Remarks by

Tony T. Brown, Director

Community Development Financial Institutions Fund (CDFI)

To the

Annual Conference
of
The Association for Enterprise Opportunity

Harbor Beach Marriott
Ft. Lauderdale, Florida

Monday, May 20, 2002

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Introduction

Good afternoon and welcome to Florida, which happens to be my home state. I have spent 20 years in banking. Ten of these years have been in community development in the state of Florida. I know the importance of community development finance and the value of micro-finance. Yes, micro-enterprise does work and it is an effective tool for successfully alleviating poverty.

I am here to say thank you and to commend you for providing capital to underserved entrepreneurs. What started as a movement has grown to an industry and the CDFI Fund has been a big part of that growth.

The CDFI Fund has invested nearly $21 million in micro-lenders. We believe in you and the work you do to bring economic stability to our nation's communities. You can count on the CDFI Fund as an effective partner in helping you "provide access to capital to all Americans."

In remarks to community and business leaders in Los Angeles this month at the 10-year anniversary of the racial disturbances in South-Central LA, President Bush acknowledged the role of community-based organizations in helping to eliminate pockets of despair. His remarks sums up the socioeconomic commitment of your sponsoring organizations. President Bush believes in you and the work you do to improve America. He knows that we must work hard and that there is plenty of work to do. And he knows that we can eliminate poverty and despair with love, compassion and decency.

President Bush often reminds people that the great strength in America is in the hearts and souls of citizens all around our country. The great strength in America is embodied in those who work, such as you, in community-based institutions across the country.

I am honored to be here today as your speaker, to represent the CDFI Fund and the U.S. Department of the Treasury.

First, let me thank Bill Edwards for that kind introduction and commend AEO for advancing the field of microenterprise development. I thought I would share my vision for the CDFI Fund largely in relation to AEO's vision for micro-finance. I will relate many of my comments to AEO's five-year strategic plan.

In thinking about my comments to your organization, I recalled my first experience at self-employment and thought about how a micro-lender could have aided me in my first venture. It was the summer of 1978 – I was fresh out of high school. Two buddies and I were brainstorming ways we could make money during the summer.

First, we took an inventory of our assets. In our case, there wasn't much in the way of financial assets. My buddy, Gregg, had just purchased a pick-up truck. Now, Terrence and I knew that this had to be a sign from God.

We thought that money could be made from that pick-up truck because how many brothers from the North in urban, inner-city America, would go out and buy a pick-up truck after high school! A sports car maybe – but a pick up truck?

A neighbor told us that they made $500 in two days over the weekend delivering telephone books in the city. Our neighbors were a middle-aged couple and they delivered these telephone books in a station wagon.

We were 18 years old. In prime physical condition with a pick-up truck! So off we went to Cincinnati Bell. We told them to load up the truck and we gave them about 20 neighborhoods we were familiar with. They, in turn, gave us the list of homes to deliver telephone books. We then learned that you make twice as much picking up the old telephone books than you get delivering the new ones.

We learned a second lesson. You can't cover much of the city on one tank of gas and going up and down stairs on an empty stomach. So, we went to our micro-lender at that time – my grandmother – for $100 loan.

After a full day going up and down stairs and running from dogs, we learned our third lesson – market perception and receptivity. We were able to drop off telephone books but there weren't many homes willing to open their doors to let us in to pick up an old telephone book. We were young, well-groomed, African-American males bartering telephone books: look at this smile – would you invite me into your home? I guess in hindsight hocking telephone books doesn't sound as credible as selling insurance.

Well, we gave up on the telephone book exchange business and went into the moving business and made a pretty good living that summer.

I share this story with you because that experience helped to shape my sensitivities later in life as a banker.

As a banker, I empathized with entrepreneurs who are willing to take business risk but can't seem to overcome a financial institutions requirement for equity or collateral, including second or third potential sources for loan repayment.

