Community Affairs Officer's note - Issue 2, 2000

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November 1, 2000

AUTHOR

JoAnne Lewellen

Community Affairs Officer

Lending in Native American communities

Economic development activities take place in communities of every size and description, from the largest cities to the smallest rural towns. No matter where development takes place or what population it affects, it depends on funding for its support. In many cases, lending is the primary vehicle for delivery of development funds.

In this issue of *Community Dividend*, we focus on aspects of lending, with a special emphasis on lending in Native American communities. As in other communities, reservation-based business owners often face barriers to obtaining start-up or expansion financing. To counter this problem, some Indian Country communities have established community development loan funds.

The Lakota Fund, the focus of our cover story, is a perfect example. Established 14 years ago in response to depressed economic conditions on the Pine Ridge Indian Reservation, the Lakota Fund is now an instrumental part of the community's development infrastructure. Our story discusses the lessons learned from the fund's lending activities and the accompanying photos depict some of the fund's success stories.

The discussion continues in "A Conversation with . . .," featuring Lakota Fund Executive Director Elsie Meeks. In our interview, Meeks explains the challenges faced by small businesses in Indian Country and offers advice to help lending institutions become involved with Indian Country loan funds.

Expanding on the theme of Indian Country lending, a feature in this issue revisits 1999's "Walking the Native Path: Seeking Solutions Through Economic Development and Housing Opportunities" conference, cosponsored by Community Affairs. The article discusses the feedback received from attendees and reports on development activities that grew from the information provided in conference sessions.

A special feature in this issue explores lending from the consumer's point of view. The article explains how loan-pricing models are used to determine interest rates for commercial lending. An awareness of these models can help consumers understand how their credit histories affect the lending process.

Finally, we round out the issue with a feature on a special happening in Community Affairs: a July tour of St. Paul's developing Phalen Corridor area, arranged for Federal Reserve System Governor Edward Gramlich.

We hope the information presented in this *Community Dividend* will enhance your understanding of community development.

FEDERAL RESERVE BANK OF MINNEAPOLIS

Montana high school students build affordable housing

November 1, 2000

Neighborhood Housing Services, Inc. (NHS) of Great Falls, Mont., has received grants totaling $10,600 to help defray the costs of constructing two High School Houses and making them affordable to buyers.

High School Houses are built by construction technology students from Great Falls high schools. With guidance from teachers and construction workers, students participate in every step of the construction process, from acquiring building permits to laying sod for the finished houses. Construction materials are donated or purchased through grants, and the completed houses are sold to local low- to median-income families that have completed NHS's homebuyer program.

Since the project began in 1997, NHS, in partnership with the City of Great Falls and local contractors, has overseen the construction of five High School Houses. Two houses are under construction and will be completed by June of 2001.

The recent grants were awarded by the Montana Community Fund, in the amount of $5,000, and the Gannett Foundation, in the amount of $5,600, according to the *Neighborhood Housing Services, Inc. of Great Falls*newsletter.

FEDERAL RESERVE BANK of MINNEAPOLIS

Economic development in Indian Country: Lessons learned by The Lakota Fund

By sharing 10 lessons learned from its lending activities, The Lakota Fund hopes to benefit all community developers.

November 1, 2000

AUTHOR

Margaret Tyndall

Community Affairs Manager

On Main Street in Kyle, S.D., Carol Vocu stands outside her restaurant, The Food Stop Cafe. Established in 1991, Vocu's business has grown with help from The Lakota Fund, which provided technical assistance and loans ranging from $1,000 to $14,000.

Johnny Sundby, Dakota Skies Photography

Electrician Darwin Eagle Elk, restaurant proprietor Carol Vocu and many other entrepreneurs on the Pine Ridge Indian Reservation (Pine Ridge) learned the lessons of running a small business from The Lakota Fund (TLF). A private, nonprofit community development financial institution, TLF was established to provide capital and technical assistance for the development of a private-sector economy on Pine Ridge.

Loan funds in brief

In areas with underdeveloped private sectors, loan funds often play a critical role, providing credit and technical assistance to local small businesses. Capital for loan funds comes from a variety of sources, including federal, state and tribal government; private banks; corporations; individual investors and foundations. Often, loan funds fill financing gaps that occur when businesses cannot meet conventional financing requirements. Loan funds consider whether a borrower has a viable business plan, the managerial skills to execute the plan and intangibles such as a personal commitment to succeed, rather than concentrating solely on a borrower's historical repayment ability and collateral.

This holistic approach to borrower eligibility makes loan funds a good fit for Indian Country communities, where low incomes and nonexistent credit histories have kept potential entrepreneurs from tapping into sources of conventional small business financing.

In the 14 years since TLF was established, many economic development agencies and organizations in Indian Country have created loan funds to assist reservation-based enterprises. When they are well-designed and well-managed, loan funds can be a vital component of a healthy reservation economy, helping create jobs and wealth.

Marcell Bull Bear surveys his 3,100-acre ranch south of Kyle, S.D. A 1999 loan from TLF helped Bull Bear expand operations at Kiyaksa Buffalo & Cattle Company. "Thanks to TLF's technical and financial assistance, I've come this far," Bull Bear says.

Johnny Sundby, Dakota Skies Photography

Lessons learned

In those 14 years, the managers of TLF learned important lessons from their experiences. Following are 10 of those lessons. They are not lessons in raising funds or designing a capital structure. Instead, they are lessons learned through the daily interactions among fund managers, borrowers and other community members. By sharing these lessons learned in Indian Country, TLF hopes to benefit all community developers.

