FRONT & CENTER

Double Whammy

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By Glen Fest

Johnny Wright is a Chicago native and a West Coast celebrity coiffeur, who earlier this year parlayed his campaign-trail service for Michelle Obama into a regular White House gig as the First Lady's First Hairstylist.

Wright's burgeoning fame (he has signed on for a reality television show, too) got its start from the training and licensing he received at a Southside Chicago beauty school a decade ago that owes its existence to a $200,000 low-income opportunity investment from a Cook County community development financial institution, in partnership with Harris Bank.

The owners "took the dollars from Harris Bank, bought a police station in the 6th district that was abandoned, and converted it into a beauty college," said Yevette Boutall, a director of the CDFI, Community Economic Development Association. "That's what you call teamwork."

Since the formal designation of CDFIs in 1994, the Treasury estimates that they have financed around $29 billion in small-business and affordable housing loans in poor communities.

Acting as intermediaries to banks, credit unions and foundations, the CDFIs provide low-cost financing to neighborhood developers and small-business owners that might otherwise have trouble obtaining market-rate loans.

But the traditional CDFI model, say many observers, is in crisis. Since last fall, CDFIs have been losing access to low-cost sources of funding from partner banks that are cutting lines or lending at higher rates - though demand for financing is as high as ever. The dried up secondary market for low-income tax credits has only added to CDFI's woes.

Community development financing faces a critical threat of sliding into a "permanently diminished role," said Mark Pinsky, the CEO of Opportunity Finance Network, a nationwide association of 170 CDFIs.

The problem has grown acute enough to grab the attention of Federal Reserve Chairman Ben Bernanke, who is calling for the creation of a broader and more diverse funding base to carry CDFIs through the current credit crisis, and beyond. CDFI organizers say banks have to be kept in the picture, since they provide 54 percent of the total funding for CDFIs.

"If we can't pull banks back into the communities, I think the level of disinvestment, unemployment and blight will increase very dramatically," said Calvin Holmes, executive director of the Chicago Community Loan Fund, which provides pre-development financing for local retail, housing and nonprofit construction. "We've got to have our traditional bank partners with us."

In its second-quarter market conditions survey of about 100 member CDFIs, Opportunity Finance found more than half of the respondents reported being "capital restrained" and were boosting loan-loss reserves in their portfolios. Most expect "operating and liquidity challenges" to continue this year, with 30 percent expected to fund fewer loans to start-ups, non-profits and housing developers. Meanwhile, the survey found that requests for CDFI funding are on the rise, in part because traditional financial has become off-limits.

Pinsky says his group is in talks with government officials to find "new ways of increasing liquidity, whether

its various forms of guarantees that would help investors put money into CDFIs" or getting additional government awards from the Treasury's CDFI Fund, a division which handles financial assistance to institutions in economically depressed areas.

The CDFI Fund responded in June with $90 million in awards provided by the government's stimulus package - with another round anticipated to reach the streets in September, for a total planned 2009 disbursement of $207 million.

The stimulus package also doubled, to $6.5 billion, the amount of New Market Tax Credits the CDFI Fund would back for approved community development investments this year.

But many think it will take more to fill in an expected 39 percent drop in available CDFI capital. The CDFI Fund last year recommended that Treasury set aside up to $2 billion from Troubled Asset Relief Program funds for CDFIs.

Where has the money gone? CDFIs have lost several of their primary benefactors of recent years, either to failure or mergers; Wachovia Corp., Washington Mutual Inc., and Merrill Lynch were among the most active in CDFIs. (The investments earn banks Community Reinvestment Act credit.) The overall market downturn, too, has played a role; a recent study presented to the Fed showed that CDFIs were frequently found to have lost "concessionary" funding or short-term capital lines. Self-Help, a community development credit union in Durham, N.C., had only hours to replace a $25 million overnight facility called in by a lender on the day Lehman Bros. collapsed. Another CDFI had to cut ties with a lender that sought full collateral on loans already guaranteed by the Small Business Administration, and ordered the CDFI to cede interest in the loans (a violation of SBA guidelines), according to Paul Weech, a former chief of staff with the SBA who interviewed dozens of CDFIs for the study.