I recall being trained as a lender to look for ways to consolidate debt to increase the loan size since our bank could not make money on a small loan. If this couldn't be done then we were to advise the customer to apply for a credit card and get a cash advance for a small dollar loan.

In my early years as a banker, bank regulations scrutinized an institution's lending policies when they reportedly had minimum loan amounts. To get around this aspect of Regulation B, a financial institution had to justify its minimum loan amounts as part of a business case.

In my mind, I felt that my financial institution was leaving too much money on the table and that scores of potential customers were being turned away. Well, you as mico-lenders, have proven me right.

Thankfully, you as micro-finance institutions help to fill this credit gap. You have proven that you are able to lend deeper with smaller loan sizes and to grow your portfolio by moving up-market as your clients mature. You have demonstrated profitable operations with strong portfolio performance.

The CDFI Fund fully supports the development of strong and effective microenterprise programs to assist underserved entrepreneurs in starting, stabilizing and expanding businesses. The numbers speak for themselves. For instance:

Annually, the CDFI Fund conducts a survey of its awardees. In 2000, 58 out of 122 awardees reported outstanding microloans in their portfolios. That means that a full 48% of the Fund's awardees engage in some degree of microenterprise, whether it is a microenterprise organization dedicated 100% to this sector or a business loan fund or credit union that has a microloan product. These institutions reported total assets of $1.8 billion and during FY 2000 they made nearly 9,200 loans for over $28 million – an average loan size of over $3,000.

Under the CDFI Data Project, 25 micrenterprise organizations completed an annual survey. These 25 had 14% delinquency (or 30 days or more past due). I consider this to be a "risky" portfolio. However, what's interesting is that larger business loan funds – which tend to do less risky investment – had 12% delinquency. So on that basis, you compare favorably. The average loan loss reserve for a micro-lender registered 12%, and compared favorably to the average loan loss provision reported for larger business loan funds at 11%.

Our analysis at the Fund generally includes a self-sufficiency calculation where we determine if earned program income covers general operating expenses. A rating of 100% or more means earned income exceeds operating expenses and the CDFI is "self-sufficient," it does not have to rely at all on grant income.

Our sample of 25 micro-finance institutions reported an average self-sufficiency ratio of 35%, while the business loan funds averaged self-sufficiency ratios of 55%.

This information helps me to better understand why many micro-lenders are part of other organizations with general socio-economic missions. It appears that you either need to achieve scale; be part of a larger organization, where operating expenses can be subsidized; or you have to attract annual operating grants just to keep your doors opened.

I understand from talking to my staff that your array of functions – entrepreneurial training, guidance to other would be business owners and other non-lending activity is a barrier for several AEO members to gaining CDFI certification. To meet the "financing entity" test it may be useful to consider forming an affiliated entity and consolidating lending activity in it, and keeping the training and other non-lending activity in the existing parent corporation.

Micro-finance institutions are important to the CDFI Fund. Our records show that 20% of our certified CDFIs are AEO members and that they offer some form of micro-finance. It is great to know that you value the CDFI Fund.

Bill Edwards also shared with me AEO's legislative priorities for 2002 where you cited the CDFI Fund as the most prominent source of funding and that you rank the CDFI Fund the highest in terms of scale and innovation for the micro-enterprise field. Thank you for this strong endorsement of importance and value.

But I think there is room for improvement. One such area is the utilization of our Small and Emerging CDFI Assistance Component (or SECA) under the CDFI Program. This program was created in response to the needs that you put forth –

- for a program that focused on new or smaller organizations that needed funding to help these organizations grow and expand;

- a program where similar entities can compete among themselves, as opposed to against much larger entities as in our CORE Component;

- and a program that provided funding for critically needed technical assistance dollars, but also allowed for smaller amounts of capital.

We introduced our SECA program in 2001 and made 70 awards. Only 9 of those awards – or roughly 13% - were made to AEO members. This number will rise in the coming months, as the CDFI Fund begins announcing the FY 2002 SECA awards. We know the SECA program is important to you, but it seems like there is a great opportunity here that many of you are not taking advantage of. I strongly encourage you to consider applying under the 2003 round of SECA. There is a great description of this program in AEO's January/March newsletter.

