Special Issue: CRA Investments

No. 47
Winter 2001

Cascade

a community development publication of the Federal Reserve Bank of Philadelphia

Survey of CDFIs Identifies 34 CRA Investment Opportunities

By Keith Rolland, Community Development Advisor, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia

The Community and Consumer Affairs Department (C&CA) of the Federal Reserve Bank of Philadelphia is frequently asked to identify CRA investment opportunities. Therefore, C&CA conducted a survey of the community development financial institutions (CDFIs) that were certified by the CDFI Fund and based in the Third Federal Reserve District.

The purpose of the survey was twofold: to inform financial institutions about CDFI-related investment opportunities so that they can investigate the opportunities further if they wish; and to get some indication of the quantity of situations in which banks can make CRA-eligible investments. The survey asked the CDFIs to identify opportunities for financial institutions to make CRA-qualified investments from December 2001 to December 2003. Of 24 CDFIs surveyed, 20 responded and identified a total of 34 investment opportunities.

The federal bank regulatory agencies have cited CDFIs as financial intermediaries that automatically qualify for the CRA investment test. This appears most recently in Interagency Questions and Answers Regarding Community Reinvestment, which was published on July 12, 2001 (see section 12 CFR 228.12[s]).

Each CDFI was asked to identify which of four community development purposes the investment met and other features. Some investments listed in the table on pages 14-17 are still in the planning stages.

For CRA credit, qualified investments must have a primary purpose of community development in one of four areas: affordable housing for low- or moderate-income (LMI) individuals (affordable housing LMI); community ser-

...continued on page 2

CONTENTS

The Reinvestment Fund — Primary Financing Source for Charter Schools

By Sandra Choukroun, Director of Investor Relations and Publications, The Reinvestment Fund

Charter schools were approved in Pennsylvania in 1997 as a new way to improve educational outcomes for children. Community-based, they offer unique educational opportunities as well as underwriting challenges. The Reinvestment Fund (TRF) considers charter schools essential for community revitalization and has developed a successful model for charter-school lending.

TRF has become a major source of financing for charter schools in the Philadelphia metropolitan area. Since 1997, it has closed loans totaling $9.8 million to 14 charter schools and has made commitments totaling $1.2 million to two other schools. It has not had any defaults in its brief history of financing charter-school loans.

Pressure from parents has fueled the rapid growth of charter schools from four in Philadelphia

...continued on page 3

Message from the Community Affairs Officer

We have heard for a long time that banks have difficulty with the CRA investment test, and, as a result, we have devoted this issue of *Cascade* to identifying CRA investment opportunities in our District.

This issue contains articles about investment opportunities in each of the three states in the Third District. Some investments are for business purposes, and others are for residential or consumer purposes. The entities providing the investment opportunities range from for-profit organizations to nonprofits to governmental agencies. We also surveyed the community development financial institutions (CDFIs) in our District on CRA investment opportunities and share the results.

Based on our experience in compiling the material for this issue, there does seem to be a limited number of CRA investment alternatives — especially investments that pay a market or near-market return. Many of the investment possibilities uncovered pay a low return or are grants. It is also clear that there is a widespread lack of understanding about the CRA investment test and how to use it to promote development. We wondered: Could community- and economic-development agencies, which have excellent loan programs, design *investment* products that address specific low- and moderate-income or small-business needs and that count for banks' CRA investment test? We are open to facilitating this dialogue.

In the meantime, it seems advisable that banks that want to claim credit under the investment test give particular care as to how the transaction is initially booked at their institutions. CRA officers may want to discuss such investment test-eligible transactions with their chief investment officer to determine whether the transaction is an investment or a loan. The CRA Q&A says that "examiners will determine the dollar amount of qualified investments by relying on the figures recorded by the institution according to generally accepted accounting principles (GAAP)" (Section 228.23(e)-2). In the end, a bank's examiner makes the final determination as to whether a transaction counts under the investment test. The bank's job is to provide the background material.

Let us know your reactions to this issue. We are trying to make *Cascade* more substantive and more interesting. Our last issue focused on financial literacy. Let us know, too, if there are other subjects about which you would like us to provide in-depth coverage.

Survey of CDFIs Identifies 34 CRA Investment Opportunities

...continued from page 1

vices targeted to LMI individuals (community services LMI); activities that promote economic development by financing small businesses or farms with gross annual revenues of under $1 million (small businesses); and activities that revitalize or stabilize LMI geographies (revitalize / stabilize LMI geographies). An abbreviated version of the four areas is used in the table. "NA" means not applicable.

Since a financial institution's primary regulatory agency makes the final determination as to whether the listed investments are CRA-eligible for that institution, investors must do their own due diligence on acceptable returns, risk, and compliance.

See the table on pages 14-17.

The Reinvestment Fund — Primary Financing Source for Charter Schools

...continued from page 1

in 1997 to 36 this year. Demand for charter schools is evidenced by an unprecedented level of community and parental involvement. According to Donald R. Hinkle, managing director of capitalization at TRF, "Years ago, small groups of neighbors would attend community meetings to discuss neighborhood plans. But we are accustomed to standing-room-only crowds when charter schools are on the agenda."

The Reinvestment Fund (TRF) has developed a successful model for charter-school lending.

Many charter schools are developed by an existing neighborhood organization or sponsor with deep roots in its community and a strong track record. TRF already had relationships with many such organizations before they established charter schools.

TRF has taken advantage of its 16 years' experience in community financing to address the considerable challenges that charter-school underwriting presents.

The two most significant challenges faced by new charter schools are: they are start-up businesses without management in place, and they usually have to purchase and renovate facilities before opening. Many founders and sponsors starting charter schools call on private management groups to provide expertise in developing the operational, financial, and educational structures needed to govern the new institution. In Philadelphia, Drexel University / Foundations, Inc. Technical Assistance Center for Public Charter Schools assists many schools with start-up operations, policy, and procedural matters, as well as ongoing business management support.

The second challenge — preparing a facility for use as a school — can present real difficulties to founders with little or no experience in construction financing and implementation. In many cases, charter schools are established in abandoned stores, factories, or schools. Since the time between the awarding of the charter and the opening day of school is usually just a matter of months, charter-school founders must work with architects and contractors who have experience doing school projects. It's very important to have a back-up plan in case the facility is not ready for the first day of school.

When reviewing an application for charter-school financing, TRF looks for strong leadership, well-defined business functions, knowledge of the reports required by state regulators, a cohesive staffing plan — and a board of directors that has expertise in managing a facility, recruiting staff, enrolling students, developing policies, and raising funds. Budgets must not reflect unrealistic fundraising goals, and projections for repayment of loans should be prepared by someone familiar with the state education department's funding policies. Strong management is indispensable because charter schools operate independently of central school district administrations.

Charters are granted by the state education department for a specific period. In the event that a school closes — if the charter is revoked or not renewed, or the school ceases to exist for any reason — the charter school's assets revert to the school district. This makes it highly

...continued on page 4

Two students build architectural models at the Charter High School for Architecture and Design (CHAD), one of 14 charter schools in the Philadelphia metropolitan area that have received loans from The Reinvestment Fund. CHAD — the first charter high school for architecture and design in the nation — is located on Seventh Street near Washington Square in Philadelphia. The two students pictured are recent CHAD graduates and are now in college.

The Reinvestment Fund — Primary Financing Source for Charter Schools

...continued from page 3

favorable for the charter school to be a lessee with another party as the landlord. Many charter schools lease from an unrelated party, thus limiting the available collateral. The term of the lease should match the term of the loan, as well as the term of the charter.

Charter schools are one way in which parents are dealing with the failure of crowded public schools, especially in low-income and minority communities. TRF's response to the demand in these communities is to find ways to manage the risk inherent in charter-school financing so that neighborhoods and the region will benefit. Successful schools anchor communities.

For bank and corporate investors, TRF offers two ways to invest in charter schools. Banks and other corporations can, at present, invest in TRF's loan fund and thereby support TRF's overall work, including charter schools. In addition, starting in 2002, they can invest in charter schools through a joint venture being formed between TRF and the National Cooperative Bank Development Corporation. Investments of $25 to $50 million will be sought to serve a region encompassing Pennsylvania, New Jersey, Delaware, Maryland, and Washington, D.C. The term of the investments will range from five to 15 years.

As Sara Vernon Sterman, TRF's director of community services, says: "Charter schools offer exciting alternatives for parents seeking a range of choices for their children's education. TRF has taken the time to understand the nuances of this industry and feels comfortable with the challenges it presents."

For information, contact Sandra Choukroun at (215) 925-1130, ext. 213, or choukrouns@trfund.com.

Charter Schools — Innovative Experiment in Education

Charter schools are innovative, depend on extensive parental participation, and are firmly rooted in their communities. Charter schools are public schools of choice that operate with freedom from many of the regulations that apply to traditional public schools. Charter schools are accountable to their sponsors — usually a local school board — to produce positive academic results and adhere to their charter contract. In addition, they are accountable for both academic results and fiscal practices to the sponsors who grant the charters, the parents who choose the schools, and their funders.