Loans that are being renewed for CDFIs are coming with rate hikes of 200 to 250 basis points, according to Weech.

The market for Low-Income Housing Tax Credits is perhaps the most critical loss for CDFIs. The credits in recent years had provided about $8 billion annually in equity financing for developers of affordable housing projects as they neared closing. But 40 percent of that volume came from Freddie Mac and Fannie Mae purchases, which were halted in the spring of 2008.

"Most of the projects that have gone on in Detroit have been so because they've been subsidized by tax credits," says Ray Waters, president of ShoreBank Enterprise Detroit - the nonprofit arm of ShoreBank in Chicago. Without the tax credits, banks became hesitant to pick up pre-development loans and that forced ShoreBank to turn away from funding new developments almost exclusively in favor of rehab projects.

In his June remarks on CDFIs, Bernanke called for bringing new venture capital investors into the stagnant LIHTC market. Some of the market has been ameliorated with a program under the 2008 Home Economic Recovery Act to provide grants to states in lieu of tax credit investments for housing developers.

The act also opened up another possible new funding channel for CDFIs: membership in the Federal Home Loan Bank System. So far, only a "small number" of CDFIs - those that are banks, thrifts and credit unions - will have the capacity to qualify for collateralized advanced for lending, says Pinsky, whose network is negotiating less restrictive CDFI terms on asset requirements with the Home Loan Bank System's regulator, the Federal Housing Finance Agency. "Most CDFIs tend to be unregulated institutions, and that creates a challenge for the FHFA and Federal Home Loan banks, who need a certain amount of 'apples-to-apples' information," says Pinsky.

Some questions have been raised whether those same regulatory issues are holding back Treasury from offering up TARP funds, as recommended by its CDFI Fund board within the agency. Fifteen to date have received TARP funds, for a total of $132 million.

In lieu of TARP, Pinsky says, "the Treasury could make equity equivalent investments in loan funds and some equity funds and secondary capital investments" to spur liquidity.

Some CDFIs are devising their own solutions to boosting capital and revenue streams. Calvert Foundation in Maryland, for example, has raised $160 million, with an average 3 percent rate of return, for a

mutual-fund type instrument in "community development notes" that has attracted 4,700 investors - and the praise of Bernanke.

And Holmes of the Chicago loan fund is considering how his and other CDFI organizations can help unfreeze the secondary market. One idea is for some CDFIs that have enough capital to take the bullet for partner banks that are unable to front loans under tightened risk management guidelines. "Maybe we can take over the long-term asset and management risk over time. Maybe we become the solution for that, because we think we have the balance sheet and the regulatory environment to do that."

Longer-term solutions may also come into play from outside the CDFI circle of influence. The president's regulatory overhaul includes expansion of financial services companies subject to CRA, which could widen the field of potential CDFI financiers.

CDFIs are also eyeing the use of $80 million in funds allocated in 2009 to the Capital Magnet Fund, a vehicle controlled by the CDFI Fund created under the Home Economic Recovery Act.

CDFIs play a crucial role in economic development because they provide cost-effective financing to borrowers that might not qualify for conventional loans. The loans provided by CDFIs are done at levels too low to be profitable for standard banks, and often need to be ferried through several layers of participation.

"CDFIs are one of the few ways to get capital into the lower quintiles," said Pinsky. "The goal here is to get the credit flowing in a responsible way. I'm not sure who else besides CDFIs are going to be doing that."

In Chicago, a $1 million loan on a 2004 project by the Chicago Community fund provided the foundation for an Uptown-area mixed-use development of housing, office and retail that has since attracted a Target anchor store.

Holmes' group is also taking the lead on a $2 million to 3 million pre-development loan - one which required more than 17 different sources of financing - to replace a decaying 70-year-old public housing project with a new 3,000-unit affordable-housing development.

"That project will be worth hundreds of millions by the time it's done," says Holmes.

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