Lesson 1: Establish and follow your mission

TLF's mission has been clear from the start: to develop a private sector on Pine Ridge that will provide jobs, offer products and services close to home and keep money on the reservation. However, to fulfill this mission, TLF has learned that capital must be made available to businesses of varying sizes and not just to the smallest businesses. A robust private sector cannot consist primarily of very small businesses. It must include larger businesses as well, to create significant wealth and employ individuals who do not wish to run their own firms.

Lesson 2: Know and meet your market's needs

Elsie Meeks, executive director of TLF, notes that fund managers must be aware of the full range of funding needs in the community, even if their organization's mission is to only make loans of a certain size. When it started operating, TLF offered micro loans to very small businesses. According to Meeks, other lenders were not making larger loans on Pine Ridge. So, as TLF gained experience, and in order to follow its mission, the fund raised its lending limit from $10,000 to $25,000. TLF then increased the limit to 6 percent of the fund's capital, up to a maximum of $200,000.

Lesson 3: Be flexible and learn as you go

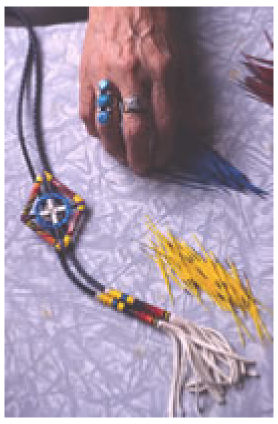
At its start, TLF's lending policy relied not on credit histories but on the philosophy that "character makes the difference" in loan repayment. The reliance on character lending forced staff members to constantly defend their decisions to deny credit, a hard task in a small community where borrowers are the friends and relatives of the lenders.

To counteract these problems, TLF began a circle lending program based on the model pioneered by the Grameen Bank in Bangladesh. (For more information on the Grameen Bank, visit www.grameen-info.org.) Potential borrowers received training before any money was lent, and other circle members took part in the lending decisions, which took some of the pressure off TLF's staff. Also, by observing the circles, staff members learned about group dynamics, which helped them devise lending policies and collection procedures appropriate for the reservation.

Circle lending provided a valuable learning experience for the staff, but it could not fulfill TLF's basic mission of building a private sector on the reservation. Circle loans were capped at $1,000, so borrowers were overwhelmingly "mom and pop" operations. By 1999, TLF managers recognized that such small-scale businesses with limited growth potential would not lead to a vibrant private sector and decided to end the circle-lending program.

Christine Red Cloud creates quillwork in her Pine Ridge home. Her 36-year-old family business, Red Cloud quillwork, received a $10,000 inventory-purchase loan from TLF.

Johnny Sundby, Dakota Skies Photography



Christine Red Cloud's handiwork. In addition to providing loans, TLF assists her business with supply ordering and bookkeeping.

Johnny Sundby, Dakota Skies Photography

Lesson 4: Approach new ventures with caution

Decent, affordable housing has always been a critical need on Pine Ridge. Several years ago, TLF managers decided that the lack of such housing was impeding local economic development and, despite their lack of experience in housing development, decided to tackle the problem by constructing affordable housing. Unfortunately, managers saw the construction drain resources from the core activity of lending to small businesses. TLF later curtailed its housing development efforts.

The experience taught TLF managers to wade into new project areas slowly, with guidance from experts in the field, instead of diving in quickly—especially when significant resources may have to be committed to the new project.

Lesson 5: Learn from others, then learn from experience

In the early days of TLF, the staff had little lending experience and countered the problem through the use of outside resources. "We relied on a lot of people in those days," comments Meeks. TLF received templates for loan policies, collection procedures, liquidity and loan reserves and loan status reports from other funds and lenders. First Nations Development Institute (First Nations) provided training for TLF's staff and, for the first five years of the fund's operations, administered the larger of its two loan programs, which allowed loans up to $10,000.

The arrangement with First Nations was designed to allow time for the inexperienced staff of TLF to learn how to lend. However, with First Nations administering the larger loan program from its offices in the state of Virginia, TLF staffers in Kyle were left managing the smaller, $1,000-limit loan program. The process of making only the small loans did not demand that staff learn and rigorously apply principles of business lending. Not until 1992, when TLF assumed authority for making loans under both programs, did TLF staff learn how to lend. According to Meeks, "We didn't grow and learn until we were left on our own, to make our own decisions and to deal with the consequences of those decisions."

Rosie Olson displays the wares at Singing Horse Trading Post, located seven miles north of Manderson, S.D., on Pine Ridge. Established in 1995 by Rosie and her husband, Howard, the business sells leather, beads and other supplies to local artisans. TLF provided the Olsons with technical assistance and a $25,000 loan, which was used to construct a bed and breakfast.

Johnny Sundby, Dakota Skies Photography

Lesson 6: Hire staff with the "right stuff"

A loan fund's success or failure is largely dependent on its employees. In the case of TLF, managers credit much of their success to hiring staffers with the right combination of abilities and experience to administer the fund well.

TLF managers always made it a priority to hire local residents who know the community and could help implement the fund's policy of character-based lending. However, local knowledge was no substitute for knowledge of and experience in lending. Meeks says she now looks for a balance. She favors staffers who are local residents but, as the fund moves into making larger loans, plans to hire for expertise and hire outsiders as needed. Hiring experienced staff from outside the organization can accelerate the training of current staff members as they learn from the expert. The hoped-for outcome is that the "outsiders" hired for their expertise will become familiar with the community, while the skills and experience of locally hired staff continue to increase.

