

# Community

January 1987

Volume 2, Number 1

## About This Issue

*In the September 1986 issue of Community, we introduced the concept of the bank- or holding company-owned community development corporation (CDC). In this issue, we take a closer look at the CDC, and in particular, at two successful CDCs.*

*The CDC is notable for its adaptability to a variety of community needs. Its scale can also vary according to community needs and resources. In the following articles we examine some of the choices that CDC originators must make when they set out to design a development corporation.*

## How is a Bank Holding Company CDC Established?

To form a CDC, a bank holding company applies to its Federal Reserve Bank using the nonbanking (FR Y-4) bank holding company application form. The processing period for such filing is normally 30 days or less. (See Processing Flow Chart on page 4.) Prefiling conferences are often desirable to ensure that the application is informationally complete. The application usually contains the following information:

- A complete description of the proposed activity.
- The major objectives of the proposed CDC and how it will meet these objections.
- The amount of the capitalization and the expected funding needs of the CDC.
- A profile of the CDC's immediate target area (neighborhood) as well as the general area of its proposed operation. Most CDCs have

*Continued on page 4*

## Community Development Corporations: Designing a CDC

### A Public Purpose

Bank-owned and bank holding company-owned community development corporations are characterized by a high degree of flexibility that enables the parent organization to tailor a CDC to meet a particular need. This flexibility makes the CDC difficult to describe in generic terms. Nevertheless, CDCs do share some common characteristics, and there are questions that nearly everyone contemplating formation of a CDC will have to answer.

The one thing that all CDCs have in common is a public purpose. This is central to the CDC's existence and must be stressed. The flexibility and powers granted to a CDC are premised on the understanding that they will be used to benefit the public. The Federal Reserve, for example, defines this public benefit to mean that the activities of the CDC are expected to benefit directly low- and moderate-income groups. Since the needs of a particular community or group of people will vary widely, the CDC is designed to give the parent organization an opportunity to exercise greater initiative and creativity in meeting unique community investment needs. Experience shows that the final structure of the CDC derives largely from the nature of the project to be undertaken.

### Designing Program Focus

The first task, then, is to define the project as completely as possible under given circumstances. This will include identifying a target group, program, or geographic area and the specific needs to be addressed. There may be a community need for housing development, for example. It might be for the elderly, for families or for people with a special need, such as the homeless. Or it might be for central city housing.

Charlotte, North Carolina's North Carolina National Bank CDC (NCNB CDC) developed housing to rebuild residential areas near the central city. Minneapolis-based First Bank System CDC (FBS CDC) focuses on programs and has developed housing for low-income students, for families, and for very low-income women with children.

The need may be for commercial development. FBS CDC's first venture was to develop a small shopping center in a minority neighborhood. In Charlotte, NCNB CDC now sees a need for development combining housing, office and retail, and is beginning its first such mixed-use project.

### Designing a Structure

Once the project is identified and defined, the parent organization must consider what structure will best enable it to manage and complete that project. The CDC will probably be set up as either a national bank subsidiary or a bank holding company subsidiary. In the former case, originators will work with the Comptroller of the Currency (OCC); in the latter, with the Federal Reserve (Fed). In some states, state-chartered banks can own or invest in CDCs.

*Continued on page 4*

# First Bank System Community Development Corporation

## FBS CDC: An Outline

First Bank System Community Development Corporation (FBS CDC) is a for profit, nonbanking subsidiary of First Bank System, a six-state regional bank holding company based in Minneapolis, Minnesota. FBS CDC is governed by a board of directors with one standing committee, an investment committee. Holding company senior management approves the CDC budget.

The CDC is managed by FBS CDC Vice President Charles E. (Chuck) Riesenberg. Chuck receives support from the urban development staffs at First Bank Minneapolis and First Bank St. Paul, as well as from special advisers in the holding company. FBS CDC's original funding was in the form of an equity investment by the holding company.

FBS CDC's purpose is to invest in projects designed primarily to promote community welfare through housing and commercial rehabilitation in low-income areas. The CDC always works with a non-profit partner who represents the project's beneficiaries, and CDC involvement must be at the invitation of the nonprofit agency. While many proposals come directly from the nonprofit sector, others originate with both CDC and affiliate bank staff. In addition, CDC officers review local government priorities for areas of concern that coincide with CDC priorities. In each case, the CDC looks for projects in the initiation stage.

The CDC's investment committee examines each potential project for consistency with community and CDC goals and policy. If these are consistent, Chuck does a basic feasibility study. This may take up to six months and involves determining community social and political support as well as financial feasibility. If the result is positive, the investment committee recommends the project to the board of directors, which must approve each project.

