FEDERAL RESERVE BANK OF SAN FRANCISCO

Community Investments Vol. 9, Issue 4 Moving Out of the Ivory Tower: The Role of Academia in Community Development

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"American colleges and universities possess a wealth of intellectual and economic resources that they can bring to bear on the problems of our cities. As centers of research and scholarship, institutions of higher learning can focus their academic energies to address some of the urban problems that lie just beyond their gates. As major economic entities, universities can create job opportunities for local residents, provide contracts for local businesses, invest in low-income housing, and provide other forms of economic lift to their surrounding communities."
-Henry G. Cisneros, former Secretary of Housing and Urban Development, January 1995

Cisneros, in his paper *The University and the Urban Challenge*, articulates a role for higher education institutions in regional economies. He also proffers a challenge to colleges and universities to become more involved in addressing the tough issues faced by residents and business owners in economically distressed communities. While Cisneros' focus is on urban America, the need for college and university involvement in rural America is equally important.

If Cisneros is right that America's institutions of higher learning are crucial in the fight to save our cities, then those who are involved in economic

development, including financial institutions, must know how to build strong, strategic alliances with these institutions.

An Historic Opportunity

Historically, higher education institutions have addressed issues of poverty by focusing on the symptoms. To be fair, some colleges and universities have provided much-needed assistance in addressing the health and welfare needs of residents in distressed communities. But few schools, with the possible exception of Historically Black Colleges and Universities (HBCUs), have adopted a dual mission of educating students *and* meeting the broader development needs of the communities they serve.

In this post-cold war era, however, higher education institutions are actively assuming economic development roles within their communities. This evolution is the result of several factors:

- Universities are now encouraged to privatize the results of their scientific research which is leading to an increase in the number of businesses started from technology transfer.
- As this nation's cities and rural communities struggle through another decade of disinvestment and the flight of manufacturing jobs, many colleges and universities find themselves physically surrounded by communities that are increasingly poor. Because of the significant capital investment in their campuses, colleges and universities aren't likely to pack up and move.
- The shift to a knowledge-based economy is increasing the ties between research universities and private industry which is intensifying the focus on the practical business applications of research.
- As colleges and universities fight for private and public dollars, they must demonstrate their benefit to society beyond the education they provide to enrolled students.

When approaching a college or university, it is important to first understand at least a little bit about the world of academia.

The Nature of Academia

Generally speaking there are four types of colleges and universities:

Research Universities conduct, as one of their primary missions, ground-breaking scientific research. Faculty are promoted based on their research, teaching and community service. But ultimately, their careers are built on research. Thus, junior faculty (assistant and associate professors) face a crucial "publish or perish" mandate. While Full Professors have tenure, their salary remains tied to their publishing ability. Examples of research universities include the University of Washington and the University of California at Los Angeles.

Land Grant Universities provide, as one of their primary goals, on-going education to farmers and business owners in rural communities. Faculty are evaluated and promoted based on their work in research, teaching and community service. But because of their land grant charter, these institutions devote resources, including staff and students, to agricultural extension programs. Land grant colleges will be likely allies in developing and expanding small business assistance programs that target distressed communities. Examples of land grant universities include Arizona State University and the University of Nevada at Reno.

Teaching Colleges focus on undergraduate education and meeting the needs of a region or a community. Faculty at these institutions are motivated by teaching and there is less emphasis on research and publishing than at research and land grant universities. Examples of teaching colleges include Occidental College in California and the University of Alaska, Southeast.

Community and Technical Colleges provide education for high school graduates and worker retraining for people seeking to re-enter the workforce or acquire new skills to be more competitive in a changing economy. These institutions may be the most receptive to becoming involved in economic development due to their established focus on worker retraining. At the same time, many faculty are paid only for the courses they teach, not for research or service they conduct. Thus, there are significant time constraints on faculty at these institutions. Examples of community colleges include Seattle Central Community College and City College of San Francisco.

For those of us in the West, it is important to note the growing presence of *Tribal Colleges* located on reservations. These colleges are an important entry point for Native peoples seeking higher education and resources for educating workers and managers in tribally-owned businesses. Examples of tribal colleges include Northwest Indian College and Dine College in Arizona.

Identifying Shared Interests

Having determined that the local college or university has resources to help reach your economic development goals and armed with an understanding of the mission of the institution, the next step is to formalize an alliance through which to build a program. This process follows five general steps:

1. Identify a key decision-maker at the college or university with whom to work;
2. Articulate benefits and goals for each party in the alliance;
3. Gain broad-based internal and external support;
4. Obtain high-level support from a Dean or President; and
5. Marshall the resources to launch the project.

Some institutions may want to improve the physical appearance and personal safety of their surrounding community. Others may want to provide students with real-world business experience. Still others might view

involvement as part of their public institution mandate to serve all segments of the community.

At the University of Washington, a shared vision for a program grew from an alliance which included the Business School, community-based organizations and the Greater Seattle Chamber of Commerce. Tenured faculty were among the leaders of the alliance which recognized that Seattle's small business owners in economically distressed communities needed assistance in obtaining advanced business education and technical assistance. In conducting an assets analysis to address this need, the University of Washington recognized its strongest asset of all — its business school students.