Most current charter schools are smaller than traditional public schools, and many are organized around themes such as international languages, performing arts, computer science, and African and Hispanic culture. While they are mandated to teach math, science, English, and social studies, there is considerable flexibility in curriculum design. Typically, charter schools have long waiting lists for admission.

Charter schools often are developed by well-established, successful nonprofit organizations in their community. For example, the TRF-financed Germantown Settlement Charter School was developed by the Greater Germantown Housing Development Corporation, which has taken a leading role in transforming the Germantown community in Northwest Philadelphia.

Another TRF borrower is the West Oak Lane Charter School, which was founded and developed by the Ogontz Area Revitalization Corporation, a Northwest Philadelphia community development corporation. It offers its elementary students instruction in five core curriculum areas and computers. The school has played a major role in keeping families in the community.

A key element in charter-school financing is the fact that the school district pays an allocation per pupil of approximately $6,000 for regular education and $11,000 for special education. This primary revenue stream may be enhanced by private donations or grants secured by school management. Achieving and maintaining full enrollment at a fully functioning, well-managed school is critical, since parents will quickly withdraw their children from a school that is floundering. — **Sandra Choukroun**

Allfirst Commits $1 Million in Grants to Nonprofits In Three Cities and Receives Pennsylvania Tax Credits

By Keith Rolland, Community Development Advisor, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia

Thomas C. Bell, vice president of community and economic development at Allfirst Bank in Harrisburg, Pennsylvania, knew the reasons why Pennsylvania's Neighborhood Assistance Program / Comprehensive Service Program (NAP / CSP) made sense — 10 years of state tax credits for 70 percent of grants made, name recognition, revitalization of a neighborhood, and goodwill. But he has been especially pleased about the ancillary business that has resulted from Allfirst's involvement in the NAP / CSP.

Allfirst made a commitment to provide NAP / CSP grants of $100,000 a year for 10 years to nonprofit organizations in Harrisburg, Lancaster, and Carlisle and plans to provide grants to nonprofits in Bethlehem and Reading in the next year. In addition, Allfirst has booked more than $1 million in small-business loans in Lancaster during the past 18 months and anticipates booking construction, permanent, and small-business loans totaling $1 million in Harrisburg and $250,000 in Carlisle in the next year.

Bell has found that the NAP / CSP involved Allfirst deeply in its community, especially with many nonprofits and government agencies — and that it opened the door to city deposits and other business. "The bank is totally a partner with the nonprofit agency and the rest of the community," he said.

In Harrisburg, Allfirst has been using the NAP / CSP with the Community Action Commission since 1998. In the first three years of a partnership to revitalize the South Allison Hill neighborhood, 16 single-family houses and 29 low-income rental units have been rehabilitated, 17 deteriorated buildings demolished, sidewalks replaced, funding secured for the development of a key commercial area, and a job training program established. A major future target is the rehabilitation and expansion of the district's only supermarket. The city of Harrisburg has committed Community Development Block Grant and HOME funds, so Allfirst's $100,000 grant is leveraging up to $1 million, Bell pointed out.

> **"By supporting our local communities, we benefit our customers, clients, and employees who live and work in them. After all, a bank is only as good as the community that it does business in."**

In Lancaster, Allfirst has partnered with the Inner City Group since 1999 to revitalize the South Duke Street corridor and surrounding neighborhood. Several of the small businesses that received Allfirst loans were located outside the targeted area, but the businesses heard of the bank's interest and approached the bank, Bell said. When the school district of Lancaster suddenly had to close a school because of severe structural problems and lacked funding to establish temporary campuses, Allfirst committed an interest-free $1 million loan to the district.

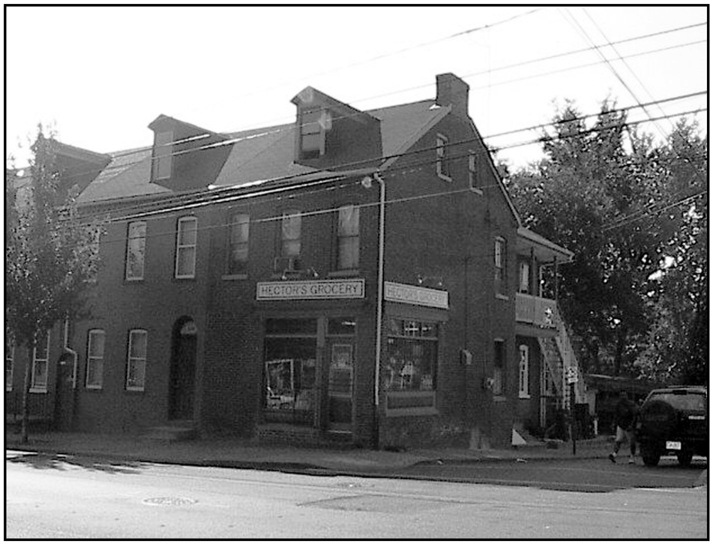
In Carlisle, Bell asked Christopher Gulotta, executive director of the Redevelopment Authority of Cumberland County, to convene a broad-based meeting with the community's nonprofit and government leaders. Late in 2000, Allfirst made an NAP / CSP commitment to the Hope Station Opportunity Area Neighborhood Council. In the first year of the partnership, a computer resource center was opened, a house rehabilitated, and a park restored.

Bell has arranged for Allfirst branch and small-business managers to meet with community and government representatives as needed. He added these final thoughts about the NAP / CSP: "By supporting our local communities,

...continued on page 6

Allfirst Commits $1 Million in Grants to Nonprofits in Three Cities and Receives Pennsylvania Tax Credits

...continued from page 5



we benefit our customers, clients, and employees who live and work in them. We hope to help people fulfill their potential and strengthen our community. After all, a bank is only as strong as the community that it does business in."

A comprehensive revitalization plan coordinated by the nonprofit Inner City Group (ICG) in Lancaster, PA, has included façade improvements to buildings such as the one shown at left. Allfirst Bank has made a 10-year $1 million commitment to ICG through Pennsylvania's Neighborhood Assistance Program/Comprehensive Service Program. ICG was established in 1997 by a consortium of four neighborhood-based organizations and the Lancaster Weed and Seed Program to promote economic development in southeastern Lancaster.

Mortgage-Backed Securities Can Meet CRA Investment Test And Be Economically Attractive

By Tom Healy, Co-Manager of the CRA Source, a division of HanoverTrade.com

A CRA-eligible mortgage-backed security (MBS) is a misunderstood and underused tool in many financial institutions' efforts to satisfy their community-reinvestment goals. If constructed properly, mortgage-backed securities satisfy both the letter and the spirit of the CRA investment test, are relatively easy to obtain, and can be an economical solution to CRA compliance.

CRA was instituted to ensure that financial institutions satisfy the credit needs of their communities. There are a variety of ways to do this — from the simple to the innovative and complex. One relatively simple way of responding to credit needs is by purchasing MBSs. The federal bank regulatory agencies generally take the position that institutions may receive investment-test consideration for purchases of mortgage-backed securities that are backed by loans to low- and moderate-income (LMI) individuals within their respective assessment areas.

The MBS markets have proven very efficient at providing the funds needed for mortgage financing in the United States. Home-ownership rates, in fact, are now approaching 70 percent. This overall statistic, however, hides the fact that white non-Hispanic home ownership is 72 percent, while minority ownership is under 50 percent. The MBS market is helping to rectify this situation.

Business theory dictates that firms build on their strengths and outsource those areas in which they are not strong. Not all financial institutions excel at LMI lending. However, large numbers of recognized firms have gotten very good at it. Purchasing loans through MBSs helps banks comply with the investment test and provides the liquidity necessary for these firms to make even more loans. Because premiums are being paid for these investments, originators are motivated to compete more aggressively for LMI business. The result is a greater level of LMI originations and better pricing for the low- and moderate-income mortgagors, which is exactly the spirit of the Community Reinvestment Act.

Mortgage-Backed Securities Can Meet CRA Investment Test And Be Economically Attractive

...continued from page 6

It is a common perception, however, that finding MBSs tailored to a specific assessment area is difficult. This need not be the case. Information technology has allowed the capital-markets industry to more easily match the specific geographic and product needs of individual financial institutions with those originators that produce low- and moderate-income loans.

The map below depicts by census tract part of the assessment area of a Philadelphia-based bank (shaded tracts are LMI). By matching these tracts with pipeline and warehouse data from a large number of originators, an MBS was constructed backed by LMI mortgages (circles) that fall within this institution's assessment area. In this example, some of the loans are to low- and moderate-income individuals, while others are to individuals in low- or moderate-income census tracts.

Since external databases allow for the construction of such information for most financial institutions, capital-markets firms can pro-actively match an individual institution's CRA needs with multiple origination databases. These firms can then tailor mortgage-backed securities that are backed by CRA-eligible mortgages within each financial institution's assessment area.