But Meeks insists that all staff she hires, whether local or from another community, must have two key characteristics: integrity and the strength and courage—or as she puts it, the "guts"—to take on tough work. She says that business lending is difficult and business lending in Indian Country is especially difficult. Local or not, experienced or not, loan fund employees must be strong and committed to upholding the values and standards of the fund.

Lesson 7: Be diligent to keep delinquencies in check

According to Meeks, managing delinquent loans has always been and will always be an issue for TLF. While losses were 10 percent in 1999, Meeks thinks the rate could easily rise to 50 percent or more if fund managers are not constantly diligent. TLF's policies clearly emphasize to staff and borrowers alike that it makes loans, not grants, and that repayment according to schedule is expected. Staff members receive training in loan monitoring and collections procedures. To stay on top of the loans, staff members meet weekly to discuss loans, perform site visits to see how businesses are doing, and receive training in the fundamentals of the businesses in TLF's portfolio.

Darwin Eagle Elk provides electrical services for a customer on Pine Ridge. His firm, Eagle Elk Services, was established in 1995 and has continuous contracts with area businesses. TLF has helped Eagle Elk with technical assistance and loans ranging from $1,000 to $7,000.

Johnny Sundby, Dakota Skies Photography

Lesson 8: Accept and manage risks

On average, loans made by a fund such as TLF are inherently riskier than loans made by a commercial bank. This is true because loan funds often work with borrowers that are not "bankable"; that is, they do not have a low enough risk profile or sufficient collateral to receive a bank loan.

According to Meeks, community development loan fund managers must understand that, given the mission of such funds, their loans are risky and some will not be repaid. Then, management must control the risk. First, the fund must set reasonable delinquency and loan loss targets and make it a top priority to not exceed them. Second, the fund must use good, basic, lending practices. In Meeks's view, this means the fund must establish and consistently apply lending criteria based on ratios, collateral policies and such. Last, but by no means least, the fund must establish and maintain a good loan tracking system and, as discussed above, have a commitment to and system for collections. While these steps seem daunting, Meeks notes that TLF has involved bankers and other lenders as advisors—advisors who have helped the fund construct and implement loan fund policies and systems.

Lesson 9: Develop borrowers through training and investment

Although TLF abandoned the circle lending approach, it incorporated the lessons learned during the circle program's operation. First, TLF managers determined that borrowers usually did not understand what it meant to be in business and that owning a business requires a total commitment. With an unemployment rate of 85 percent, many residents of Pine Ridge have never worked in a business or held a regular job.

Second, fund managers learned that it is essential to the eventual repayment of the loan that borrowers invest something of themselves in the process. Since borrowers on Pine Ridge often have few or no assets to offer as security on a loan, the "something of themselves" that they must invest has to be another scarce commodity—time.

The fund requires potential borrowers to attend seven weeks of business preparation classes. As evidence of their seriousness and commitment, potential borrowers must have perfect attendance at all classes and fulfill all assignments before they can qualify for a loan. The classes prepare potential business owners for the realities and hard work of owning a business and dissuade the less committed from borrowing funds and starting businesses.

Lesson 10: Don't mix politics with private-sector lending

Often in Indian Country, the tribal government controls the reservation's loan fund. According to Meeks, in the end, these funds invariably pursue goals other than developing profitable businesses, such as providing jobs or filling spaces in a shopping center.

In Meeks's opinion, if developing a private sector is the goal, lending decisions must be made free from the political considerations that inevitably creep into tribally controlled funds. Lending staff must be able to make, deny and collect loans free from political pressure, no matter how well-intentioned that pressure may be. In her view, only funds that are controlled by a body independent from the tribal government will have that freedom and be able to foster the successful private businesses necessary to develop a private sector on a reservation.

The final lesson

The lessons learned by established Indian Country loan funds like TLF provide a primer for the development of other loan funds, in Indian Country and elsewhere. Implicit in the lessons learned by TLF is a final lesson—perhaps the most important lesson of all: operating a thriving loan fund, just like operating a thriving small business, requires hard work, perseverance, and an adherence to basic business principles. That lesson is key to the success of small business owners like Darwin Eagle Elk and Carol Vocu, and key to the success of TLF as well.

Pine Ridge and The Lakota Fund: Then and now

The Lakota Fund (TLF) was established to assist the Oglala Lakota Nation on the Pine Ridge Indian Reservation in southwestern South Dakota. TLF operates out of Kyle, South Dakota, in the geographic center of Pine Ridge. The reservation covers roughly 2 million acres and is home to about 22,000 people. At the time TLF was organized, Pine Ridge had fewer than 40 small businesses, most owned by non-Indians. According to a 1983 study by First Nations Development Institute (First Nations), the lack of local businesses caused some $74 million to flow off the reservation to neighboring towns each year. Rampant unemployment and inadequate housing added to the reservation's economic woes.

In 1986, First Nations created TLF as an economic development project. According to Elsie Meeks, executive director of TLF, First Nations provided start-up support, which allowed the fund time to become operational while shielding it from political interference. First Nations' support also helped TLF build its local capacity and develop relationships with national funders. In 1992, First Nations spun off TLF and it became an independent organization.