FBS CDC does two or three small, community-based projects a year. In a given year, the CDC will re-

view perhaps 10 to 20 projects. The CDC works with each from the beginning. Perhaps two will prove financially feasible for CDC investment. About one in six proposals examined is financially feasible. However, in many cases where a CDC investment is not feasible, the CDC acts as technical adviser and resource.

Although the CDC can do either housing or commercial development, its main concern is housing. Each year, CDC management sets housing needs priorities and selects a program focus. In 1984 and 1985, the focus was

*(Above right) FBS CDC Vice President Chuck Riesenberg talks about the successful partnership with the St. Paul YWCA to rehab a 20-unit apartment building (below) for women in transition.*



women's housing needs related to domestic violence. In 1986 and 1987, the focus is homelessness. The CDC proposes to acquire and rehab one single room occupancy housing project in each Minneapolis, St. Paul and Duluth. Chuck has studied the feasibility of several projects and a Duluth project shows particular promise.

When FBS CDC does invest in a project, it limits its role to making equity investments and/or acting as developer. Any necessary debt financing is handled by combining loans from public and private sources.

Chuck believes that the need and market for the CDC development

approach is great and probably growing, in particular because of cuts in certain federal programs. The CDC is often instrumental in achieving a variety of community initiatives. Moreover, it can be an important way for a bank or holding company to build relationships within the community. It also offers to banking organizations a unique opportunity to act as a developer by initiating projects and making equity investments.

For more information, contact:

Charles E. (Chuck) Riesenberg  
Vice President  
FBS CDC  
P.O. Box 522  
Minneapolis, MN 55480  
612-370-5028

## NCNB CDC: A Case Study

By the mid 1970s, Charlotte, North Carolina's central city had seen serious reversals. Few residential structures remained in adjacent urban redevelopment areas. There had been an increase in crime. But the city, a group of banks, and interested citizens were committed to bringing back the "uptown." Their plan was to create a vital, 24-hour a day city by rebuilding the Fourth Ward, a nearly depopulated residential area adjacent to uptown, and encouraging people to move back to the central city.

Although local banks and the city had devised a below-market mortgage loan program, development was slow in starting. Then Dennis Rash, currently president of North Carolina National Bank CDC, (NCNB CDC) saw an *American Banker* article describing a west coast CDC. The notion of an NCNB development corporation was born.

### Private Developers Weren't Interested

As part of Charlotte's plan to bring housing back to the Fourth Ward, a consortium of banks made a loan to the city for recycling as below-market mortgage loans available for people who would build or relocate in the area. When the city

and consortium weren't able to interest commercial developers in the project, one of the banks, NCNB, stepped in and took the lead. Working with the Comptroller of the Currency (OCC), NCNB established a national bank subsidiary CDC whose first venture was to rehabilitate and rebuild Fourth Ward housing.

CDCs must have a public purpose, and the Fourth Ward project met this standard. As it has in all its



*Dennis Rash, president, North Carolina National Bank CDC.*

subsequent projects, NCNB CDC worked within a designated poverty area (as defined by North Carolina law). To further ensure that its project would benefit the public good, management also chose to become involved where local government had an overall development plan. This, too, has become a standard procedure for NCNB CDC. It ensures that the CDC will be part of locally approved development.

### The CDC Focused on Housing

Initially, because the aim of the Fourth Ward project was to bring residential development back to the central city, NCNB CDC became involved strictly with housing. It has continued to work in housing development as it has expanded into other cities. But the CDC is geared to having the needs of the community help determine its program di-

rection, and its new mixed-use development project adjacent to the Fourth Ward is an example of responding to community needs.

The decision to establish a bank subsidiary (under OCC rules) and not a holding company subsidiary (under Federal Reserve rules) was made in part because at the time, the bank was more highly capitalized than the holding company. Since permissible investment is related to capital and surplus (the OCC has specific maximums; the Fed considers investment levels case by case), an NCNB subsidiary could be capitalized at a level more in accordance with projected needs than could a holding company subsidiary.

Equally important, the particular managerial resources necessary to operate a CDC were concentrated in the bank. Moreover, the originators felt that although OCC and Federal Reserve guidelines for CDCs differ only slightly, OCC guidelines were more coincident with their goals.

After discussions with the OCC, NCNB elected to form a nonprofit subsidiary. The OCC requires that a CDC's board of directors include neighborhood representation. Since there was, in effect, no Fourth Ward neighborhood, the OCC permitted board representation by people "associated with" the area. One third of the board must be "associated with," and 51 percent must be from outside the bank.

### Risks and Rewards

Dennis Rash says that the original decision to form a CDC was risky. The bank CDC movement was new, and there was only a scant track record. Even though there are now more CDCs that have proven successful, he believes that operating a CDC is fundamentally an entrepreneurial venture that some bankers might find uncomfortable. And he cautions that banks must be aware of and willing to take the risks and deal with the difficulties that they will face. "If you get involved in a designated redevelopment area, for example, you know that you're

*Continued on page 4*

This newsletter is designed primarily to assist financial institutions in the Ninth Federal Reserve District in developing credit responses to consumer issues and to the goals of the Community Reinvestment Act.