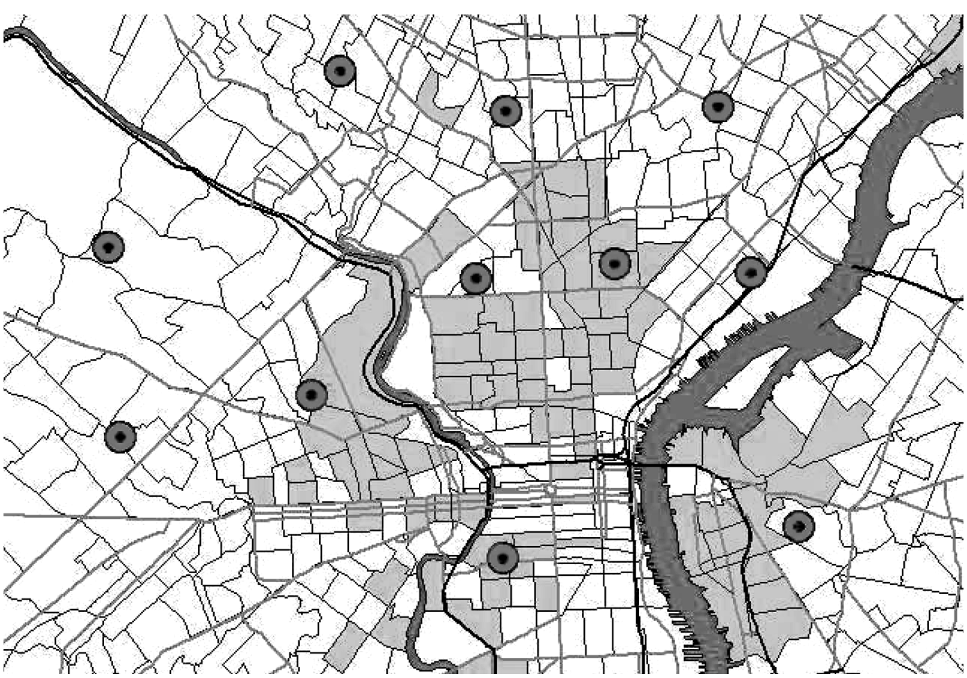
Some financial institutions have been concerned that they may purchase an MBS that will turn out to contain predatory loans. Purchasers can reduce this risk by buying MBSs that are sold by companies they know and have confidence in and are seller-servicers approved by Fannie Mae, Freddie Mac, or Ginnie Mae. Purchasers can reduce their risk even further by buying MBSs that consist of loans underwritten according to the standards of one of those government-sponsored enterprises (GSEs). The GSEs recently implemented detailed predatory-lending standards that emphasize mortgagor protections, such as discouraging single-premium insurance and encouraging escrow accounts, and they will be making periodic audits of approved seller-servicers. Although it is impossible to have total assurance that a specific MBS will not include such loans, an institution can greatly reduce the likelihood of purchasing an MBS containing predatory loans by taking these factors into account.

Information technology has allowed the capital-markets industry to more easily match the...needs of individual financial institutions.

CRA-eligible MBSs not only satisfy investment-test needs but also may be economically attractive. While the process of creating an agency security out of a pool of mortgage loans strips some of the yield off the underlying mortgage coupon (for example, a 7.2 percent mortgage will be put into a 6.5 percent MBS), it also transfers the mortgages' credit risk to that agency. Accordingly, there is no need for the investor to book a corresponding provision for loan loss. Additionally, because of the agency guaranty, risk-based capital requirements on the security are less than half of what they would be on the underlying loans.

However, CRA-eligible MBSs are ordinarily sold in the market at

...continued on page 8



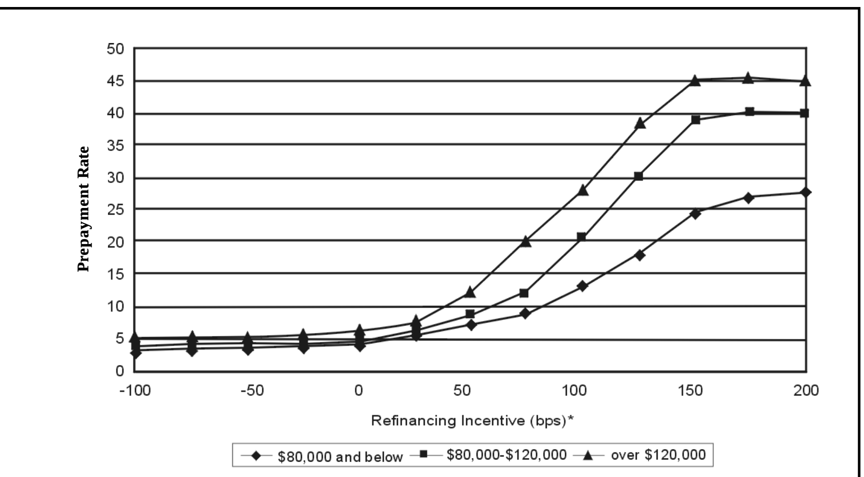
Mortgage-Backed Securities Can Meet CRA Investment Test And Be Economically Attractive *...continued from page 7*

a premium to comparable non-CRA-eligible securities. While premiums are driven by supply and demand and, therefore, vary tremendously by location as well as over time, they are somewhat offset by the avoidance of origination costs. The national average cost of originating a mortgage loan approximates 0.75 percent to 1.00 percent.

CRA loans also tend to have lower loan balances than non-CRA loans, and loans with lower balances have been shown to have, on average, more stable prepayment characteristics than their higher balance counterparts. As the graph shows, if market rates are 100 basis points lower than a mortgagor's rate ("refinance incentive"), an $80,000 or lower-priced loan will prepay at about 12 percent per year. Its $120,000 or greater counterpart will prepay at over 25 percent per year. This lesser volatility of return translates to lower risk. Investors have traditionally accepted the relationship between risk and reward. The lower the risk, the lower the return the markets will demand. Investors do not have to forgo market returns on investment in many CRA-eligible mortgage-backed securities.

Home ownership in our communities is clearly a worthwhile goal. Not only is it one of the cornerstones of federal housing policy, but home ownership has also been shown to enhance family stability and increase family wealth. These are all attributes we would like to see in our respective markets. Home ownership can be facilitated by financial institutions' investments in CRA-eligible MBSs. By using information technology to match financial institutions' unique needs with loans underwritten to GSE standards, tailored securities can be built that help satisfy the CRA investment test while providing reasonable returns to your institution.

CRA Source, a division of HanoverTrade.com, focuses on selling loans eligible for the CRA lending test and selling securities eligible for the CRA investment test. For information, contact Tom Healy at 954-764-1767 or at CRASource@HanoverTrade.com.



Source: Countrywide Securities Corp.

UrbanAmerica

UrbanAmerica, L.P., a real estate investment company formed in 1998, has invested in 22 commercial properties valued at $182 million, primarily in low- and moderate-income census tracts in the United States.

Officials at UrbanAmerica, L.P. said that the company has raised $90 million from 35 investors and has paid the intended preferred return of 8 percent cash on invested equity. They added that UrbanAmerica, L.P. is seeking to raise an additional $24 million, then plans to close the fund. Investors become limited partners in UrbanAmerica, L.P.

Financial institutions that have invested in UrbanAmerica, L.P. include PNC Financial Services Group, Inc., which received CRA investment-test credit through one of its affiliates in a recent CRA examination.

For information, contact Richmond McCoy at (212) 612-9100 or mccoy@urbanamericalp.com.

New CRA Q&A Addresses Investment Test

By Donald W. James, Manager, Regulations Assistance, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia

On July 12, 2001, the most recent supplement to a document entitled "Interagency Questions and Answers Regarding Community Reinvestment (Q&A)" was published. The Q&A, which is supplemented periodically with new questions and revisions to existing ones, helps interpret the Community Reinvestment Act (CRA) regulation, which itself was revised on May 4, 1995. The July 12 supplement adopted a revision to a question and answer proposed in an earlier supplement, adopted six new questions and answers, and made revisions to eight existing questions and answers. This article will present the changes that relate to the investment test, which is one of the performance criteria used to assess a financial institution's performance.

Adopted Revision

This question and answer was re-proposed in the April 28, 2000, supplement and adopted in the July 12, 2001, supplement. It relates to section .12(i)(2)(ii) of the regulation, the definition of *community development* loans.

Q .12(i)—5: Must there be some immediate or direct benefit to the institution's assessment area(s) to satisfy the regulation's requirement that qualified investments and community development loans or services benefit an institution's assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s)?

A5. No. The regulation recognizes that community development organizations and programs are efficient and effective ways for institutions to promote community development. These organizations and programs often operate on a statewide or even multi-state basis. Therefore, an institution's activity is considered a community development loan or service or a qualified investment if it supports an organization or activity that covers an area that is larger than, but includes, the institution's assessment area(s). The institution's assessment area(s) need not receive an immediate or direct benefit from the institution's specific participation in the broader organization or activity, provided that the purpose, mandate, or function of the organization or activity includes serving geographies or individuals located within the institution's assessment area(s).