Once a vision was developed, based on the creation of a student/small business mentoring program, the alliance expanded to include financial institutions, insurance companies, private industry leaders, government officials, small business owners and other community-based organizations. The Dean of the Business School, William Bradford, was a key leader in expanding the alliance and formalizing the vision. This process took more than a year to complete but we needed the time to build a strong, long-term partnership.

The significant level of external involvement in the alliance will be key to sustaining the Business School's efforts. Corporate and community support ensures access to the resources we need to be successful. The program is primarily funded by the private sector to ensure that we maintain the balance between meeting our educational and the community's economic development objectives.

As a strategic alliance is built, it may be helpful to examine models that are emerging in cities across the nation from which to form a base for local planning.

Developing Projects and Programs

Examining models to develop new programs is important, but it is equally important to recognize that each city and region has a different mix of resources and challenges. There is no "one-size-fits-all" approach. Yet, there appear to be two general trends emerging through effective, successful programs: 1) the provision of direct, long-term technical assistance to small business owners and community-based organizations; and 2) policy analysis and development.

Long-term technical assistance programs work with businesses from three months to many years. The Small Business Administration funds Small Business Development Centers (SBDCs) that are housed at colleges and universities across the nation. Washington State University has a contract which allows it to staff nearly 30 SBDCs in cities and towns across the state. Businesses can receive assistance for several years through these centers. At other universities, such as Yale and the University of Texas, one faculty member runs a semester-long class in subjects such as business planning where students write a plan for an existing, perhaps struggling, firm. Our program at the University of Washington Business School sends graduate school students to work with inner-city businesses for a period of three to nine months. And Tuskegee University in Alabama is expanding their technical assistance to include financial assistance through grant and loan funds.

A policy analysis and development approach has been adopted by the University-Oakland Metropolitan Forum. This is a partnership of the University of California, Berkeley; California State University, Hayward; Mills College; Holy Names College; and the Peralta Community College District. The Forum has focused on designing an improved labor force preparation system and conducting research on transportation issues for community-

based organizations. The Forum works primarily with government agencies and business associations.

An approach that combines technical assistance and policy analysis might look like the program at the University of Nevada, Las Vegas which compiles econometric and market research data. They make the data available to policy makers, individual businesses, and industry associations who need it for use in planning local business development.

Conclusion

Colleges and universities, like financial institutions, have multiple functions. Financial institutions accept deposits, make loans, and serve as a medium of exchange. Colleges and universities provide education, conduct research, and are centers for theoretical debate. The type of alliances and the programs that are developed in each community will reflect the unique needs and resources of the region. But through alliances to support economic development, institutions, individuals and the entire region will benefit from the increased economic strength within its distressed communities.

About the Author

Michael Verchot is the founding director of the University of Washington's Business & Economic Development Program. This program supports private sector economic development initiatives through

consulting services to small businesses and research and analysis of economic development strategies. Michael has spent 15 years working in small businesses with a focus on marketing, public and government relations, and general management. Michael received his undergraduate degree from Springfield College and his MBA from the University of Washington. He currently serves on the Board of Directors for the Technology Access Foundation which provides education and internships for students of color and on the Advisory Board for the Millennium Fund, a community development venture capital fund.

For further information on the small business technical assistance program at the University of Washington, please call Michael Verchot at (206) 543-9327. Or, you can e-mail Michael at mverchot@u.washington.edu

FEDERAL RESERVE BANK OF SAN FRANCISCO

Community Investments Vol. 9, Issue 4 “Unbanked” Citizens Draw Government Attention

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The Debt Collection Improvement Act of 1996 (Act), requires the government to deliver all payments except federal tax refunds using electronic funds transfer (EFT) by January 1, 1999. The expanded use of EFT means that millions of individuals who receive federal benefits will be brought into the banking system for the first time. The Treasury Department's Financial Management Service (FMS) would prefer that these federal recipients become "banked," through the establishment of accounts at financial institutions. This makes direct deposit of federal benefits a viable payment option. But if recipients remain "unbanked," the government will pursue other options which can accommodate EFT payments. Without such options, unbanked individuals cannot meet the EFT payment requirement, and millions of people may continue to conduct their financial affairs in ways that compromise their financial safety. The Treasury Department is currently seeking industry ideas for how these EFT options will operate and how they will be offered at a reasonable cost through a proposed rule (31 CFR Part 208) which was published on September 16, 1997.

After the public comment period, which ends on December 16, 1997, the rule and compliance measures will be finalized. Until 1998, one can only speculate how the government will make electronic payment options available to federal recipients who lack bank accounts. However, Treasury

currently sponsors two programs designed to provide EFT account services. One is the *Direct Payment Card* pilot in Texas; the other is the *Benefit Security Card*® program that is available in eight southeastern states. Different from these government-sponsored approaches (but designed to indirectly expand direct deposit participation among unbanked recipients) is Treasury's promotion of its *Direct Deposit Too* concept.