COMMUNITY is produced under the direction of Richard K. Einan, assistant vice president and community affairs officer, and Carolyn P. Line, community affairs coordinator.

COMMUNITY is available without charge from the Office of Public Information, Federal Reserve Bank of Minneapolis, Minneapolis, Minnesota 55480 (telephone 612-340-2048).

Articles may be reprinted if the source is credited and the Federal Reserve Bank of Minneapolis is provided with copies of reprints.

dealing with problems that haven't proved easily solvable," he continues.

But Dennis believes that the bank CDC is a potentially strong force, and there have been notable successes. For example, since it broke ground on its first project in 1979, NCNB CDC has done \$30 million of development both on its own and in joint ventures. Their involvement has spurred an additional \$54 million of housing development and has increased the value of fringe commercial areas, even though no actual development has taken place there. By 1984, assessed property values in the Fourth Ward core area had gone up 40.72 times.

#### Some Principles Have Emerged

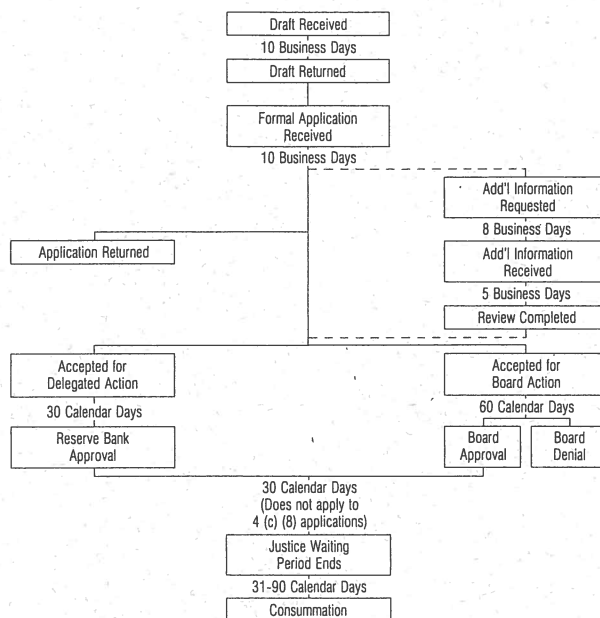
Experience has led Dennis to identify principles that he believes are applicable to all areas of the country. First, a successful venture requires a partnership among interested citizens, private developers and local government. Each has a different role, and each is necessary to make things happen. Second, there must be creativity. "Remember that you're in there because others decided to invest elsewhere," Dennis says. Third, the revitalization must be approached as a business proposition as much as a good will gesture. The CDC's work promotes good community relations, but it also makes good business sense to put an area back on its feet financially. For example, and happily for NCNB, it has gotten the largest share of the new residential construction market that the CDC created in the Fourth Ward.

Finally, there must be courage on the part of all the partners—courage to tackle, and invest in, a difficult situation. It took tremendous courage to build our nation, Dennis observes. "We need to recapture some of that same courage in resettling our abandoned heritage."

found the easiest way to succeed is by starting small—for example, by focusing on a neighborhood. However, the applicant should indicate if it intends to function in larger geographic areas such as a city, county, or state.

- A brief discussion of any other agency or community activity in the target area.
- A description of specific projects contemplated.
- A description of how and by whom the CDC would be managed.

#### Processing Flow Chart



#### Designing a CDC continued from page 1

Whether to form a bank or holding company CDC depends on several factors. One important consideration is where the appropriate management resources are located. Another is whether one entity or the other is more highly capitalized.

Other imperatives will also come into play. For example, if the project is conditioned on the use of grant money, the CDC will be set up as a non-profit. Or the guidelines established by the Fed may be more aligned with a particular project than the OCC's. (Fed and OCC guidelines for CDCs are substantially the same, though there is some variation in specifics.)

Management will have to answer questions that include but are not necessarily limited to, the following.

- Will the CDC be for profit or nonprofit?
- Will the CDC be a bank or bank holding company subsidiary?
- Will the banking organization fully or partially own the CDC?
- Will the banking organization make debt or equity investment in the CDC?
- Will that investment be large or small?

While a well-run CDC need not entail any undue risk to the parent organization, the parent must be aware of the type of risks that are involved with the CDC's activities. The bank or holding company must, therefore, carefully scrutinize the nature of the risk it intends to assume. Both in the management and financial sense, the CDC and banking organization must have risk-taking ability commensurate with the nature of the risk to the organization.