TLF fulfills its mission by providing small business loans and technical assistance to members of the Oglala Lakota Nation. It has lent more than $1.6 million to more than 400 borrowers, helping to create a private-sector economy on Pine Ridge and lessening the flow of money off the reservation. In addition, TLF has initiated and operated a marketing program and opened a retail gift shop to assist artists; obtained funding for and constructed a 13,000-square-foot building to provide office space for TLF and other businesses; developed—with the help of the Small Business Administration—a Tribal Business Information Center, making PCs and Internet access available to borrowers; constructed a 30-unit affordable housing project and provided housing loan packaging for individuals who wished to obtain funds from the U.S. Department of Agriculture's Rural Development program. Recently, TLF received certification as a Community Development Financial Institution (CDFI) from the Department of Treasury's CDFI Fund, making it one of only two reservation-based loan funds to receive this certification.

For more information, visit www.lakotafund.org.

Use of "Indian Country"

The term "Indian Country" is commonly used to refer to tribal lands. Congress defined it first in 1948 in a federal criminal statute. See 18 U.S.C. § 1151. The Supreme Court also borrowed this definition for several civil cases. See DeCoteau vs. District County Court, 420 U.S. 425, 427 n. 2 (1975). Generally, the courts have defined Indian Country broadly to include formal and informal reservations, dependent Indian communities and Indian allotments, whether restricted or held in trust by the United States.

FEDERAL RESERVE BANK OF MINNEAPOLIS

How do lenders set interest rates on loans?

A discussion of the concepts lenders use to determine interest rates.

November 1, 2000

AUTHOR

Matthew D. Diette

Field Supervisory Examiner

Article Highlights

› Funding and operating costs, risk premium, target profit margin determine loan's interest rate

› Competition between banks affects interest rates

› Most difficult part of loan pricing is calculating risk premium

For many borrowers, the factors that determine a bank's interest rate are a mystery. How does a bank decide what rate of interest to charge? Why does it charge different interest rates to different customers? And why does the bank charge higher rates for some types of loans, like credit card loans, than for car loans or home mortgage loans?

Following is a discussion of the concepts lenders use to determine interest rates. It is important to note that many banks charge fees as well as interest to raise revenue, but for the purpose of our discussion, we will focus solely on interest and assume that the principles of pricing remain the same if the bank also charges fees.

Cost-plus loan-pricing model

A very simple loan-pricing model assumes that the rate of interest charged on any loan includes four components:

- the funding cost incurred by the bank to raise funds to lend, whether such funds are obtained through customer deposits or through various money markets;
- the operating costs of servicing the loan, which include application and payment processing, and the bank's wages, salaries and occupancy expense;
- a risk premium to compensate the bank for the degree of default risk inherent in the loan request; and
- a profit margin on each loan that provides the bank with an adequate return on its capital.

Let's consider a practical example: how this loan-pricing model arrives at an interest rate on a loan request of $10,000. The bank must obtain funds to lend at a cost of 5 percent. Overhead costs for servicing the loan are estimated at 2 percent of the requested loan amount and a premium of 2 percent is added to compensate the bank for default risk, or the risk that the loan will not be paid on time or in full. The bank has determined that all loans will be assessed a 1 percent profit margin over and above the financial, operating and risk-related costs. Adding these four components, the loan request can be extended at a rate of 10 percent (10% loan interest rate = 5% cost of funds + 2% operating costs + 2% premium for default risk + bank's targeted profit margin). As long as losses do not exceed the risk premium, the bank can make more money simply by increasing the amount of loans on its books.

Price-leadership model

The problem with the simple cost-plus approach to loan pricing is that it implies a bank can price a loan with little regard to competition from other lenders. Competition affects a bank's targeted profit margin on loans. In today's environment of bank deregulation, intense competition for both loans and deposits from other financial service institutions has significantly narrowed the profit margins for all banks. This has resulted in more banks using a form of price leadership in establishing the cost of credit. A prime or base rate is established by major banks and is the rate of interest charged to a bank's most creditworthy customers on short-term working capital loans.

This "price leadership" rate is important because it establishes a benchmark for many other types of loans. To maintain an adequate business return in the price-leadership model, a banker must keep the funding and operating costs and the risk premium as competitive as possible. Banks have devised many ways to decrease funding and operating costs, and those strategies are beyond the scope of this article. But determining the risk premium, which depends on the characteristics of the individual borrower and the loan, is a different process.

Credit-scoring systems and risk-based pricing

Because a loan's risk varies according to its characteristics and its borrower, the assignment of a risk or default premium is one of the most problematic aspects of loan pricing.

A wide variety of risk-adjustment methods are currently in use. Credit-scoring systems, which were first developed more than 50 years ago, are sophisticated computer programs used to evaluate potential borrowers and to underwrite all forms of consumer credit, including credit cards, installment loans, residential mortgages, home equity loans and even small business lines of credit. These programs can be developed in-house or purchased from vendors.

Credit scoring is a useful tool in setting an appropriate default premium when determining the rate of interest charged to a potential borrower. Setting this default premium and finding optimal rates and cutoff points results in what is commonly referred to as risk-based pricing. Banks that use risk-based pricing can offer competitive prices on the best loans across all borrower groups and reject or price at a premium those loans that represent the highest risks.