The government is moving boldly to convert federal benefits such as Social Security to EFT. A major challenge: the estimated 10% of check recipients that lack bank accounts. Treasury is encouraging all financial institutions to expand the use of direct deposit by offering accounts that are more "unbanked friendly." Still, a national strategy to provide banking services for recipients that remain unserved is being defined. It's unclear what the final plan will look like, but Treasury's FMS has been offering basic banking services to a limited target audience since 1992.

Banking Services Through the Private Sector

Direct Deposit Too (DD Too)
Direct deposit is the most popular form of payment by EFT and is currently the method used for approximately 55% of federal benefit payments. Converting the remaining payments to EFT could save taxpayers roughly $500 million over the next five years, while enhancing safety, reliability, and convenience to consumers. However, if federal benefit recipients lack bank accounts, direct deposit does not work. There are many reasons why individuals lack basic bank accounts, but *DD Too* responds to many of the problems commonly linked to checking accounts. Specifically, improper account reconciliation, bounced checks, and penalty fees may create feelings of uncertainty and anxiety plus added cost to some bank customers. This increased cost often surpasses the price of cashing checks and purchasing money orders at non-depository institutions.

Government research indicates that 60% of federal benefit recipients cash their monthly benefit checks at financial institutions. FMS is asking financial institutions to serve recipients by adopting the Direct Deposit Too model.

DD Too is a bank account model that any financial institution may adopt. *DD Too* is NOT a government product where account features and fees are regulated. However, if the *DD Too* model is widely adopted, it increases direct deposit potential for any payor including the federal government. FMS markets the *DD Too* model to all financial institutions in an effort to increase the availability of "risk free" and "penalty free" accounts for unbanked federal benefit recipients. This expands consumer choice, and brings more benefit recipients into mainstream banking. Some financial institutions are adopting the *DD Too* concept by permitting direct deposit of recurring payments plus an over-the-counter deposit feature for infrequent payments. These same financial institutions often supplement on-line debit with over-the-counter access features. Treasury applauds such efforts and is pleased that the four banking regulatory agencies consider accounts based on the *DD Too* model eligible for credit under the Community Reinvestment Act (CRA.)[1]

Eighty-eight percent of all Treasury-disbursed benefit payments (EFT and checks) involve programs administered by the Social Security Administration.

DD Too's Suggested Standards

Payments: *Direct deposit of federal benefits into a consumer-owned and consumer-established bank account offered by private sector financial institutions.*

Access: *No checks, no potential to overdraw, no minimum balance requirements, and reasonably priced services. Card/PIN access to accounts by on-line debit is generally suggested.*

Government-Sponsored Bank Accounts

Direct Payment Card

FMS's *Direct Payment Card* pilot in Texas is a banking service where account features and fees are uniform since they are defined by government. In 1992, Citibank was competitively selected to provide account services as the Treasury Department's agent. These accounts are recipient-owned and are "prefunded" because federal benefit payments are delivered through the Automated Clearing House (ACH) network on the appropriate payment date. No other deposits are permitted into the account. Recipients access their federal payments at existing ATMs and at retail point-of-sale (POS) terminals using a standard Citibank issued on-line debit card and a personal identification number (PIN).

The Comptroller of the Currency and the three other federal regulatory agencies conclude that DD Too would receive favorable consideration as either a community development service-low cost account that improves access to low-moderate income persons, or as an alternative delivery system, for delivering retail banking services.

Payment access is fully compatible with private sector requirements since transactions are routed through regional and national financial networks. Recipients pay a reasonable fee for services, but unlike most basic accounts that are available through the private sector, the *Direct Payment Card*account cannot be overdrawn, has no minimum balance requirements and there are no "penalty fees" due to the risk-free nature of the account. FMS markets *Direct Payment Card* services directly to check recipients in Texas, targeting recipients who lack bank accounts. Citibank enrolls recipients, issues cards/PINS, trains recipients, and handles customer service inquiries via a toll-free phone line. Recipient participation in the *Direct Payment Card* pilot is voluntary and FMS pays Citibank an

additional subsidy since the pilot nature of the program limits payment volume and client participation.

Benefit Security Card®

The *Benefit Security Card®* program is an EFT application that is rolling-out across eight southeastern states, known as the Southern Alliance of States (SAS). This effort is a partnership between the federal government and SAS, and marks the only instance where state-administered welfare benefits and federal benefits are either mutually or singularly available using a single debit card. Among SAS states, this EFT service is referred to as Electronic Benefits Transfer (EBT). Although EBT services appear identical to benefit recipients, the federal approach for servicing these accounts is fundamentally different from the states' approach.

Within the SAS, both federal and state recipients access their benefits using the *Benefit Security Card®* at ATMs and retail point-of-sale outlets. However, unlike state benefits, all federal benefits via EFT must be deposited into a consumer-owned account. Unlike federal benefits, SAS recipients who receive only state administered benefits do not receive Regulation E protection and the banked or non-banked status of the SAS state recipient is not generally relevant. Most states have, or will soon have, EBT systems in place, but many do not contract with financial institutions to provide EBT services. In the SAS, however, a financial institution must be the primary service provider because federal payments are a part of the *Benefit Security Card®* program. All other aspects of the federal approach in the *Benefit Security Card®* program, including voluntary participation by federal recipients, are similar to the *Direct Payment Card* program except there is no federal subsidy to the financial institution.

