This issue of *Community* focuses on *Principles & Practices of Community Development Lending*, a manual for depository financial institutions' lending officers and senior management. *Principles & Practices* develops a five-step model for analyzing community development loan proposals. It also includes background information on public-private partnerships and illustrative case studies.

The 152-page manual was developed as a joint project by the Federal Reserve Bank of Minneapolis and First Bank System, Inc., of Minneapolis. The book emphasizes that community development lending, when done prudently, can be safe, sound and profitable.
Community development as we know it is a relatively recent phenomenon. In its earliest form, community development meant efforts by government to shape local projects, typically either housing or urban development initiatives. However, during the late 1960s and early 1970s, legislation delineated equal roles for and real partnerships between the public and private sectors. Government monies were often treated as "seed money" to absorb risk, attract investors and leverage additional private capital. This combining of public and private funds and experience to finance development, called the "public-private partnership," evolved through the 1970s and continues to evolve today.

Several recent trends have added importance to the private sector's role in this partnership:

- Federal resources have diminished.
- Management of funds has shifted from the federal government toward state and local units of government.
- From time to time, various tax incentives have been used to stimulate community investment.
- Foundations have increased social and program-related investments into community development projects.
- Federal financial agencies encourage the financial institutions they supervise to help meet their communities' credit needs.
- The Federal Reserve System and the Comptroller of the Currency authorized formation of bank and holding company community development corporations (CDCs) which have special powers to invest in projects to improve low- and moderate-income neighborhoods and communities.

As a result of these changes, local lenders find themselves increasingly involved in programs to aid their own lower-income neighborhoods and communities. The analytical method developed in *Principles & Practices* is designed to assist lenders working in this interesting and challenging lending discipline.

**The Community Development Lending Market**

Community development (or community investment or reinvestment) should be viewed as a market, and like any other market area, it should be approached analytically. While perceptions about community development lending are mixed, the banker should generally be motivated by profits and the desire to make good, sound loans as well as the desire to be a good corporate citizen.

One key to making safe and successful community loans is to use the wide array of public and nonprofit sector credit enhancements available to all lenders and communities. Indeed, many successful projects have been completed using blended public and private funds, and private financial institutions have enjoyed respectable earnings on their investments.

When projects fail—and they occasionally do—it is often because public enhancements and private money are combined ineffectively. Moreover, good community investments may be overlooked. There are four common blunders: applying too much subsidy, applying too little subsidy, using the wrong financial tools (or credit enhancements), or failing to make the investment because of inadequate information or experience. Blending the right sorts of funds and tools correctly is critical; therefore, to prevent problems, lenders and their public agency or foundation counterparts should carefully make an appropriate "mix and match."

Community investment is a creative process, and each loan request is apt to have unique features. For this reason, it is difficult to standardize processing of community investment loans. Neverthe-
Applying the Model

The five-step model is applicable to both large and small lending situations in all kinds of communities. Community investments can range from the straightforward to the very complex; nevertheless, the five analytical steps remain constant.

Step 1: Credit analysis. The lender performs standard credit analysis and makes the loan if feasible.

Step 2: Identify Financial Gaps. If a loan request does not conform to standards, it may have a curable financial flaw. These financial flaws, or gaps, are high risk (credit, collateral or maturity), low return, low profitability, and interest-rate risk.

Step 3: Match to Financial Solutions. Each financial gap has corresponding financial solutions. For example, high credit risk is addressed by increasing income or decreasing expenses. Collateral or maturity risk are approached by seeking a collateral cushion or replacement. Low return and low profitability can be addressed by shifting or reducing costs. Interest-rate risk is addressed by obtaining a new source of funding.

Step 4: Match to Community Assistance Techniques. Assistance programs, which are often classified according to a social policy goal, can also be classified financially. After determining what financial response is appropriate to address a loan proposal’s financial gap, community assistance techniques exhibiting the right financial characteristics are located. For example, to increase income, a source of additional, guaranteed income might be sought. To reduce internal costs, organizational changes might be implemented, or costs can be shifted to community intermediaries. Other financial solutions can similarly be matched to appropriate assistance techniques.

Step 5: Match to Community Assistance Program. Government or nonprofit sector programs may offer the precise financial tool required for a particular community development proposal. In its last step, the model links financial assistance techniques to specific programs that fill a proposal’s financial gap. Collateral risk might be addressed by a collateral cushion in the form of a soft second mortgage from foundation or Community Development Block Grant sources, for example. Costs might be shifted from the lender to community intermediaries which include Certified Local Development Corporations, Small Business Development Centers or other local intermediaries.

The investment model is designed to make the process of blending public and private funds clearer. Using it cannot guarantee success, of course, but it can improve the likelihood that a community investment request will become a successful loan.

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Principles & Practices will be distributed principally through workshops that the Federal Reserve Bank of Minneapolis will conduct at several locations in the Ninth District. For information, contact Carolyn Line, Community Affairs Coordinator, Federal Reserve Bank of Minneapolis; 250 Marquette Avenue, Minneapolis, Minnesota 55402; (612) 340-2048.
The Community Affairs Division at the Federal Reserve Bank of Minneapolis will be sponsoring several upcoming events:

- We will be co-sponsoring a seminar on community reinvestment issues with the Federal Home Loan Bank of Des Moines on September 28 and 29. The seminar will be held at the Minneapolis Marriott City Center Hotel. The 1 1/2 day program will feature local and national experts on community reinvestment.

- A CRA-related workshop is tentatively scheduled for November 1989. The workshop will focus on identifying community partners and recognizing community reinvestment opportunities.

- Programs are also planned for other district locations.

For additional information on any of these events, please contact Eileen Halvorson, Community Affairs Specialist, at (612) 340-2548.

What is a Community Profile?
Many Federal Reserve Banks have prepared profiles of metropolitan areas in their Districts. These profiles include economic, business and population information as well as the results of surveys completed by a sampling of community residents. These surveys seek perceptions of the community's strengths and weaknesses, opportunities for community investment and banks' involvement in the community.

The completed survey results and profiles will be available to bankers and other interested individuals.

For more information on profiles, see upcoming issues of Community.