19.44 million in loans (660 housing units) that were matched by $15.71 million in funds from the sale of low income housing tax credits, SAIL (State Apartment Incentive Loan) funds, county grants, and city or county impact fee waivers. The CFCRC has also made loan commitments of approximately $12.3 million, which if funded, could add 560 units of affordable housing for Central Florida residents with incomes at or below 60% of the median income.

Seedco: Partnerships for Community Development, 1994 Annual Report, provides an in-depth overview of this organization's unique mission to serve as an intermediary to forge partnerships between large institutions such as universities and hospitals, and community-based groups in nearby neighborhoods. Since its inception as an independent nonprofit organization in 1985, the "Structured Employment/Economic Development Corporation" has undertaken four additional neighborhood revitalization programs: Historically Black Colleges and Universities (HBCU)/Community Development Partnership Program, Partnerships for Self-Sufficiency, Neighborhood and Family Initiative, and HOME Technical Assistance. Seedco's HBCU program is its largest effort with eleven sites, five of which were added in 1994. In addition to a major Ford Foundation grant, the organization receives funding from several public and private donors. In the period ending September 30, 1994, Seedco's assets increased from fiscal year 1993 by 70.1 percent to $10.6 million. The fund balance totaled $3.29 million, an increase of 36.6 percent from the prior year.

Home Purchase Lending in Low-Income Neighborhoods and to Low-Income Borrowers, 32 pps., Board of Governors of the Federal Reserve System, reviews the use of 1993 HMDA data to measure the extent of mortgage lending to low-income borrowers and in low-income neighborhoods, also presents three “views” on CRA. For free copies call, (404) 589-7307.

Circular Letter 110-95 - Revised Regulation BB (Community Reinvestment Act), 117 pps., Federal Reserve Bank of Atlanta, provides guidance to financial institutions on the assessment of their CRA-related activities. For free copies, call (404) 589-7307.

Financial Services Used by Small Businesses: Evidence from the 1993 National Survey of Small Business Finances, 38 pps., Federal Reserve Bulletin, July 1995, provides preliminary findings regarding the characteristics of the U.S. population of small businesses, including the use of credit by small and minority-owned firms.

SHOP: The Card You Pick Can Save You Money, 17 pps., Federal Reserve System, provides a convenient summary of terms and conditions of credit card plans offered by financial institutions. For free copies, call (404) 589-7307.

Detecting Discrimination by the Numbers, speech by Lawrence B. Lindsey, Governor, Federal Reserve Board, June 7, 1994. Governor Lindsey discusses the pros and cons of statistical analysis and credit scoring systems to combat lending discrimination.

Closing the Gap: A Guide to Equal Opportunity Lending, 27 pps., Federal Reserve Bank of Boston, provides a comprehensive list of suggestions and practices to ensure loan applicants are treated fairly and to expand markets for banks. A must for lenders! For copies, call (617) 973-3459. Also available on videotape from VIDICOPY. Call 800-708-7080 for pricing and availability information.

The Credit Process: A Guide for Small Business Owners, 26 pps., Federal Reserve Bank of New York, provides detailed information for small businesses on potential methods and criteria to obtain credit from financial institutions. For free copies, call (404) 589-7307.

Community Development Financial Institutions: Investing in People and Communities, prepared by Woodstock Institute provides an overview of the entire range of CDFIs by describing the various types of CDFIs, the roles they play in meeting credit needs, examples of specific lending programs, capital needs of CDFIs, and relationships between CDFIs and conventional financial institutions. For a copy, call (312) 427-8070 or write to Woodstock Institute, 407 South Dearborn, Suite 550, Chicago, Illinois 60605.


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Small Businesses Face Large Obstacles to Obtain Surety Bonds

Solutions available include mentoring, escrow accounts, and SBA guarantees

By Hank Helton

One of the biggest obstacles for small contractors wanting to participate in development projects is access to surety bonding. The process of bid, payment, and performance bonding for small contractors is usually somewhat complex and of such a magnitude that it sometimes prohibits participation in larger developments.

The “Mentoring” Approach

A number of techniques have been employed to address these issues and increase participation of small contractors in bonded projects. One of the most successful tools that has been used is the “mentoring” approach.

Under this approach, the general contractor secures the contract, obtains bonding for the project, and then subcontracts the work to its smaller partners. Bonding for the subcontractors is provided by the general contractor. Through this partnership, the general contractor assists the subcontractor in becoming a bondable enterprise. One of the requirements for participation in the partnership is an extensive technical assistance program. The technical assistance program assists the subcontractors in the bidding, accounting, and bonding process.

Utilizing the development experience of the general contractor in combination with knowledge gained through the technical assistance program, the subcontractors are able to secure bonding that may not be available to them in the normal course of business. A surety control account is also established once the bond is issued. The mentor or general contractor, in conjunction with a CPA, monitors the activities of the subcontractors to ensure compliance with the bond.

Escrow Control Programs

Another approach is to utilize a surety bonding agency that is knowledgeable of the issues surrounding bonding for small contractors and subcontractors. Once again, the technical assistance component, that could be provided through the agency, is important in the bonding process. The bonding agency could also establish a construction escrow control program to provide payment protection by establishing a reserve fund that ensures the work will be completed even if the subcontractor has to be dismissed. Under this program, the project owner would utilize bond reserves or a guarantee fund to pledge as collateral for the contractors’ bond. In exchange for this, the surety agency could offer specific lines of credit (bonds) to small contractors that are having difficulty becoming bonded.

The Regional Approach

Regional coalitions can also assist small contractors seeking bonding. For example, the Regional Alliance for Small Contractors, a partnership of large construction firms, public agencies, and small contractors, actively solicits commitments from surety companies to make bonds available to small contractors in the New York City metropolitan area. In addition, for contracts under $250,000, the City of New York is responsible for guaranteeing payment of workers and suppliers, thus making it easier for small contractors to obtain bonding.

Bond Guarantees

Finally, the Small Business Administration (SBA) has a surety bond guarantee program. Under this program, the SBA guarantees to a qualified surety up to 90% of any losses incurred under bid, payment, or performance bonds issued to contractors up to $1.25 million. This guarantee is only for the surety agency; no surety bonds are issued directly by the SBA. There is a guarantee fee of approximately $6 per $1,000 of the contract face value.

DID YOU KNOW?

The national homeowner turnover rate declined to 11.8 years in 1994 from 14.3 years in 1991, according to the Chicago Title and Trust Family of Title Insurers.
## CALENDAR

### August

- National Housing and Rehabilitation Association, August 17-20. Summer Institute, Woodstock Inn, VT. Contact: (202) 328-9171.
- New Mexico Mortgage Finance Authority, August 24-25. 1995 Governor's Housing Conference, Albuquerque, NM. Contact: (503) 649-8880.

### September

- National Association for County Community and Economic Development Conference, September 23-27. 20th Annual County Community and Economic Development Conference, Salt Lake City, UT. Contact: (202) 429-5118.

### October

- National Puerto Rican Coalition, October 4-5. Advancing the Puerto Rican Community into the 21st Century, New York, NY. Contact: (202) 223-3915.
- Heartland Center for Leadership Development, October 19-23. Helping Small Towns Survive, Snow King Resort, Jackson Hole, WY. Contact: (800) 927-1115 or (402) 474-7667.

### November

- American Bankers Association, November 5-9. National Community Development Lending School, Norman, OK. Contact: (800) 338-0626.

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