The Search for Broad-based Solutions

EBT represents state initiatives where paper payments such as checks and food coupons are permanently replaced by Electronic Funds Transfer. FMS

has piggybacked on states' efforts, but unlike EBT, the federal program is offered to unbanked recipients on a voluntary basis. In addition, the federal recipient receives deposit insurance and Regulation E protection since, unlike EBT, payments to a federal recipient must be deposited into an account at a financial institution.

The government continues to be concerned that roughly 10 million federal benefit recipients conduct their financial affairs in ways that compromise safe and sound practice. Mr. John D. Hawke Jr., Under Secretary of the Treasury for Domestic Finance, echoed this concern in his *American Banker* article:

"...At a time when the complexity of our economy makes it unthinkable for most people to conduct their daily affairs without a bank account, it has been estimated that as many as 20% of American families — including almost one-third of minority group families — have no such accounts. Many of these families...rely on check cashers, pawnbrokers, money transfer agents or local merchants to cash their payroll or benefit checks, frequently at a high cost." [2]

The Debt Collection Improvement Act will significantly impact federal EFT activity. Treasury encourages financial institution officials to assertively market direct deposit to existing customers, and to actively offer the DD Too model to potential consumers that are currently unserved.

The Treasury Department continues to build momentum for financial institutions to offer reasonably priced accounts based on the *DD Too* model. This is because everyone gains when "unbanked" recipients are presented with competitive account choices that are easy-to-use, reasonably priced, and available through neighborhood financial institutions. However, if there are voids in private sector availability, and given Treasury's mandate to expand EFT participation by January 1999, Treasury will seek-out additional

EFT options and target services to Federal benefit recipients who lack bank accounts. How closely such account services will be modeled on FMS's *Direct Payment Card* and *Benefit Security Card*® programs is speculative at best. But stay tuned...early in 1998, Treasury will begin to lay a framework for a national strategy to deliver federal benefits to a constituency that remains unbanked.

FMS's proposed rule, 31 CFR Part 208, is available for public comment through December 16, 1997. Before any final decisions are made as to the attributes of a federally-sponsored, consumer-owned card/PIN account, Treasury is asking stakeholders to comment. Immediate access to the proposed rule is available on the Internet: http://www.fms.treas.gov/eft.

[1] *For a copy of the full written opinion regarding DD Too's applicability to the CRA, contact the Federal Reserve Bank of San Francisco's Community Affairs Department, or contact FMS at (202) 874-6540.*

[2] *"New Law Means Millions of New Customers,"* American Banker, *November 6, 1996.*

About the Author

William Sessums is responsible for managing the U. S. Department of Treasury's Direct Deposit Too Project in the Product Promotion Division of the Financial Management Service (FMS). He created Treasury's Direct Deposit Too model and is the primary coordinator of FMS's Direct Payment Card program. Prior to joining FMS, Mr. Sessums held positions with the State of Maryland, Department of Human Resources.

FEDERAL RESERVE BANK OF SAN FRANCISCO

Community Investments Vol. 9, Issue 4 Building Healthy Communities

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Today's definition of community reinvestment has expanded beyond jobs creation and the development of affordable housing. Successful community reinvestment programs approach community development using holistic applications that take into account, in addition to jobs and housing, other components of healthy communities which include education, transportation and health care. These reinvestment programs are successful because community participants with diverse interests and skills work together to identify issues, seek solutions and measure progress. They do this to foster an improved quality of life within a geographically defined area. Participants in these "healthy community" partnerships may include financial institutions, community-based organizations, local governments, hospitals, businesses, academic institutions and local citizens.

Through their CRA and community development strategies, financial institutions play a critical role in improving the overall health of their communities. By building long-term partnerships with local organizations, banks can leverage their efforts and ensure the creation of community initiatives which have measurable, tangible results. Partnerships among financial institutions, community-based organizations and local governments

are already addressing the need for safe, affordable housing and adequate employment, both of which are components of healthy communities. Success in these areas can be tracked and demonstrated through the establishment and review of specific benchmarks. Developing "community benchmarks" is essential to ensuring that participants with diverse ideas agree on common goals and share the responsibility for attaining these goals.

Tyler Norris, executive director of the Coalition for Healthier Cities and Communities, defines health as "the product of both individual genetic factors and factors related to people's living and working environments." The factors that create health, and therefore healthy communities, include education, adequate housing, meaningful employment, job-skills training, efficient public transportation, recreational opportunities, clean physical environments, and health education and prevention services.

To effectively build healthy communities, Norris says communities must continually develop ways to link information streams, establish priorities and assess resources. For example, in Columbus, Ohio, the Together 2000 Healthy Communities Initiative established a set of long- and short-term community priorities and then sponsored more than 30 community-based initiatives to address the identified local and regional issues. Similarly, the Healthy Detroit Initiative brought together leaders from health care, government, business and neighborhood groups to identify community health issues and develop a plan for improving Detroit's quality of life.