In addition, a retail institution that, considering its performance context, has adequately addressed the community development needs of its assessment area(s) will receive consideration for certain other community development activities. These community development activities must benefit geographies or individuals located somewhere within a broader statewide or regional area that includes the institution's assessment area(s). Examiners will consider these activities even if they will not benefit the institution's assessment area(s).

An example may help explain this important revision. Hypothetically, a financial institution is located in Philadelphia. Its assessment area is the Philadelphia metropolitan area. Its community development activities include loans, investments, and services to organizations and projects located in and benefiting Philadelphia, its assessment area. The institution's community development activities also include loans and investments in several projects that benefit the entire state of Pennsylvania, including Philadelphia. Assume that, after considering its performance context, examiners have determined that the institution has adequately addressed the community development needs of its assessment area through loans, investments, or services. Examiners then would also consider the institution's investment in a community development organization located in Harrisburg, Pennsylvania, that will serve only the Harrisburg area — with no potential that it will ever benefit Philadelphia, the institution's assessment area. Harrisburg, of course, is in the statewide area (Pennsylvania) that includes the institution's assessment area. The institution would receive consideration for its investment in Harrisburg.

To understand what is meant by the term "regional area," refer to the next question and answer in the Q&A, .12(i)—6.

New Questions and Answers

Three of the six new questions and answers relate in some way to the investment test. The first deals

...continued on page 10

New CRA Q&A Addresses Investment Test *...continued from page 9*

with section .12(h)(4) of the regulation, part of the definition of *community development.*

Q .12(h)(4)—1: What are activities that revitalize or stabilize a low- or moderate-income geography?

A1. Activities that revitalize or stabilize a low- or moderate-income geography are activities that help to attract and retain businesses and residents. Examiners will presume that an activity revitalizes or stabilizes a low- or moderate-income geography if the activity has been approved by the governing board of an Enterprise Community or Empowerment Zone (designated pursuant to 26 U.S.C. 1391) and is consistent with the board's strategic plan. They will make the same presumption if the activity has received similar official designation as consistent with a federal, state, local, or tribal government plan for the revitalization or stabilization of the geography. To determine whether other activities revitalize or stabilize a low- or moderate-income geography, examiners will evaluate the activity's actual impact on the geography, if information about this is available. If not, examiners will determine whether the activity is consistent with the community's formal or informal plans for the revitalization and stabilization of the low- or moderate-income geography. For more information on what activities revitalize or stabilize a low- or moderate-income geography, see .12(h)—2 and .12(i)—4.

The second new question and answer addresses section .24(e) of the regulation, *community development services*, but it also affects the investment test.

Q .24(e)—1: Under what conditions may an institution receive consideration for community development services offered by affiliates or third parties?

A1. At an institution's option, the agencies will consider services performed by an affiliate or by a third party on the institution's behalf under the service test if the services provided enable the institution to help meet the credit needs of its community. Indirect services that enhance an institution's ability to deliver credit products or deposit services within its community and that can be quantified may be considered under the service test, if those services have not been considered already under the lending or investment test (see .23(b)—1). For example, an institution that contracts with a community organization to provide home ownership counseling to low- and moderate-income home buyers as part of the institution's mortgage program may receive consideration for that indirect service under the service test. In contrast, donations to a community organization that offers financial services to low- or moderate-income individuals may be considered under the investment test but would not also be eligible for consideration under the service test. Services performed by an affiliate will be treated the same as affiliate loans and investments made in the institution's assessment area and may be considered if the service is not claimed by any other institution. See .22(c) and .23(c).

The third new question and answer applies to section .25(a) of the regulation, the scope of the community development test for wholesale or limited-purpose institutions.

Q .25(a)—1: How can certain credit card banks help to meet the credit needs of their communities without losing their exemption from the definition of "bank" in the Bank Holding Company Act (the BHCA), as amended by the Competitive Equality Banking Act of 1987 (CEBA)?

A1. Although the BHCA restricts institutions known as CEBA credit card banks to credit card operations, a CEBA credit card bank can engage in community development activities without losing its exemption under the BHCA. A CEBA credit card bank could provide community development services and investments without engaging in operations other than credit card operations. For example, the bank could provide credit card counseling or the financial expertise of its executives, free of charge, to community development organizations. In addition, a CEBA credit card bank could make qualified investments, as long as the investments meet the guidelines for passive and noncontrolling investments provided in the BHC Act and the Board's Regulation Y. Finally, although a CEBA credit card bank cannot make any loans other than credit card loans, under .25(d)(2) (community development test —- indirect activities), the bank could elect to have part of its qualified passive and noncontrolling investments in a third-party lending consortium considered as community development lending, provided that the consortium's loans otherwise meet the requirements for community development lending. When assessing a CEBA credit card bank's CRA performance under the community development test, examiners will take into account the bank's performance context. In

...continued on page 11

particular, examiners will consider the legal constraints imposed by the BHCA on the bank's activities, as part of the bank's performance context in .21(b)(4).

Revised Question and Answer

Only one of the eight revisions relates to the investment test. This revision was made necessary by the creation of the new markets venture capital program, which is administered by the Small Business Administration (SBA) and allows the SBA to designate new market venture capital companies (NMVCCs). NMVCCs are investment funds that will promote economic development in low-income geographies through equity-type investments in smaller enterprises located in those low-income areas. The regulatory agencies will presume that any loan to or lawful investment in NMVCCs will promote economic development, and they revised the answer to question .12(h)(3)—1 to reflect this presumption.

Q .12(h)(3)—1: "Community development" includes activities that promote economic development by financing businesses or farms that meet certain size eligibility standards. Are all activities that finance businesses and farms that meet these size eligibility standards considered to be community development?

A1. No. To be considered as "community development" under .12(h)(3), a loan, investment, or service, whether made directly or through an intermediary, must meet both a size test and a purpose test. An activity meets the size requirement if it finances entities that either meet the size eligibility standards of the Small Business Administration's Small Business Development Company (SBDC) or Small Business Investment Company (SBIC) programs, or have gross annual revenues of $1 million or less. To meet the purpose test, the activity must promote economic development. An activity is considered to promote economic development if it supports permanent job creation, retention, and/or improvement for persons who are currently low- or moderate-income, or supports permanent job creation, retention, and/ or improvement either in low- or moderate-income geographies or in areas targeted for redevelopment by federal, state, local, or tribal governments. The agencies will presume that any loan to or investment in an SBDC, SBIC, or new markets venture capital company promotes economic development. In addition to their quantitative assessment of the amount of a financial institution's community development activities, examiners must make qualitative assessments of an institution's leadership in community development matters and the complexity, responsiveness, and impact of the community development activities of the institution. In reaching a conclusion about the impact of an institution's community development activities, examiners may, for example, determine that a loan to a small business in a low- or moderate-income geography that provides needed jobs and services in that area may have a greater impact and be more responsive to the community credit needs than does a loan to a small business in the same geography that does not directly provide additional jobs or services to the community.

The rest of the new and revised questions and answers deal with predatory lending, the lending test, and data collection. In addition to the questions and answers presented that relate to the investment test, the Q&A as a whole contains many others that address all facets of the investment test as well as the lending and service tests. The Q&A is available at: www.access.gpo.gov / su_docs / fedreg / a010712c.html. The entire CRA regulation is available at www.federalreserve.gov / Regulations / RegRef.htm.

Community Preservation Corporation Invests Equity in Multifamily Housing

A subsidiary of the Community Preservation Corporation (CPC) has invested in 350 units through an equity fund it established for deteriorated multifamily units and mixed-use projects in urban areas of New York and New Jersey. The subsidiary, CPC Resources, Inc., expects to launch a second equity fund once the capital of its $42.5 million fund has been exhausted.

CPC launched its equity fund, the Opportunity Fund, in December 2000. The fund limits its exposure on any single project to about $6 million, and it invites co-venturers to share in ownership and equity investment, CPC officials said.

The fund will not normally obtain mortgage financing from CPC, and there is an opportunity for financial institutions to provide loans to some major redevelopment projects, they added.

For information, contact John McCarthy of CPC at (212) 869-5300 or: info@communityp.com. CPC's web site is www.communityp.com.

Delaware Economic Opportunity Fund Creates Low- and Moderate-Income Jobs

By Keith Rolland, Community Development Advisor, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia

A Delaware venture-capital fund's investment of $500,000 is enabling a printing company to expand its 150-employee workforce by about 50 percent over several years.

The business, located in Newark, Delaware, received an investment late last year from Intrust Venture Partners of Delaware, LLC (IVPD), which has been renamed the Delaware Economic Opportunity Fund (DEOF) and is now being managed by GS-DE, a wholly owned subsidiary of GSA Management, LLC. Both IVPD and DEOF have had a primary focus on businesses that create jobs for low- and moderate-income individuals or that are led by women or members of racial and ethnic minorities.

Michael J. Kelley, vice president of GSA Management, LLC and previously the manager of IVPD, said that the positions created by the printing-company investment offer livable wages and benefits and a career path for low-skill and semi-skilled workers. As the lead investor, IVPD helped the company raise a total of $3.5 million, consisting of $2 million in venture-capital investments and a $1.5 million bank loan, Kelley explained. Major corporations retain the company on an outsourcing basis to provide their entire printing and fulfillment needs, he said.