Another major change you will see at the Fund is how we manage compliance and measure CDFI performance and impact.

Bill has met with me and shared the details on the valuable work AEO has undertaken to develop a standard for accrediting micro-enterprise organizations. Your work has influenced my thoughts as the CDFI Fund moves from our present compliance, monitoring and evaluation systems to a new evaluation tool we are calling PLUM (Performance, Leverage, Underwriting, Management).

In a 1998 report completed by the General Accounting Office on the Fund's systems, it was recommended that the Fund review its assistance agreements and establish procedures to encourage the greater use of accomplishment measures. To encourage the use of accomplishment measures, GAO recommended that the Director waive sanctions for accomplishment measures beyond the awardees' control – such as economic conditions – while retaining sanctions for activity measures within an award recipient's control.

Treasury Secretary Paul O'Neill is asking us to measure the outcome of your lending activities. He wants to know how did this lending improve the area's local economy? Were jobs created and retained? Did we build personal wealth? How many people were removed from welfare rolls and made successful entrepreneurs, as examples?

Our Compliance Monitoring program will begin to take on a more sophisticated approach. Our goal is to measure compliance based on your performance and capacity to reach and serve distressed markets, not merely on your performance to a five-year business plan that gets outdated after one year.

The point I want to make is that we are now at the stage where it is essential that we be able to measure the true impact of CDFIs in building community wealth through community development financing activities for our nation's financially underserved and economically distressed areas.

I will discuss my last point by addressing an issue of concern to micro-finance institutions and that is the growth of micro-lenders through mergers and partnerships that achieve scale. I think we all agree that the field of community development finance has grown considerably. The issue at hand is whether or not we can sustain our loan programs with existing and traditional funding sources.

One of the major policy objectives of President Bush is to see an increased flow of private capital into low-income communities. One new initiative at the Fund that you need to evaluate is the New Markets Tax Credit program.

- The New Markets Tax Credit Program is the newest of the CDFI Fund's program. It is designed to help spur $15 billion worth of new investments in low-income urban and rural communities across the country. Briefly, here's how NMTCs will work:

- An organization may apply to the CDFI Fund to become certified as a CDE. To qualify as a CDE, the entity must have a mission of community development and demonstrate accountability to the low-income communities served;

- The CDE applies for an allocation of NMTCs;

- If the CDE is awarded an allocation of tax credits, it may offer them to its equity investors;

- Investors can receive NMTCs worth 39% of the invested amount over the seven-year life of the credit. Investors may not redeem their investment in the CDE prior to the conclusion of the seven-year period;

- The CDE must use substantially all of the proceeds from these investments to make Qualified Low-Income Community Investments (QLICIs). QLICIs include:

    - Loans and investments in support of commercial real estate development in low-income communities;

    - Loans and investments to businesses operating in low-income communities;

    - Loans and investments to other CDEs;

    - The purchase of loans made by other CDEs to businesses operating in low-income communities; and

    - The provision of counseling to businesses operating in low-income communities.

    - Tax incentives covering $15 billion in investments will be available over the next six years. We expect to allocate up to $2.5 billion in NMTC in calendar year 2002.

- If you have not done so, you should be completing applications for certifications. As CDFIs, it is a simple online registration.

I encourage you all to think out-side-the-box on how we might utilize this new tool to help capitalize the important work you do. Don't let this opportunity slip by.

Conclusion:

The Fund is initiating a number of changes. These changes reflect the organizational maturity of the Fund and that of the CDFI industry itself. The Fund is poised to better connect our nation's distressed and underserved markets with financing alternatives to increase economic health and build community infrastructure.

We can achieve these changes and fulfill the goals described with your help. If the CDFIs do their share, the Fund, as your federal government partner, will do what it needs to in order to fulfill its end of the bargain. It is a partnership about which I am very excited.

Thank you so much for your attention.