Several major healthy cities initiatives, including most notably those in Jacksonville, Pasadena and Seattle have developed quality of life benchmarks that measure changes affecting these communities. These benchmark indicators vary depending on the focus of each initiative and on the needs of each community. For example, Seattle's "sustainable indicators" track everything from population shifts to the number of salmon

spawning in their native beds. Each indicator has a different community health implication, but each is vital to the ongoing health status of the city and residents of Seattle.

Healthy community initiatives are not limited to cities, since "community" may be defined in numerous ways. Initiatives might occur on the neighborhood level, as in Oakland, California, where activity is focused on improving the health status of the San Antonio neighborhood in east Oakland. Initiatives can be broad, as in Oklahoma City, where a collaborative has been formed which includes four counties and 30 municipalities. A healthy community might even result from the initiative of only one organization, such as Riverside Hospital in Columbus, which has developed a menu of over 150 diverse indicators for measuring the overall health of the communities it serves.

Norris also notes that increased consolidation within the health care industry has accelerated the process of building healthy communities. Recent partnerships among hospitals, HMOs and other insurance providers are resulting in integrated delivery systems which merge diverse interests and require greater consensus within the health care industry. Insurance providers, who traditionally focus on long-term prevention and investment are now partnering with health care providers, who tend to focus on short-term critical care issues. To stay competitive, hospitals and insurance providers are increasingly seeking competitive advantages including an emphasis on preventative measures to improve the health of community members and therefore reduce health care costs. These measures increasingly include the improvement of a community's economic health as an integral part of this prevention process.

Consolidation within the banking industry has also created opportunities to improve banking services and reduce costs, with an eye toward improving the economic health of the communities in which they do business. Tom

Mitrano, communications and community services manager for Bank of Hawaii, believes financial institutions can benefit by combining a focus on long-term investment in the economic health of their communities with the flexibility to meet short-term needs. Mitrano introduced an "assets planning" strategy at the bank which brought him to the attention of the Coalition for Healthier Cities and Communities. This strategy insists that community reinvestment activities produce measurable economic results. Mitrano says "the key to success is to agree on specific, measurable ways a community can be better off, then to structure lending, service, and investment opportunities to deliver those results."

An example of Mitrano's assets planning approach is demonstrated through an agreement that was structured with a local nonprofit to provide job training and life skills for unemployed Hawaiians. In addition to helping the non-profit launch this particular program, the Bank of Hawaii stayed committed to the organization and its long-term goals. It lent bank staff to help the non-profit develop sound financial practices and reduce their reliance on public and private grants. To complete the process, the bank provided targeted investment funds to support these newly created initiatives.

This results-oriented approach has also worked in the Sunnyslope neighborhood of northern Phoenix, where financial institutions have relied on Joel McCabe to help define measurable goals and identify investment opportunities in the area. McCabe, who heads a community development corporation called Sunnyslope Village Revitalization, Inc., has an interest in building a healthy community in part due to his dual role as CDC director and as community development coordinator for John C. Lincoln Hospital, which is located in Sunnyslope. McCabe says the hospital hasn't promoted good health "if it treats someone in its emergency room or outpatient clinic, just to return that person to unhealthy living conditions in the surrounding

community. The hospital believes in preventive medicine for people and neighborhoods."

As director of the CDC, McCabe initially commissioned an Arizona State University community needs assessment for Sunnyslope. Using this document as a blueprint, and through its support of the CDC, the hospital has subsequently been instrumental in the acquisition and development of vacant properties for both commercial and multi-family use. The CDC has partnered with local nonprofits to create a home rehabilitation program in the area, and with the City of Phoenix, local banks, and the Arizona Department of Commerce, has created an in-fill housing program. The Local Initiatives Support Corporation has also been a significant supporter of the CDC's efforts, which are now focused on bringing a supermarket and new businesses into the area.

As a hospital employee, McCabe focuses on community organizations including the development of block-watch groups which have reduced crime in the neighborhoods surrounding the hospital. He points out that there are economic considerations for creating healthier communities. "Hospitals can't stay in business, no matter how good their clinical capabilities, if patients are too fearful to travel to them for services."

As people are increasingly concerned with the health of their communities, "creating the building blocks of good health, such as strong families, good jobs and education, lies largely outside the health care system," according to Norris. "In healthy communities, the health status of community residents is not the sole responsibility of health care providers."

The Healthy Communities Movement

The healthy communities movement can be traced to a 1974 Canadian government report which concluded that environment and lifestyle improvements would make a greater contribution to the health of Canadians

than would improvements to the health care system. This report led to a full-scale effort by the World Health Organization (WHO) to support an effort to improve quality of life in 34 European cities in the mid-1980s. The movement has since spread to more than 1,500 communities in more than 50 countries around the world.

The U.S. Department of Health and Human Services embraced the concept in 1989 when it asked the National Civic League to help launch the U.S. Healthy Communities Initiative, which served as a resource for communities nationwide.

Support for healthy communities projects is available from the WHO Healthy Cities Collaborating Center at Indiana University in Indianapolis as well as from organizations including the American Hospital Association's Hospital Research Trust in Chicago and the Healthcare Forum in San Francisco.