Kelley said that he has found "surprisingly strong deal flow" in a relatively small state. Kelley said that until recently, venture capital was not widely available in Delaware and that entrepreneurs there traditionally did not seek venture capital. He added that he expects that DEOF would play an important part in leveraging mainstream financing for projects that create job opportunities for low-income residents of Delaware.

IVPD made four investments that totaled $1.5 million and are expected to create 1100 jobs. One was in a restaurant owned by an African-American woman in the Ship's

...continued on page 13

Minority-Owned Businesses Receive Small Amount of Equity Investments Made

Small business investment companies (SBICs) provided financing totaling $4.2 billion from October 1998 to September 1999 — but only 3 percent of that amount went to businesses at least 50 percent owned by African-Americans, Latinos, native Americans, and Asians, according to a research report.

The data on SBICs, which are privately organized and managed investment firms licensed by the Small Business Administration, are contained in a report released in September 2000 from the Milken Institute, a nonprofit economic-research organization based in Santa Monica, California. The study was conducted jointly with the Minority Business Development Agency of the U.S. Department of Commerce.

The report said minority-owned businesses grew from 1987 to 1997 at the rate of 17 percent a year — about six times the growth rate of all firms. However, based on a venture-capital firm's estimate, minority-owned businesses receive only 2 percent of all private equity investments, the report noted.

The report recommends research and development of equity, mezzanine, and debt instruments attractive to institutional investors, increased investments in minority-owned businesses, and the formation of incubators that will support minority-owned businesses.

Financing minority-owned businesses provides needed capital to a fast-growing business sector while creating a vehicle for greater minority participation in the workforce, the study noted.

Further information on this and other institute studies may be obtained from www.milkeninstitute.org.

Delaware Economic Opportunity Fund Creates Low- and Moderate-Income Jobs ...continued from page 12

Tavern district of downtown Wilmington, an area that is the focus of a major revitalization effort. The other two investments were in a home-décor business and a firm that provides back-office services to small businesses.

Businesses eligible for DEOF investments must have high-growth potential, be located in or serve Delaware, create good-quality jobs for low-income people, or provide a needed service in low-income communities of the state.

DEOF is seeking investments totaling $10 million. The minimum investment for a 10-year partnership in DEOF is $250,000. A closing of the DEOF partnership is expected to occur in the first quarter of 2002.

DEOF has formed an advisory committee of community and business leaders. Two full-time and two part-time employees of GSA Management, LLC are managing the fund, Kelley said.

For information, contact Michael J. Kelley, vice president of GSA Management, LLC at (302) 658-9230, ext. 105, or mkelley@gsamanagement.com.

GS Capital Provides Venture Capital to Minority- and Women-Owned Businesses on East Coast

By Keith Rolland, Community Development Advisor, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia

A $4.1 million venture-capital investment has helped a Wilmington woman start a home-decor business that has created 3000 commission-based positions in just three years.

GS Capital, L.P., a small business investment company (SBIC), made the $4.1 investment to Homes for Living, Inc. GS Capital, L.P. was the lead venture-capital investor in the business. Other investors were the Delaware Innovation Fund and Intrust Venture Partners of Delaware.

GS Capital, L.P. was licensed by the Small Business Administration in 1997 as an SBIC. SBICs are privately owned and managed investment firms that provide venture capital to small businesses. They use their own capital and funds borrowed at favorable rates from the federal government. GS Capital, L.P. raised $20.7 million in private equity and received a two-for-one match from the SBA, creating a $62 million fund. The fund has made 19 investments totaling about $50 million, creating 3310 new jobs.

Richard J. Gessner, Jr., general partner of GS Capital, L.P., said that GS Capital, L.P. is the only SBIC based in the Third Federal Reserve District that focuses primarily on investing in businesses that are

...continued on page 18

Officials with Homes for Living, Inc. (HFL) and GS Capital, L.P. gather at HFL's offices in Wilmington after a recent meeting. GS Capital, L.P., a small business investment company, made a $4.1 million investment in HFL, a home-decor business that has created 3000 commission-based positions in just three years. HFL officials shown in front row are Dana Fecak, director of operations; Carrie Wedo, president and co-founder; Rod Heckman, chief executive officer; and Susan Adams, director of design. In back row are Eilis Rodriguez, customer service representative, and Karri Gilcken, director of communications, of HFL; Michael J. Kelley and Ray Sarnacki, partners in GS Capital, L.P; and Richard J. Gessner, Jr., general partner of GS Capital, L.P.

CRA Investment Opportunities

Organization	Form of Investment	Purpose of Investment	Use of Funds
American Street Financial Services Center (ASFSC)	Grant	Small businesses; revitalize/ stabilize LMI geographies	Support three-year-old bilingual entrepreneurial-training program that provides technical assistance to help entrepreneurs develop business plan & apply for loans from ASFSC. Grants will match federal funds from empowerment-zone contract.
Berean Federal Savings Bank	Deposit	Affordable housing LMI; small businesses	Expand home-mortgage & small-business lending.
Borinquen Federal Credit Union	Deposit	Affordable housing LMI	Expand home-mortgage lending.
Cooperative Business Assistance Corporation	Investment	Small businesses	Capitalize small-business lending pool.
Cooperative Business Assistance Corporation	Grant	Small businesses	Fund administration & special projects.
Delaware Community Investment Corporation (DCIC)	Investment	Affordable housing LMI; revitalize/stabilize LMI geographies	DCIC expects to organize its sixth equity fund. DCIC has raised about $200 million in equity & debt since 1994 & has developed about 3,500 rental-housing units.
First State Community Loan Fund (FSCLF)	Investment	Affordable housing LMI; community services LMI; small businesses; revitalize/stabilize LMI geographies	Equity-equivalent investment sought.
First State Community Loan Fund (FSCLF)	Grant	Affordable housing LMI; small businesses	Matching grants & operating-support assistance sought for individual development account program administered by FSCLF.
First State Community Loan Fund (FSCLF)	Grant	Affordable housing LMI; community services LMI; small businesses; revitalize/stabilize LMI geographies	Grants sought for permanent equity in FSCLF loan pool; loan pool loss reserves; & operating expenses.
Impact Loan Fund, Inc	Investment	Small businesses	Capitalize lending to start-up & early-stage businesses; support operations. Loan fund may also provide housing-rehabilitation loans in the future.
Impact Loan Fund, Inc.	Grant	Small businesses	Capitalize lending to start-up & early-stage businesses; support operations.
Intrust USA	Investment	Small businesses	Investments will be used for working capital to enable Intrust to create regional or statewide equity funds to be operated by CDFIs or community-development entities created to take advantage of new markets tax credits. Investors receive Intrust USA preferred stock, which is convertible into common stock for public offering anticipated within 3 years.
Intrust USA	Investment	Small businesses	Intrust USA co-manages National Economic Opportunity Fund (NEOF), a limited-liability company. NEOF is also co-managed by Community Capital Resources Corporation, an affiliate of National Congress for Community Economic Development. Proceeds will be invested in local or regional funds that specialize in new markets tax credit-qualified investments.
Lancaster Housing Opportunity Partnership	Grant	Affordable housing LMI	Support home-buyer training & fund closing-cost loans.
Murex Investments 1, LLP	Investment	Small businesses; revitalize/ stabilize LMI geographies	SBA-designated new markets venture capital company plans to provide community development venture capital (equity & convertible debt) to manufacturing & early-stage technology businesses. Businesses must pay at least $7.90 an hour, provide benefits, profit-sharing, & be employee-owned. 80% of investments must be in most distressed areas of region.