So, how do credit-scoring models and risk-based pricing benefit the borrower who only wants a loan with reasonable repayment terms and an appropriate interest rate charge? Since a bank is determining a reasonable default premium based on past credit history, borrowers with good credit histories are rewarded for their responsible financial behavior. Using risk-based pricing, the borrower with better credit will get a reduced price on a loan as a reflection of the expected lower losses the bank will incur. As a result, less risky borrowers do not subsidize the cost of credit for more risky borrowers.

Other risk-based pricing factors

Two other factors also affect the risk premium charged by a bank: the collateral required and the term, or length, of the loan. Generally, when a loan is secured by collateral, the risk of default by the borrower decreases. For example, a loan secured by a car typically has a lower interest rate than an unsecured loan, such as credit card debt. Also, the more valuable the collateral, the lower the risk. So it follows that a loan secured by the borrower's home typically has a lower interest rate than a loan secured by a car.

However, there may be other factors to consider. First, the car may be easier to sell, or more liquid, making the risk of the loan lower. Second, the term, or length of a car loan is usually short—three to five years—as compared to the 15- to 30-year term of a home loan. As a general rule, the shorter the term, the lower the risk, since the ability of the borrower to repay the loan is less likely to change.

Assessing the interplay of credit score, collateral and term to determine the risk premium is one of a lender's most challenging tasks. Whether loan-pricing models are based on a simple cost-plus approach or price leadership, use credit-scoring or other risk-based factors, they are valuable tools that allow financial institutions to offer interest rates in a consistent manner. Knowledge of these models can benefit customers as well as banks. Although it cannot help customers make their payments, an awareness of loan-pricing processes can ease the uncertainty that may be involved in applying for a loan.

Matthew D. Diette is a field supervisory examiner in the Community and Regional Banking section of the Banking Supervision Department, Federal Reserve Bank of Minneapolis.

How does credit scoring work?

To determine a credit score, lenders use credit-scoring software, which analyzes data from a large pool of borrowers. Most lenders rely on the credit-scoring software developed by Fair, Isaac and Company, with data gathered by the three major credit reporting agencies: Experian; Equifax, Inc.; and Trans Union Corporation.

When a customer's name and address are entered into a credit-scoring program, a complete credit history is obtained from one of the three credit-reporting agencies. Through a series of calculations, the history is analyzed and compared to the histories of other borrowers. The customer is then assigned a credit score, which is usually between 400 and 825.

A score above 710 is normally considered a good credit risk, while a score under 620 is considered a very high risk. Customers in the latter category have blemishes or irregularities in their credit histories and are often referred to as "subprime" borrowers. So what is the benefit of knowing a credit score? The information is vital for lenders, because a customer with a score of 710 has a statistically determined default rate of only 1 in 21, while a customer with a score of 680 has a default rate of 1 in eleven.

Although the calculations that determine credit scores are complex, obtaining your credit history is fairly simple. You have the legal right to see your credit report and can request it from any of the three major credit reporting agencies.

Lenders are not obligated to share your credit score with you when you apply for a loan, but there are signs that this may be changing. According to the November 13, 2000, issue of *Newsweek*, Fair, Isaac and Company recently took steps to better explain credit scores to lenders, so they can convey the information to customers. And, according to the article, Fair, Isaac plans to make credit scores available to customers soon through Experian and Equifax, while Trans Union plans to release scores on its own.

Five Minnesota communities receive housing grants

November 1, 2000

Five Minnesota communities will receive grants totaling $3,489,550 through the Minnesota Department of Trade and Economic Development's Small Cities Development Program.

According to Southwest Minnesota Housing Partnership's *Home Works*newsletter, the funds will be used for housing construction and rehabilitation. Recipients and grant amounts are: City of Marshall, $1,395,900; City of Mountain Lake, $587,800; City of Round Lake, $411,100; City of Woodstock, $564,800; and County of Chippewa, $529,950.

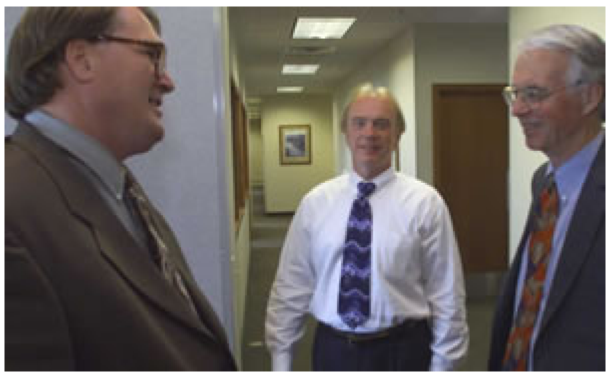
Fed Gov. Gramlich tours Phalen Corridor project in St. Paul

A summary of Federal Reserve Governor Edward Gramlich's July 2000 visit to St. Paul.

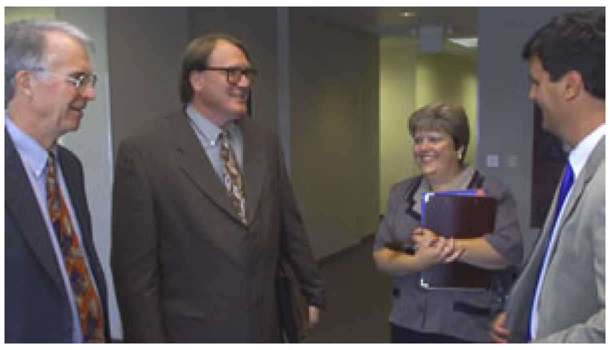
November 1, 2000

On July 19, Edward Gramlich, member of the Board of Governors of the Federal Reserve System, and Gary Stern, president of the Federal Reserve Bank of Minneapolis, toured the Phalen Corridor, a large mixed-use redevelopment area on St. Paul's East Side. The Phalen Corridor boasts active residents and community groups, and its diverse population includes Hmong, Laotians, African Americans and Latinos.