For more information on the Coalition for Healthier Cities and Communities, call Tyler Norris at (303) 444-3366. Information about Sunnyslope Village Revitalization, Inc. is available by calling Joel McCabe at (602) 997-4310.

About the Authors

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Tyler Norris conducts community-based planning and capacity-building processes around the world as Executive Director of the Coalition for Healthier Cities and Communities and as President of Tyler Norris Associates, a consulting firm. Previously, he directed the Civic Assistance and United States Healthy Community Programs for the National Civic League in Denver and the Connections Program for the Windstar Foundation in Snowmass, Colorado. He is also a fellow of the W.K. Kellogg Foundation National Fellowship Program.

Tom Mitrano is Vice President and Manager of Communications and Community Services for Bank of Hawaii. Tom has worked as a legislative advocate and heads the strategic planning committee of the Hawaii Community Foundation.

Joel McCabe is Community Development Coordinator for John C. Lincoln Hospital and Executive Director for Sunnyslope Village Revitalization, Inc. His role is to serve as the hospital's liaison in the immediate vicinity of the hospital and to improve the economic health and well-being of residents in the Sunnyslope Village Revitalization area.

FEDERAL RESERVE BANK OF SAN FRANCISCO

Community Investments Vol. 9, Issue 4
SBICs: More Than An Equity Investment

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There's good news for financial institutions seeking ways to earn investment test credit under the new, performance-based CRA. In addition to earning a healthy return on capital, investing in a Small Business Investment Company (SBIC) offers a unique opportunity to serve the equity needs of emerging small businesses while receiving favorable consideration under the CRA investment test. Under the new CRA, a qualified investment must have community development as its primary purpose. The regulation defines community development to include the following provision related to SBICs: "activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Small Business Investment Company programs." According to the Federal Financial Institutions Examination Council (FFIEC), examiners "will now presume that any loan to or investment in a Small Business Investment Company promotes economic development."[1] Small business and banking experts expect that these recent regulatory changes will generate new interest in SBIC investments among financial institutions.

SBICs are privately-owned venture capital funds licensed by the Small Business Administration (SBA) to invest in the long-term debt and equity securities of small businesses. These businesses possess generally less than $18 million in net assets or $6 million in annual net income and are represented in a variety of industries such as manufacturing, services and

wholesale trade. Almost 75 percent of the small businesses funded by SBICs are non-technology businesses.[2]

Banks can establish their own SBICs, work in partnership with other banks to develop a joint SBIC, or invest in an existing SBIC. Currently, 73 commercial banks own and manage their own SBICs while 12 banks invest in but do not manage SBICs (i.e. bank associated SBICs). These bank-owned or bank-associated SBICs provide $3.3 billion or over half of the $6 billion in capital under management by all SBICs. The remaining $2.7 billion in capital is generated by more than 200 non-bank SBICs nationwide.

The Benefits of SBIC Investment

Through SBIC investments, financial institutions can realize a number of potential benefits and regulatory easements not otherwise permitted. For example, banks will find a safe harbor from Glass-Steagall Act restrictions that have traditionally separated commercial and investment banking. In addition, banks are allowed to own more than five percent of a company, thus making equity investments that would otherwise be prohibited by banking statutes. Keep in mind, however, that banks are not permitted to invest more than five percent of their capital and surplus in any one SBIC or multiple SBICs.

The SBIC program also offers leverage options, such as raising capital through the sales of SBA-guaranteed certificates, yet few banks utilize these options. If a bank chooses to use SBA leveraged capital, it would have to repay it with interest and in some cases, pay a percentage of its profits before the bank could receive a return on its original investments. Not surprisingly, most banks find it more profitable to use their own capital rather than leveraging SBA-guaranteed securities. Of the $3.2 billion in bank capital, only $19 million is leveraged.

Of course, money motivates. One of the primary reasons financial institutions are attracted to the SBIC program is the opportunity to make equity investments with healthy returns. An example is Wells Fargo Equity Capital, Inc., an SBIC established by the bank-holding company of Wells Fargo Bank in 1995. In its early years of operation, the SBIC has invested $26 million in 12 companies. All of its investments are either in common/preferred shares or are subordinated debt with equity warrants. According to Richard Green, manager of Wells Fargo Equity Capital, Inc., these SBIC investments make solid returns on invested capital and help augment the bank's commercial banking business. Through its SBIC, Wells Fargo is able to meet the equity needs of the large "middle banking" market, such as family-owned businesses; a segment that can be difficult to serve through conventional commercial lending products.

Given the recent implementation of the revised CRA regulation, banks have another reason to invest in SBICs. Large banks contemplating qualified investments under CRA might consider SBIC investment as a viable financial instrument *and* an effective way to meet CRA requirements. Prior to July 1997, a bank's investment in an SBIC was considered under CRA only if the SBIC's portfolio investments were qualified investments. Now that SBICs are specifically referenced in the new regulation, investing in an SBIC itself is considered a qualified investment as long as the SBIC serves some or all of the bank's business region.