Investment Minimum	Total Amt. Sought	Time Period for Investment	Term of Investment	Estimated Return	Geographic Area Served	Contact
$5,000	$85,000	2001 to 2002	NA	NA	Philadelphia — North Front to North Sixth streets & Girard to Lehigh avenues	Luis Mora (215) 426-3882 E-mail: ASFSCOED@AOL.COM
None	NA	Currently	Up to 8 years	Approx. up to 4.75%	Primarily West Philadelphia	Benjamin Gilbert (215) 472-4545 E-mail: president@bereanfsb.org
$100,000	$300,000	12/2001	3 to 5 years	2%	North Philadelphia bounded by Olney Ave., Spring Garden St., 10th St., & Front St.	Ignacio Morales (215) 228-4180 E-mail: nacisa0506@aol.com
$250,000	$1.8 million	Currently	5 years	3% to 4%	Camden, Cumberland, Gloucester, Salem, Cape May, & Atlantic counties	R. Michael Diemer (856) 966-8181 E-mail: mdiemercbac2000@aol.com
$5,000	$70,000	Currently to March 2002	NA	NA	Same as above	Same as above
$500,000	$50 million	2004	10 years	8% to 10%	Delaware	Doris Schnider (302) 655-1420 E-mail: dschnider1@aol.com
$100,000	$350,000	Currently	5-year minimum	0% to 3%	Delaware	Caroline Glackin (302) 652-6774 E-mail: Cglackin@diamondnet.org
$5,000	$500,000	Currently	NA	NA	Delaware	Same as above
$1,500	Unlimited	Currently	NA	NA	Delaware	Same as above
$25,000	$150,000	Currently	5 to 10 years	2% to 4%	25 census tracts in North Philadelphia	Roy G. Viehweger (215) 423-2944, ext. 137 E-mail: loanfund@impactservices.org
$25,000	$150,000	4/2002 to 12/2002	NA	NA	Same as above	Same as above
$10,000	$499,000	Currently	3 to 5 years	20% or more.	National, with concentration in DE, TX, NJ, MD, DC, & PA	James F. Mingey (302) 571-8100, ext. 11 E-mail: jmingey@intrustusa.com
$1 million	$25 million, expanding to $100 million over four years	Currently	7 to 8 years	15% or more.	National	Same as above
$4,000 to $20,000	$200,000	12/2001 for 2002; 12/2002 for 2003	NA	NA	Lancaster County	Daniel E. Basehoar (717) 291-9945 E-mail: dbasehoar@lancasterhousing.org
$100,000	$11 million	8/2001 to 1/9/2002	10 years	8% to 12%	Eastern PA, southern NJ, & northern DE	Joel Steiker (215) 951-0300 E-mail: Joel@RHD.org

Organization	Form of Investment	Purpose of Investment	Use of Funds
Murex Investments 2, LLP	Investment	Small businesses; revitalize/stabilize LMI geographies	Same as Murex 1 on pages 14-15, except that 80% of investments must be in severely distressed areas of region.
National Community Capital Association	Investment	Affordable housing LMI; community services LMI; small businesses	Expand financing to CDFIs around U.S.
National Community Capital Association	Grant	Small businesses	Expand training, technical assistance, & financing to CDFIs.
Neighborhood Housing Services of Reading, Inc. (NHSR)	Investment	Affordable housing LMI; revitalize/stabilize LMI geographies	Equity-equivalent investment for 52-unit project for older people in Berks County. NHSR is community housing development organization for project.
Neighborhood Housing Services of Reading, Inc. (NHSR)	Grant	Affordable housing LMI; revitalize/stabilize LMI geographies	Fund financing gap in 52-unit project described above.
New Jersey Community Loan Fund	Investment	Affordable housing LMI; community services LMI; small businesses; revitalize/stabilize LMI geographies	Capitalize affordable-housing, small-business, community-facility & child-care loans.
New Jersey Community Loan Fund	Grant	Affordable housing LMI; community services LMI; small businesses; revitalize/stabilize LMI geographies	Fund technical assistance (TA), including TA provided for child-care facility development, & operating support.
Pennsylvania Appalachian Capital Alliance	Investment	Small businesses	Capitalize loans to businesses owned by low- and moderate-income individuals.
Pennsylvania Appalachian Capital Alliance	Grant	Small businesses	Same as above; also, to fund operations.
Philadelphia Neighborhood Housing Services, Inc. (PNHS)	Grant	Community services LMI; revitalize/stabilize LMI geographies	Support PNHS' consumer workshops on financial literacy, predatory lending, & home ownership.
Rural Enterprise Development Corporation (REDC)	Grant	Small businesses	Expand REDC's equity capital.
The Reinvestment Fund (TRF)	Investment	Affordable housing LMI; community services LMI; small businesses; revitalize/stabilize LMI geographies	Investment in TRF's core fund. Investment governed by prospectus.
The Reinvestment Fund (TRF) Charter-School Joint Venture	Investment	Community services LMI	A joint venture to be formed by TRF & the National Cooperative Bank Development Corporation will seek investments in charter-school loan program.
The Reinvestment Fund (TRF) New Markets LP or LLC	Investment	Community services LMI; small businesses	TRF expects to form new markets LP or LLC to make economic-development investments in low-income communities. Will seek equity investments in conjunction with new markets tax credits.
TRF Urban Growth Partners, LP	Investment	Small businesses	Ltd. partnership interest in community-development venture-capital fund. TRF has received commitments of $20 million.
United Bank of Philadelphia	Investment	Affordable housing LMI; community services LMI	Seeks investments to support growth in home-mortgage & community-service facility lending.
United Bank of Philadelphia	Grant	Small businesses; revitalize/stabilize LMI geographies	Seeks grants to capitalize new small-business microloan fund.
USSCO Federal Credit Union	Investment	Small businesses	USSCO, established in 1958 & located in Johnstown, Pa., is considering participations in small-business loans. Currently makes home-mortgage & auto loans.
Women's Opportunities Resource Center (WORC)	Investment; grant	Small businesses	WORC seeks funds to increase capital of microbusiness-loan fund & to support operations.

Investment Minimum	Total Amt. Sought	Time Period for Investment	Term of Investment	Estimated Return	Geographic Area Served	Contact
$100,000	$10 million	1/1/2002 to 6/30/2003	10 years	8% to 12%	Eastern-Central PA, NJ, & DE	Joel Steiker (215) 951-0300 E-mail: Joel@RHD.org
$100,000	$20 million	Currently	7 to 15 years	2%	National	Allyson B. Randolph (215) 923-4754, ext. 206 E-mail: allysonr@communitycapital.org
$5,000	$2 million	Currently	NA	NA	National	Same as above
NA	$3 million	Currently to 2/1/2002	Minimum of 15 years	Not known	Berks County	Ronald E. Miller (610) 372-8433 E-mail: rmiller@nhsreading.org
NA	$200,000	Currently to 2/1/2001	NA	NA	Berks County	Same as above
$5,000	$10 million	Currently	1 to 25 years; 5 or more preferred	0% to 4%	New Jersey	David M. Scheck (609) 989-7766, ext. 500 E-mail: dscheck@njclf.com
No minimum	$1.5 million for operations & $1 million for child-care initiatives	Currently	NA	NA	New Jersey	Same as above
$100,000	$3 million during 5-year period	Currently	8 years	3.5% to 5%	52 primarily rural counties (not including southeastern PA)	James N. Graham (717) 909-8787 E-mail: Exdirpaaca@aol.com
$10,000	$200,000	Currently	NA	NA	Same as above	Same as above
NA	NA	Currently	NA	NA	City of Philadelphia	Bernard Hawkins (215) 988-9879 E-mail: bhawkins@phillynhs.org
$5,000	Unlimited	Currently	NA	NA	North-Central PA	Frank Lindenfeld (570) 784-7384 E-mail: DrsL@epix.net
$1,000	$9 million (TRF's goal for 2001 & 2002)	Currently	2 years	2% to 7% (subject to amt. & term)	21-county region in eastern PA, central & southern NJ, & northern DE	Don Hinkle (215) 925-1130, ext. 212 E-mail: hinkled@trfund.com
NA	$25 million to $50 million	2002; then ongoing	Approx. 5 to 15 years	Not yet available	NJ, New York City, PA, DE, MD, DC, & VA	Same as above
NA	$25 million to $100 million	Estimated 2003	Approx. 7 to 10 years	Not yet available	Mid-Atlantic U.S.	Same as above
$1 million	NA	Currently to summer 2002	Approx. 7 to 10 years	See private placement memorandum	NJ, PA, DE, MD, DC	Same as above
$500,000	$2.5 million	Currently	2 years	Not known	Metropolitan Philadelphia region	Evelyn F. Smalls (215) 351-4638 E-mail: esmalls@unitedbankofphiladelphia.com
$500,000	$2.5 million	Currently	NA	NA	Philadelphia and possibly Camden County, NJ	Same as above
NA	$1 million	Currently	5 years	6% to 10%	Cambria & Somerset counties, PA	Brian R. Riffle (814) 535-4646 E-mail: briffle@floodcity.net
NA	NA	Currently	NA	Negotiable	Philadelphia, Bucks, Montgomery, Chester & Delaware counties, PA	Ana G. Rodriguez (215) 564-5500 E-mail: coo@worc-pa.org

GS Capital Provides Venture Capital to Minority- and Women-Owned Businesses on East Coast *...continued from page 13*

owned by members of ethnic and racial minorities or women or that are located in low- and moderate-income census tracts. Of GS Capital's 19 investments, 17 have been in such businesses.

There continues to be "a very underserved market" for minority-owned and women-owned businesses nationwide and especially along the East Coast.

GS Capital invests mostly in service-industry businesses in the northeastern corridor, which encompasses Delaware, Maryland, Massachusetts, New Jersey, New York, Ohio, and Pennsylvania. Its investments are usually for expansion or acquisition, rather than start-ups. About 70 percent of its investments have been to franchise businesses. GS Capital has found this an attractive niche because of the excellent financial performance of most major franchises, management oversight provided to the entrepreneur by the franchisor, stable cash flow, ability to attract other private capital, and an ability to create jobs.

The most likely exit mechanisms for GS Capital investments are through a recapitalization in which either management or employees buy out GS Capital's position, sale of the company, or merger with another equity fund. GS Capital has not yet exited from any of its 19 investments, so its investors have not yet received a return. Gessner said that he expected GS Capital's return on its gross portfolio to be between 20 percent and 25 percent.