More than 60 public, private and nonprofit partners from the area have joined forces as the Phalen Corridor Initiative. The organization works to create new business opportunities, jobs, housing and retail establishments for area residents. (For more information on the Phalen Corridor Initiative's successes to date and its upcoming projects, see the box below.)



Following the tour, Gov. Edward Gramlich (right) meets with Jim Erchul (left) of Dayton's Bluff Neighborhood Housing Services and Rick Johnsen of Aries Precision Metal (center). (Photo courtesy St. Paul Port Authority)



Gramlich and Erchul discuss Phalen Corridor redevelopment with Muffie Gabler of Wells Fargo Bank and Curt Milburn of the Phalen Corridor Initiative. (Photo courtesy St. Paul Port Authority)

While leading the tour, Curt Milburn describes a Phalen Corridor redevelopment project to Jessica Deegan, Phalen Corridor Initiative, and Gov. Gramlich.

Curt Milburn, Phalen Corridor Initiative project director, conducted the July tour, which visited the following sites:

- Phalen Village—a development featuring green space, wetlands, commercial redevelopment and a planned townhouse complex;
- The Job Bank—a neighborhood jobs and employment connection;
- Edgerton Bridge—an elevated spot for viewing the initiative's road-improvement and transportation plan layout and seeing Phalen West, the next industrial project slated for development in the corridor;
- Rivolli Bluff—the planned site of new housing; and
- Williams Hill Business Center—formerly a polluted industrial site, now an industrial park.

At the conclusion of the tour, Governor Gramlich and President Stern met with Phalen Corridor Initiative partners including Dick Hanson, 3M and 3M Foundation; Muffie Gabler, Wells Fargo Bank; Lorrie Louder, St. Paul Port Authority; Jim Erchul, Dayton's Bluff Neighborhood Housing Services; Howard Siewert, owner of Ideal Printers; and Rick Johnsen, owner of Aries Precision Metal. The partners discussed their reasons for getting involved in the area's redevelopment project and the importance of having business, community and government sectors participate in the initiative.

"It's impressive to see the hard work and dedication of the Phalen Corridor partners and their willingness to seize opportunities for building a livable community. Touring a community that's undergoing revitalization and talking to the local partners provides the opportunity to witness economic growth firsthand."
—*Gary Stern, President, Federal Reserve Bank of Minneapolis*

"We're always excited to conduct tours for individuals like Governor Gramlich and President Stern. Showing them our work brings out our partners' pride and reconnects them to the business, community and government relationships that have been the keys to our success. It also gives us the opportunity to have visitors with a national perspective critique our work and introduce us to best practices from other projects nationwide."
—*Curt Milburn, Project Director, Phalen Corridor Initiative*

The Phalen Corridor Initiative: Successes and upcoming projects

The Phalen Corridor Initiative is a community partnership working to rebuild the economic, social and physical prosperity of St. Paul's East Side. Initiative partners have achieved the following successes to date: the Williams Hill Business Center, which created six new businesses with 650 jobs; a new Job Bank and Eastside Work Resource Hub; the Johnson Achievement Plus Elementary School with an attached YMCA; the Ames Lake Wetland, which replaced a former parking lot; the construction of 29 mixed-income housing units at Phalen Village Town Homes; development of the East Metro Transit Facility, opening in 2001 with 300 projected jobs; and the Bureau of Criminal Apprehension Building, opening in 2002 with 300 employees.

Upcoming projects include constructing Phalen Boulevard, with groundbreaking scheduled for 2002; building more than 100 new housing units in the Rail Road Island Neighborhood, which will connect new housing with jobs, transit and greenspace; developing the Phalen Westminster site, with 270 jobs expected; converting 100 polluted acres into desirable business sites; connecting two regional bicycle and recreational trails; and linking East Side schools with a job-training curriculum.

For more information, contact Curt Milburn at (651) 772-6220, or cmilburn@isd.net, or visit www.phalencorridor.org.

Indian business group receives $1 million grant

November 1, 2000

The U.S. Department of Commerce awarded a $1 million Economic Development Administration (EDA) grant to the American Indian Business Development Corporation (AIBDC) for the revitalization of Minneapolis's economically distressed Phillips neighborhood.

The grant will be used to construct a multipurpose business incubator facility and make neighborhood lighting and landscaping improvements, according to Congressman Martin Olav Sabo (D-Minn.), who is an AIBDC supporter. The AIBDC works to improve economic conditions and stimulate business development in Phillips, which suffers from high unemployment and extremely low per capita income.

The grant was awarded through the EDA's Public Works and Development Facilities Grant Program, which encourages new industry, business expansion, economic diversification and job creation in communities threatened by low per capita income and high unemployment.

Honors for housing initiative

November 1, 2000

The Federal Home Loan Bank of Des Moines (FHLB) announced it has given a Community Partnership Award to Norwest Bank South Dakota, N.A. (Norwest) for its work in addressing the affordable housing shortage on Native American reservations in South Dakota.

Using nearly $1.8 million in grants from FHLB's Affordable Housing Program, Norwest partnered with local organizations on constructing and renovating nearly 200 affordable homes on the Pine Ridge Indian Reservation, the Rosebud Indian Reservation and other reservations in the state.