Federal Home Loan Banks Get Into the Act

Another change that could render SBICs more attractive to small banks is the Federal Home Loan Banks' new authority to invest in SBICs. Federal Housing Finance Board (FHFB) Chairman Bruce Morrison stated, "The Finance Board is exploring ways to bring the Federal Home Loan Bank System together with the SBIC program in areas where private investment is inadequate."[3] According to legislation passed in October 1996, the Federal

Home Loan Banks may now establish their own SBICs, set up SBIC investment vehicles for small banks, or invest in existing SBICs.

Because not all banks are able to meet the $5-10 million investment requirement without exceeding the 5 percent cap on total assets in an SBIC, a Federal Home Loan Bank SBIC could be a wise alternative for its members who want to make pooled, smaller investments with less risk. It is not clear how many Federal Home Loan Banks will establish SBICs since parameters for Federal Home Loan Bank SBIC activities have not yet been set by the Federal Housing Finance Board. Look for more information on FHLB-SBIC activities in the coming months.

Although investing in an SBIC is not a new idea, recent regulatory refinements may encourage financial institutions to take a fresh look at these innovative investment opportunities. For financial institutions interested in learning more about the SBIC program, contact Mr. Len Fagan, Financial Analyst, SBA Investment Division at (202) 205-7583 or visit the SBIC homepage at http://www.sba.gov/INV.

Bank-Owned SBICs

Midwest
1st Source Capital Corporation
ABN AMRO Capital (USA), Inc.
Banc One Capital Partners, L.P.
Banc One Venture Corp.
Continental Illinois Venture Corp.
First Chicago Equity Corporation
Heller Equity Capital Corporation
Key Equity Capital Corp.
M&I Ventures Corp.
Norwest Equity Partners IV

Norwest Equity Partners V, L.P.
National City Capital Corporation
Peterson Finance and Investment Corp.
Shorebank Capital Corporation
United Missouri Capital Corp.

South
Banc One Equity Investors, Inc.
Banc First Investment Corporation
Charter Venture Group, Incorp.
CFB Venture Fund I, Inc.
CFI Venture Fund II, Inc.
First Commerce Capital, Inc.
First Union Capital Partners, Inc.
Hibernia Capital Corp.
Hickory Venture Capital Corp.
MESBIC Financial Corp. of Houston
MESBIC Ventures, Inc.
Mapleleaf Capital, Ltd.
UNCO Ventures, Ltd.
Victoria Capital Corp.

West
Bancorp Hawaii SBIC
Far East Capital Corp.
First Interstate Equity Corporation
First Security Business Investment Corp.
Hall, Morris & Drufva II, L.P.
Imperial Ventures
Opportunity Capital Corporation
Shaw Venture Partners IV, L.P.
UnionBanCal Venture Corporation

Wasatch Venture Corp.
Wells Fargo SBIC, Inc.

East
399 Venture Partners
BT Capital Partners, Inc.
BancBoston Ventures
Barclays Capital Investors Corp.
CB Investors, Inc.
CIBC Wood Gundy Ventures
Chase Manhattan Capital Corp.
Chemical Venture Capital Associates
Citicorp Venture Capital, Ltd.
Commonwealth Enterprise Fund, Inc.
CoreStates Enterprise Capital, Inc.
Creditanstalt SBIC
Domestic Capital, Inc.
First Fidelity Private Capital, Inc.
First New England Capital, L.P.
Fleet Venture Resources, Inc.
Greater Phil. Venture Capital Corp.
IBJS Capital Corp.
J.P. Morgan Investment Corporation
M&T Capital Corp.
Mellon Ventures, L.P.
NatWest USA Capital Corp.
PNC Capital Corp.
Paribas Principal Incorporated
Pyramid Ventures
RFE Capital Partners, L.P.
Sixty Wall Street SBIC Fund, L.P.
Societe Generale Capital Corp.

Toronto Dominion Corp (USA), Inc.
Triad Capital Corp. of New York
UBS Partners, Inc.
UST Capital Corp.

[1] Bylsma, Michael, Interpretative letter regarding Lake County Integrated Financing Program, FFIEC, May 22, 1997.

[2] Today's SBICs: Investing in America's Future, National Association of Small Business Investment Companies, Page 2.

[3] Financial Institutions, New CRA Rules Open Doors for Banks, Small Businesses, Daily Report for Executives, Lotus Notes/Newsstand, Page 2.

About the Author

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FEDERAL RESERVE BANK
OF SAN FRANCISCO

Community Investments Vol. 9, Issue 4 Interagency Interpretive Letter Clarifies How Investments in National Funds Are Treated Under the Investment Test

Author(s): Shawn Elliott Marshall, Associate Editor, Community Investments
Fall 1997

Responding to concerns raised by the Local Initiatives Support Corporation (LISC) and its subsidiary, National Equity Fund (NEF), the OCC issued an interagency interpretive letter on September 11, 1997 which clarifies how investments in national funds, which are then invested in low-income housing tax credit transactions, will be treated under CRA's investment test.