GS Capital's limited partners include First Union National Bank, JP Morgan Chase & Co., M&T Bank, MBNA Community Development Corporation, PNC Bank, N.A., Sovereign Bank, and State Street Bank & Trust Co. Others are the city of Philadelphia Board of Pensions, New Jersey Economic Development Authority, and the Prudential Insurance Company of America.

GSA Management LLC, which manages GS Capital, has begun to seek capital commitments of $75 million for a new fund that will also be operated as an SBIC. Named GS Capital II, L.P., the fund will have three objectives: achieving a competitive return; assisting minorities and women to create and expand businesses; and creating jobs. GS Capital II intends to invest in privately held consumer retail firms, franchises, and service and technology businesses. GSA Management expects an increase in the number of solid expansion-stage companies that have received some funding but are unable to attract new capital. GS Capital II is expected to be different from GS Capital in that it will have a more diversified portfolio and will serve some additional locations along the East Coast.

Gessner said that he continues to see "a very underserved market" for minority-owned and women-owned businesses nationwide and especially along the East Coast. He added that there is "huge potential" for such businesses, noting that women are the fastest-growing business incorporators in the United States.

GS Capital II is expected to have a $10 million closing by the end of 2001 and will continue to seek funds in 2002, according to Gessner. The minimum investment is $1 million.

The advisory committee for GS Capital II includes William Stallkamp, retired vice chairman of Mellon Financial Corporation, and Dick Vermeil, head coach of the Kansas City Chiefs and former head coach of the St. Louis Rams and the Philadelphia Eagles.

For information, contact Richard J. Gessner, Jr., general partner, GS Capital, L.P., at (610) 254-4224 or rgessner@safeguard.com.

Pennsylvania's Neighborhood Assistance Program — A Popular Way to Make Grants and Get Tax Credit

By Keith Rolland, Community Development Advisor, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia

Pennsylvania's Neighborhood Assistance Program (NAP) has been a "win-win" proposition for banks for three decades: they can make grants to nonprofit organizations that usually count toward the Community Reinvestment Act investment test, and they get state tax credits for up to 70 percent of their contributions. In fact, the NAP is such a compelling idea that 14 states have replicated Pennsylvania's legislation authorizing the NAP.

Fred N. Abrams, division chief in the office of community services of the Pennsylvania Department of Community and Economic Development (DCED), said that the NAP "has reduced the cost of doing business to the state and contributors and has enabled nonprofits to receive contributions they otherwise would not have gotten. Everybody wins!" Abrams, who has overseen the program for about 30 years, works to encourage banks and nonprofit organizations to use the NAP as part of community-development partnerships.

NAP has three variations: the basic NAP; the NAP / Comprehensive Service Program (NAP / CSP); and the NAP / Enterprise Zone Tax Credit Program. Banks and other corporations can obtain NAP tax credits for up to $250,000 each year ($600,000 in the case of the NAP / CSP).

Under the basic NAP program, contributors who qualify for the 50 percent credit also can obtain a federal charitable tax deduction, resulting in a cost of about $0.24 for each contributed dollar. Under the NAP / CSP, contributors can obtain state tax credits for 70 percent of contributions of either $100,000 or $250,000 a year for 10 years. Finally, corporations that own or lease buildings or land in the state's 56 Enterprise Zones can receive a 20 percent tax credit for physical improvements, such as rehabilitation or expansion.

Pennsylvania has awarded about $200 million in NAP tax credits since the Neighborhood Assistance Act was passed in 1967. As successful as the NAP has been, its guidelines will be completely revised for the first time since the program's inception. The revisions, which will be completed by next summer, will clearly outline the responsibilities of corporations and nonprofits "to make the program better and more useful," Abrams explained. He said he also hoped to start a peer-review program for corporations and nonprofits participating in the NAP \ CSP.

NAP "has reduced the cost of doing business to the state and contributors and has enabled nonprofits to receive contributions they otherwise would not have gotten. Everybody wins!"

The NAP has been used extensively by the state's largest banks, most regional banks, and some community banks, Abrams explained. He said that the NAP / CSP in particular could be used to a greater extent, and he expressed interest in working with community banks that have not used the basic NAP program to date.

Pennsylvania makes available $18 million in NAP-related tax credits each year. Corporations must apply to DCED to become eligible for NAP tax credits and have up to five years in which to use the credits after they have been awarded. Tax credits are awarded for grants that benefit a low-income community or individuals with income under 150 percent of federal poverty guidelines. The guidelines, issued by the U.S. Department of Health and Human Services, are based on the poverty thresholds used by the Bureau of the Census to prepare its statistical estimates of the number of persons and families in poverty.

Contributions for the 50 percent tax credits can be in-kind technical assistance as well as cash. A technical-assistance contribution could consist of a bank's attorney or other employee who provides

...continued on page 20

Pennsylvania's Neighborhood Assistance Program — A Popular Way to Make Grants and Get Tax Credit

...continued from page 19

technical assistance during regular work hours to a nonprofit organization, Abrams said. To become eligible for the tax credits, in-kind technical assistance must be included in a nonprofit organization's budget approved by DCED.

In the NAP / CSP, a bank or other corporation works directly with a nonprofit organization to develop and implement a neighborhood-revitalization plan. The first year of a 10-year grant commitment can be used to develop a comprehensive plan that addresses community needs in housing, education, health and social services, community development, job training, crime prevention, and resident involvement. At present, there are 18 NAP / CSP partnerships in Pennsylvania.

Ten of the 18 NAP / CSP partnerships have been in Philadelphia and have become known as the "Philadelphia Plan." Philip Price, Jr., a consultant who assisted the formation of many of the Philadelphia partnerships, recalled that the CSP was modeled after Tasty Baking Company's support for the Allegheny West Community Development Project. For the past 33 years, Tasty Baking has provided grants and technical assistance to the project, which has rehabilitated 370 single-family houses for sale or rent, developed 20 mixed-use projects, and provided job training, reading enrichment, and other programs.

For further information, contact the DCED Office of Community Services at (717) 787-1984. In Philadelphia, Philip Price, Jr., may be reached at (215) 564-5678 or ppricejr215@aol.com.

Pennsylvania Housing Finance Agency Plans About $200 Million in Mortgage Revenue Bonds

About $210 million in Pennsylvania Housing Finance Agency (PHFA) mortgage-revenue bonds (MRBs) will be available for sale in 2002. The majority of the bond proceeds are used to make loans to first-time low- and moderate-income home buyers.

Approximately $70 million of the MRBs will be available for purchase on or about March 15, July 15, and October 15. The MRBs are tax-exempt and typically provide a return of 3.25 percent to 5.5 percent, are sold in denominations of $5000, and have terms of six months to 30 years. About $210 million in MRBs are also expected to be available in 2003.

In addition, PHFA will make available in 2002 and in 2003 approximately $21 million in low-income rental housing tax credits. Half of next year's credits will likely be awarded in May, and the balance will be awarded in September.

For information on the MRBs, contact Joseph Knopic at (717) 780-3837 or knopic@phfa.org. For information on the tax credits, contact Dave Evans at (717) 780-3882 or devans@phfa.org.

Community Development Trust Plans Equity Offering in 2002

The Community Development Trust (CDT), a real estate investment trust (REIT) created solely to acquire community-development assets, anticipates raising additional equity in the second or third quarter of 2002.

CDT was created by the Local Initiatives Support Corporation, which has a minority investment in the REIT. CDT raised $32 million in equity from 18 institutional investors in 1999. In its two primary activities, it invests long-term equity capital to preserve affordable-housing developments, and it purchases multifamily mortgages from community lenders.

CDT, which is based in New York City, makes investments in different parts of the U.S. Its charter requires that it invest in assets that meet CRA requirements. It plans to use equity raised in 2002 to invest in additional affordable-housing developments and community-service facilities.

For information, contact Judd S. Levy at (212) 271-5099 or levy@commdevtrust.com.

Pennsylvania Department of Community and Economic Development Has Range of CRA Investment Possibilities

By Keith Rolland, Community Development Advisor, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia

Pennsylvania Department of Community and Economic Development (DCED) programs involving the state's community-development bank, first-time farmers, and student scholarships have CRA-investment possibilities for financial institutions.

Investments in the Pennsylvania Community Development (PCD) Bank program will fund loans to state-accredited community development financial institutions (CDFIs). The minimum PCD Bank investment amount is $250,000 for a seven-year term. PCD Bank investments, which are expected to pay a market-rate return, are considered on a case-by-case basis.

A second possibility involves the next generation farmer (NGF) program, which finances farm purchases by first-time farmers. Tax-exempt bond issues of $250,000 or less are issued by local industrial-development authorities and are usually purchased by banks. Up to $2.9 million of the bonds have been issued or are expected to close before the end of this year. Next year, at least $2 million of the bonds are expected to be issued and available for purchase.