A conversation with … Elsie Meeks of The Lakota Fund

Community Dividend discusses the economic development efforts of The Lakota Fund with its executive director, Elsie Meeks.

November 1, 2000

The Lakota Fund, a loan fund serving the Pine Ridge Indian Reservation (Pine Ridge) in South Dakota, is a major source of small business capital for tribal members. Established in 1986 in response to a high unemployment rate and a depressed local economy, the fund provides loans and technical assistance to pursue its mission of developing a private-sector economy on Pine Ridge.

Community Dividend *discussed the economic development efforts of the Lakota Fund with its executive director, Elsie Meeks.*

Community Dividend: Economic development in Native American communities presents many challenges. What are the greatest challenges to Native small businesses and to the loan funds that serve them?

Elsie Meeks: The greatest challenge to Native small businesses is a lack of experience in business, and the greatest challenge to our loan fund is to build a business foundation. Most people here have not even had the chance to work in a small business, let alone run one. If people haven't had the opportunity to work in or run a business, how do they learn to be good managers? They must learn from experience, and our work is about giving people that experience.

CD: The Lakota Fund's mission is to develop a private-sector economy on Pine Ridge. How has this mission changed since the Lakota Fund was founded?

Meeks: It hasn't changed a lot, although we do see ourselves becoming more of an economic development organization instead of just a small business loan fund.

CD: Your economic development efforts involve providing capital and technical assistance to very small businesses, or microenterprises. How necessary are capital and technical assistance for microenterprises?

Meeks: In our experience, most people need capital and technical assistance. That's especially true if they want to expand their business. Even if people have been operating microenterprises for a period of time, we've found that most haven't kept very good track of their expenses and haven't priced their products or services in the right way. Sometimes, people can operate a microbusiness without a loan by financing it themselves, but most people need at least a short-term loan.

One thing I want to stress is that a microenterprise loan fund shouldn't be an end unto itself, but should be a tool used for growing people's expertise. I believe that there is one instance, in the U.S., when microenterprise development is needed. That instance is when people do not have credit viability or business experience. Microenterprise development allows people their first entry into credit and business, but it alone doesn't create jobs or increase income substantially. Although microenterprise is a tool that The Lakota Fund utilizes, we identify ourselves as a small business loan fund.

CD: Aside from small business loans and technical assistance, what services do you provide?

Meeks: We provide small business training for people who wish to borrow from the Lakota Fund. We provide credit counseling and assist in workouts with creditors. For those interested in developing a business plan, we provide access to computers and other business resources through the Tribal Business Information Center. We also provide assistance for people who want to obtain a loan for a house. And we recently completed a 30-unit low-income tax credit housing project, which was a whole new arena for us.

CD: How is the Lakota Fund managed?

Meeks: We have a nine-person board made up of enrolled members of the Oglala Lakota Nation, with the exception of one member. The outside position was designed so we could bring in some outside expertise. So, eight of our board members are members of this tribe. They're community people, extremely committed to seeing positive changes happen, and they're very supportive of our vision.

One of the board positions is reserved for a tribally elected person. All of the board members, except the elected person, serve on the loan committee.

Our board is self-selecting, which means that it isn't elected by a public vote. The reason for this is that when we were organizing, people didn't want the fund to be modeled after tribal organizations. Most tribal boards become too political, and we thought it was important that we not be a political organization. And we are not connected to tribal government in any way; we're a private nonprofit. The board hires the executive director, and the executive director hires the staff.

CD: Is there anything that tribal governments should do to assist tribally operated loan funds?

Meeks: The best thing that tribal governments can do is to pass laws that assist small businesses—effective laws governing collection of debt, checks, etc. If a tribe can provide capital, it should provide it in a nonpolitical way. By that, I mean that it should not have strings attached to the capital, and it should not try to influence decisions that loan funds make.

CD: How does your loan approval process work?

Meeks: Anyone who wants a loan from The Lakota Fund must complete our seven-week small business training program. This not only provides good information and training for the potential businessperson, it also tells us how committed someone is about starting a business. After the training, if the person hasn't completed a business plan, staff assists them in completing it. At that point, the lending director analyzes the person's business plan and credit history. If the borrower has an acceptable plan and debt-to-income ratio, the application is taken to the loan committee for a decision. The lending director has the authority to approve loans of $1,000 or less.

CD: Do you work closely with your borrowers?

Meeks: Yes, very. That's absolutely key to our success. First, we get to know them through our small business training program. After training, if they want to pursue their business idea and a loan, we assist them in completing their business plan. If they get a loan, we do quarterly site visits. We have a great staff that is completely dedicated to helping people and to getting our loans repaid.

CD: How can financial institutions become involved with tribal loan funds?

Meeks: One way, of course, is to provide capital at a reasonable rate for loan funds to relend, or perhaps contribute to a loan loss reserve fund to help protect investments in the loan fund. Another way is to lend their considerable expertise in business analysis and underwriting. That would be a great help, because most reservation-based loan funds have limited access to experienced business lenders.

CD: Have you noticed a change in the local economy resulting from the capital and technical assistance that the fund has provided?

Meeks: To this point, we've been building a foundation by teaching people basic business principles through training and microenterprises and teaching them about credit. A foundation isn't that visible, but it's very important. When we started, there were very few businesses here and most, if not all, were owned by non-tribal members. Today, there are many more businesses, and tribal members own almost all of them.