The letter addressed three major areas of concern and responded to each as follows:

1. *Direct vs. Indirect Investments:* The agencies clarified that the CRA regulations do *not* differentiate between direct investments in specific projects vs. indirect investments made through regional or national funds — as long as the investments meet the definition of *qualified* community development investments. Both are considered legitimate investments.
2. *Geographic Distribution:* At the time limited partnerships are formed through national funds such as NEF, financial institutions are obliged to invest in "blind pools," since actual projects receiving committed funds haven't yet been identified. Given CRA's focus on an institution's assessment area, there was concern that tax credit investments made

through a national fund (such as NEF) would not receive the same level of consideration as investments in local or regional funds.

However, NEF has reported that financial institutions can *geographically target* their investment(s) to areas that correlate with their assessment area or a broader statewide/regional area. "NEF will provide investors a written statement that it intends to invest a specified dollar amount in a geographical region specified by the investor and based on the NEF regional structure. These targeting assurances from the NEF allow a retail institution to meet its geographic investment needs with an investment in NEF."

Furthermore, for limited purpose or wholsesale banks, qualified investments in a statewide or regional area which includes its assessment area will be favorably considered in the evaluation of an institution's CRA performance. If the wholesale/limited purpose bank has adequately addressed the needs of its assessment area(s), it may invest in a nationwide fund without targeting its funds.

3. *How Examiners Evaluate Investments in Equity Funds:* A financial institution may receive CRA consideration for its equity investment in low-income housing tax credits *at the time it makes a binding investment commitment to the partnership;* there is no need to wait until funds have been dispersed to specific projects. Once the partnership is formed, each investor records the promissory note on its books and amortizes the investment over the life of the tax credit benefit period. In each subsequent year after the initial investment, the CRA consideration that an institution would receive for the dollar amount outstanding would reflect the investor's accounting treatment in that year. Thus, examiners will consider both new and outstanding investments in their investment test determinations.

"The interpretive letter provides a needed comfort level for financial institutions considering investing in national funds. These funds have proven to be excellent tools for increasing investment in low-income housing."
-Ellen Lazar, Executive Director, National Association of Affordable Housing Lenders

For a complete understanding of the issues, CRA and investment officers are encouraged to read the full text of the interagency interpretive letter. For a copy, please contact June Yambao in Community Affairs at (415) 974-2978.

FEDERAL RESERVE BANK
OF SAN FRANCISCO

Community Investments Vol. 9, Issue 4
1996 CRA Data Now Available

Author(s): Shawn Elliott Marshall, Associate Editor, Community Investments

Fall 1997

The FFIEC has announced the inaugural release of the new CRA data which includes 1996 information about small business and farm loans, community development loans and institution assessment areas. All 2,078 CRA reporting institutions should have received the 1996 data in early October. For other organizations, the data may be obtained for $10 in two format options — a CD-ROM software package or an individual institution or aggregate report on paper.

The CD-ROM software package includes data for all reporting institutions from around the country. It also includes an easy-to-use search capability which enables users to retrieve reports in a timely and efficient manner. The paper-based report includes an institution's disclosure or an aggregate report for either an individual MSA or all non-MSA counties in a particular state.

Several key findings of the data are delineated in a September 30, 1997 press release issued by the FFIEC. Highlights of those findings include:

- In 1996, 2.4 million small business loans, totaling $147 billion, and 216,629 small farm loans, totalling $10.4 billion were reported by 2,078 lending institutions. Reported loans include both originations and purchases of loans during the year.[1]

- Among all reported small business loans, the average loan size was about $61,000. Eighty-seven percent were for amounts under $100,000. The maximum loan reported was $1 million.
- Among all reported small farm loans, the average loan size was about $48,000. Eighty-eight percent of small farm loans were for amounts under $100,000. The maximum loan reported was $500,000.
- Small business lending varies by region of the country, a variance which closely follows the differences in the number of business establishments across regions.[2] For example, New England reported 5 percent of small business loans with 5.9 percent of all business establishments. The Pacific reported 14.7 percent of small business loans with 16.2 percent of all business establishments. The regional variation in small farm lending is more pronounced than in small business lending, though this regional variation closely tracks differences in the share of farms and share of farm sales by region.
- Small business loans are heavily concentrated (about 80 percent) in central city and suburban areas. Most small farm loans (74 percent) are made in rural areas.
- In 1996, 32,677 community development loans totaling $17.7 billion were reported. The average community development loan amount was $542,000, much larger than the average small business or small farm loan.
- Fifty-seven percent of reporting commercial banks and 46 percent of reporting savings associations extended community development loans in 1996. Eighty-five percent of all community development loans were originated by commercial banks.

If you would like a copy of the press release which contains a CRA data fact sheet with corresponding tables as well as a 1996 data order form, please contact June Yambao in Community Affairs at (415) 974-2978. If you have specific questions about the `96 CRA data or would like to place a data

order, please contact the FFIEC at (202) 872-7584. Data requests will be filled by the FFIEC within a few days of receipt of your order.

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[1] Unlike mortgage lending, a well-developed secondary market for small business loans does not exist. As such, only about 2 percent of small business loans and less than 1 percent of small farm loans were reported as purchases from another institution.

[2] FFIEC analysis of small business and small farm data are categorized within the following nine U.S. regions: New England, Middle Atlantic, East North Central, West North Central, South Atlantic, East South Central, West South Central, Mountain and Pacific.