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Bank CDCs [Community Development Corporations]

by

Ron E. Shaffer

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BANK CDCs

Ron Shaffer*

Bank** community development corporations ("Bank CDCs") are being used more and more for economic development. Bank CDCs are flexible private sector sources of funding which may finance many different types of local projects. There are several reasons for this increased interest in Bank CDCs: their feasibility has been proven, they can be part of a bank's Community Reinvestment Act ("CRA") activities, and many communities are searching for new resources to replace declining federal funds for economic development.

BANK CDC's

Bank CDCs are funded by banks, bank holding companies and/or federal savings associations under special regulations that encourage investments in community and economic development projects. Bank CDC investments must meet a public purpose test, and typically have financed affordable housing or economic development, but other types of community investments have been permitted.

Bank regulators have historically wanted banks to participate in local community development activities, but banking laws and regulations have meanwhile limited some banks' investments. The Bank CDC program offers banks more flexibility to make some types of investments. Bank CDC investments are special in several ways:

- Bank CDCs can make equity investments in real estate or small businesses;
- Bank CDC investments are treated separately from regular bank loans for accounting purposes;
- Bank CDC investments are viewed differently than regular bank loans by bank regulators and examiners; and
- Bank CDC programs are considered favorably for CRA.

Bank CDCs may take many organizational forms, and may be for-profit or non-profit. They may be owned by a single bank, a group of banks, or by a combination of banks and other investors such as savings associations and utilities or joint-venture, public-private partnerships with government agencies or non-profit organizations.

BANK REGULATORS

Bank CDCs are created and regulated by federal and state bank regulators, and any investment in a Bank CDC must be reviewed and approved by each institution's regulator.

Despite the recent uncertainties in banking, bank regulators generally have been very supportive of Bank CDC activities. The joint statement on CRA issued by the federal bank regulators in 1989 cites the establishment of a community development corporation as one (but not the only) element of an effective CRA program.

The most difficult step with economic development Bank CDCs is usually negotiating a consensus among participating banks about the need and structure of a program and then deciding each bank's level of commitment to the program. The subsequent relationships between the banks and local development organizations are less difficult.

The strategies for working with bank regulators may be complex when a group of bank holding companies, national banks, state banks and/or savings associations are involved. Each institution's investment in the Bank CDC must be approved by its own regulator.

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* Drawn from John Sower, "Bank CDC's," *Commentary* (Winter 1992 issue). Washington, DC: Council for Urban Economic Development.

** The term "bank" is used for convenience to refer to banks, bank holding companies and savings associations.

Role of Economic Development Organizations

In organizing Bank CDCs local economic development organizations can play many important roles, including, and perhaps most important, acting as the organizing catalyst. Each Bank CDC program is organized differently, and the economic development organization can state the needs, convene the parties, and start the process. Ultimately a successful Bank CDC program needs to benefit all of the parties, and the banks need to be involved both in planning and implementation.

In several recent Bank CDCs, non-profit economic development groups have management contracts with the Bank CDC to market the program, screen and package the deals, and provide administrative support. The banks invest in the Bank CDC, serve on the board of directors, and serve on an investment committee which ultimately approves investments in individual businesses. In short, the economic development organization should take the initiative and provide the leadership to start the Bank CDC organizing process, and then participate in this on-going public-private partnership.

Types of Investments

Bank CDCs' investment strategies fall into several "niches." Most frequently they invest capital to fill the "small business equity gap" between conventional bank loans to small businesses and investments by venture capitalists.

Regular bank loans and Bank CDCs differ most significantly in that the CDCs can make equity investments. Simply stated, an equity investment by a Bank CDC is a way to defer the short-term, relatively certain return of a bank loan for the expectation of a larger but less certain equity return in the long-term.

Bank CDC Future

Several Bank CDCs have already been closed down by their sponsoring banks. Similar programs such as Small Business Investment Companies (SBICs) have had problems or, in some cases, have produced unsatisfactory returns. Will Bank CDCs follow? Or, will they continue with investment "niches" that meet the public purpose tests of the regulators and produce benefits to the banks?

Experience suggests that the key to successfully organizing Bank CDCs is assuring that the sponsoring banks receive real benefits from their involvement. Banker's benefits from Bank CDCs can vary tremendously and can include:

- Direct return on investment;
- Tax credits or other tax advantages;
- More "front door" business (regular bank loan or deposit business generated by Bank CDC-funded projects);
- Indirect benefits from local area growth; or
- Positive image, publicity and community relations.

The economic development community needs to become more involved with bank regulators, many of which are not familiar with the policies, organizations and programs of economic development, although they may be experienced with non-profit community-based organizations and financing programs for low- and moderate-income housing. Organizers of for-profit Bank CDCs that are targeted to invest in small business venture capital, or other investments with "equity kicker" yields above those of conventional bank loans, may be negotiating with bank regulators whose only experience has been with non-profit community-based organizations. In short, bank regulators control Bank CDC investment policies, and economic development professionals need to become more involved with them.

CONCLUSION

Bank CDCs have proven effective for some local economic development investments. Successful prototypes exist where Bank CDCs have invested in small business equity capital, minority business development, shell buildings, small business incubators, and other types of economic development projects.

Bank CDCs are not panaceas for all economic development needs because the problems are large and Bank CDC funds are limited. More importantly, to be successful Bank CDCs probably require a return on investment, and in many economic development areas returns on investment are difficult to achieve. Also, Bank CDC investments require accountability, they are not another government grant or low-interest loan program that doesn't really have to be repaid.

The challenge to economic development professionals is to learn more about Bank CDCs, to become more involved with them, and to use them effectively in their own communities.

Ron Shaffer
Community Development Economist