CD: In 2006, The Lakota Fund will be 20 years old. How do you see the fund operating in six years?

Meeks: I see us making larger loans to bigger businesses in a more effective, efficient manner. We have made strides in building the foundation. Now, we will become more effective, and our success will be more visible.

FEDERAL RESERVE BANK of MINNEAPOLIS

Walking the Native Path to Economic Development: Results of Fall 1999 conference

A discussion of the results of a Fed-sponsored, Fall 1999 conference on tribal economic development.

November 1, 2000

AUTHORS

Margaret Tyndall

Community Affairs Manager

Thomas Moore

Community Affairs Project Manager

On Sept. 27, 1999, more than 250 housing and economic development practitioners gathered at the Walking the Native Path: Seeking Solutions Through Economic Development and Housing Opportunities conference at the Grand Casino Mille Lacs Hotel and Convention Center in Onamia, Minn. Located on the Mille Lacs Indian Reservation, the conference center was the site for three days of sessions that provided participants with the opportunity to increase their knowledge of lending and investing issues and opportunities on tribal lands.

Community Affairs, a sponsoring partner of the conference, recognizes that such meetings are often informative and enjoyable but are not ends in themselves. A conference is not truly successful unless its sessions lead participants to action. In this article, we will discuss the gains that have resulted from the Walking the Native Path conference, the topics that were discussed in conference sessions and the next steps for maintaining the meeting's momentum.

New steps on the path: What was gained

In April of this year, we sent an evaluation survey to attendees, soliciting opinions on the conference's usefulness. The feedback was overwhelmingly positive. More than 75 percent of the 52 participants who responded to the survey said they learned something from the conference that will enable them to solve a particular problem or concern that their tribe, bank or agency is currently facing. Impressively, 70 percent of the respondents have formed or anticipate forming a partnership with another entity in the near future to achieve a specific housing or economic development objective. These respondents credited the conference with providing the information or contacts that made such relationships possible.

Examples of respondents' new partnerships include a banker who has started working with two reservations in his bank's lending area and another banker whose institution plans to underwrite mortgage loans on a reservation in its lending area. A tribal housing official has formed a partnership with a local bank and tribal officials from two other reservations are pursuing low-income housing tax-credit projects. Finally, a community development venture capital firm is now working with many more Indian clients, having gained an understanding of Indian Country lending and investing issues at the conference.

Illuminating the path: What was discussed

Kicking off the conference on Sept. 27, Patrick Borunda, former executive director of First Nations Oweesta Corporation, spoke on the relationship between economic development and housing. In his remarks, Borunda expressed a concern that on some reservations affordable housing has suffered due to an emphasis on small business lending, while on other reservations the situation is reversed. He stressed that reservation-based community development practitioners must learn to balance the short-term and long-term needs of reservation residents for both housing and business development.

Borunda emphasized the need for lenders' products to conform to the realities of doing business on reservations. He also asserted that reservation economies will continue to suffer unless reservation-based practitioners and private-sector lenders maintain a dialogue about ways to manage the integration of housing and small business creation.

The next day, Marge Anderson, former chief executive officer of the Mille Lacs Band of Ojibwe, spoke about the economic struggles and achievements of the tribe, which has sought private-sector investment and leveraged its gaming profits in pursuit of a more diversified economy.

Conference workshops were split into two concurrent tracks: housing and economic development. The housing sessions focused on financial literacy and the latest housing initiatives under way in Indian Country. The economic development sessions addressed operational and technical aspects of microenterprise lending organizations and provided an overview of emerging private-sector business opportunities on reservations.

The path ahead: Next steps

On the final day of the conference, JoAnne Lewellen, Federal Reserve Bank of Minneapolis Community Affairs officer, challenged attendees to write down three steps they would take individually to transform what they learned at the conference into an increase in housing and small business lending activity on reservations. We in the Community Affairs section accepted our officer's challenge and began planning our next steps.

In survey responses and other contacts, conference attendees indicated that they wished to continue meeting to study and work on reservation community development issues. In response, the Federal Reserve Bank of Minneapolis, in partnership with other organizations, is sponsoring a series of sovereign lending workshops to present information and explore ways of removing barriers to reservation-based lending and investing.

Earlier this fall, we inaugurated the workshop series in Minnesota, North Dakota, and Wisconsin. The goal of the workshops is to engage the partners in Indian Country, encourage them to search for appropriate solutions to development problems and assist them in setting priorities and action plans.

Whether or not you participated in the conference, we encourage you and all who are interested in Indian Country to join us as we continue "walking the Native path"—the path to full participation by Indian Country residents in this country's economic life.

Sponsoring partners made conference a reality

Successful economic development depends on the participation of many organizations. Successful economic development conferences are no different. Following is a list of the sponsoring partners of the September 1999 Walking the Native Path conference.

American Indian Housing & Community Development Corporation
Fannie Mae Minnesota Partnership Office
Federal Deposit Insurance Corporation, Kansas City and San Francisco
Federal Home Loan Bank of Des Moines
Federal Reserve Bank of Minneapolis
Department of Housing and Urban Development
The Minnesota Chippewa Tribal Housing Corporation
Minnesota Dakota Indian Housing Authority
Minnesota Housing Finance Agency
Office of the Comptroller of the Currency, Kansas City
Office of Thrift Supervision, Dallas
Red Lake Housing Finance Agency
United States Department of Agriculture Rural Development.