A third investment possibility involves DCED's educational improvement tax credit program (EITC). EITC makes available annual tax credits of $20 million for elementary- and high-school scholarship programs and another $10 million for innovative educational programs in the state's public schools. Corporations receive a 75 percent tax credit for a one-year contribution and a 90 percent tax credit for a two-year contribution.

Nonprofit organizations operate the scholarship and school programs. An interested bank can ask the nonprofit organizations that operate such programs in its trade area about whether any of the programs serve a majority of low- or moderate-income (LMI) students. Bank contributions to programs that serve such students, or serve students in LMI census tracts, may qualify under the investment test.

For information on the PCD Bank, contact Carlton L. Ketchen at (717) 720-1376 or cketchen@state.pa.us. For information on the NGF, contact Gail Wagner at (717) 720-1374 or gaiwagner@state.pa.us. For information on EITC, contact Ted Knorr at (717) 720-1420 or tknorr@state.pa.us.

Delaware State Housing Authority Has Bond, Grant, and Equity CRA Investment Opportunities

By Keith Rolland, Community Development Advisor, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia

In Delaware – a small state with many banks – the state housing authority has created bond and grant opportunities to respond to the demand for CRA investments.

Delaware is planning $60 million in two single-family mortgage-revenue bond issues for 2002. The majority of the bond proceeds will be used to make mortgages to low- and moderate-income first-time home buyers.

James M. Peffley, housing finance administrator at the Delaware State Housing Authority (DSHA), said that next year, for the first time in DSHA's history, a portion of the issues will include "premium bonds." The premium bonds

...continued on page 22

The bonds were designed to provide an opportunity for financial institutions in Delaware to meet their CRA responsibilities.

Delaware State Housing Authority Has Bond, Grant, and Equity CRA Investment Opportunities

...continued from page 21

will enable the agency to provide down-payment and closing-cost grants for about 4 percent of the loan amount. Investors, who will purchase the premium bonds above par at a slightly higher interest rate than untargeted bonds, will receive a yield equivalent to that on the rest of the bond issue, Peffley said. Peffley explained that many states have found that first-time buyers especially need down-payment and closing-cost assistance, rather than a reduction in the interest rate.

Another portion of the two bond issues next year will include CRA bonds, which are structured specifically for banks needing CRA investments. CRA bonds produce a sizable reduction in DSHA's cost of funds and, therefore, in the mortgage rate it is able to offer its borrowers. The bonds were designed to provide an opportunity for financial institutions in Delaware to meet their CRA responsibilities. More than half of the $60 million bond issues will consist of premium and CRA bonds, Peffley said. All the bonds in these issues will be sold in $5000 denominations.

DSHA works closely with banks in the state and contacts the banks before planning a bond issue to get an indication of the banks' willingness to invest, Peffley noted. In another CRA investment possibility, DSHA is seeking grants of $3 million to $5 million in 2002 in connection with homes that will be built for low- and moderate-income buyers under the Delaware Housing Partnership (DHP). The grants will be used to provide down-payment and closing-cost assistance loans.

DSHA is also seeking grants of $250,000, primarily from banks, for the Housing Capacity-Building Program, which in turn provides grants to improve the capacity of nonprofit organizations to build or maintain housing. The program is a partnership of DSHA, the Delaware Community Investment Corporation, and the University of Delaware Center for Community Development and Family Policy.

In addition, DSHA will allocate low-income housing tax credits (LIHTC) totaling about $2 million next year — double the amount it has had in the past — creating opportunities for equity investments in developments that will be built with the tax credits. Actually, the agency especially needs loans at below-market rates for LIHTC projects next year because it will not have enough subsidy funds to fill financing gaps in LIHTC-financed projects, Peffley said.

For information, contact James M. Peffley at (302) 577-5005 or JIM@dsha.state.de.us.

New Jersey Economic Development Authority Seeks CRA Investments in Five Programs

By Keith Rolland, Community Development Advisor, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia

The New Jersey Economic Development Authority (EDA) is seeking bank investments in several programs in which banks have previously provided loans or made grants. In addition, the EDA is interested in working with banks to develop new programs for brownfields pre-development and community development related to school construction.

Banks can work with the EDA's Fund for Community Economic Development, which assists nonprofit organizations and for-profit groups in designated urban areas to provide loans to microbusinesses and small businesses or to develop real estate projects. They can make equity investments in real estate projects and in turn receive nonrecourse notes, or they can provide grants for real estate feasibility studies, EDA officials explained. In the past, banks have participated in the program by providing loans to nonprofit and for-profit organizations on a project-by-project basis.

...continued on page 23

New Jersey Economic Development Authority Seeks CRA Investments in Five Programs

...continued from page 22

The EDA also will seek its second round of grants early in 2002 to fund a business-training program through its Strengthening the Economy with Entrepreneurial Development (SEED) program. This program is a great opportunity for banks to develop new business relationships, EDA officials said. The grants would fund training, offered twice a year for new entrepreneurs, particularly women and members of racial and ethnic minorities, in 10 primarily urban locations. The EDA also invites banks to provide facilitators, review business plans, and provide financing to at least three entrepreneurs who have completed the training.

In addition, the EDA seeks investors to purchase tax-exempt bonds for day-care centers, charter schools, and social-service projects in urban and low-income communities, federal empowerment zones, and enterprise communities. The EDA expects to issue about $500 million in bonds next year, depending on economic conditions. A minimum investment amount is $750,000; the term is usually 10 to 20 years. (The EDA seeks letters of credit as an alternative to purchase of the bonds.)

The EDA seeks investors to purchase tax-exempt bonds for day-care centers, charter schools, and social-service projects in urban and low-income communities, federal empowerment zones, and enterprise communities.

The EDA would like to discuss with banks two other programs that are in the preliminary stages: school renaissance zones and a brownfields redevelopment program. The first program is related to the state's responsibility, following a court decision, to finance and construct public schools in 30 special-needs school districts. The EDA is looking to stimulate economic-development projects and community facilities and thereby enhance the communities that include the new schools. The EDA, which plans to establish zones in about five school districts in 2002 on a pilot basis, is seeking equity investments, loans, or grants for commercial, recreational, and health-facility projects, among others.

In cooperation with banks, the EDA is also interested in organizing an equity or loan pool to fund pre-development site preparation or engineering and other studies on brownfields and other older industrial sites in the state's urban aid communities. Funds would not be used for environmental cleanup. The EDA seeks equity investments either in a pool or on a case-by-case basis. Another option is a loan participation on a project-by-project basis.

For information, contact Rose M. Smith, Director, Marketing and Policy, EDA, at (609) 292-0359 or rms@njeda.com.

Penn Venture Partners Focuses on Venture Capital in Primarily Rural 34-County Pennsylvania Region

By Keith Rolland, Community Development Advisor, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia

Penn Venture Partners (PVP), a conditionally approved new markets venture capital company (NMVCC), wants to establish a $25 million fund that will invest in businesses in a primarily rural 34-county region in Pennsylvania.

PVP represents a joint venture between the Ben Franklin Technology Center of Central and Northern Pennsylvania, Inc. (BFTCCNP) and Zero Stage Capital Company, an established venture-capital firm in Boston.

PVP will focus on a 34-county region now served by BFTCCNP — a mostly rural region in central and northwestern Pennsylvania that includes such cities as Erie, Harrisburg, Lancaster, Williamsport, and York. BFTCCNP is one of four Ben Franklin Technology Centers that have been providing early-stage financing, technical assistance, and other services to businesses in Pennsylvania for nearly two decades.

V. F. Russo, managing director of PVP and president and chief executive officer of BFTCCNP, said that there are virtually no venture-capital firms based in PVP's targeted region. PVP has commitments for $9.7 million and hopes to raise an additional $0.3 million. It is also raising funds for technical assistance.

PVP will focus on a mostly rural region in central and northwestern Pennsylvania that includes such cities as Erie, Harrisburg, Lancaster, Williamsport, and York.

PVP, which will invest a substantial portion of its capital in businesses located in low-income areas of Pennsylvania, is one of seven NMVCCs across the United States that have been conditionally approved by SBA.

Before joining BFTCCNP in 1997, Russo held positions with United Technologies Corporation as director of technical programs in China, director of European operations, and director of business development. Russo, who opened the first wholly foreign-owned technology center in China, holds a doctorate in physics from Penn State University.

For information on PVP, contact V. F. Russo at (814) 863-4881 or vfrusso@psu.edu. Information on BFTCCNP is available at www.cnp.benfranklin.org. Information on NMVCCs is available at www.sba.gov/inv or at sbic@sba.gov.

NCCA Starts Asset-Management Services for Bank Investors in CDFIs

By Keith Rolland, Community Development Advisor, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia

National Community Capital Association (NCCA) has started an asset-management service in which it will underwrite, monitor, and manage bank loans to investments in community development financial institutions (CDFIs).

NCCA, which has a decade's experience in financing CDFIs, was in the process of developing an asset-management contract with its first client in mid-November.

NCCA will manage loans and investments in a broad range of CDFIs — entities certified by the CDFI Fund as well as nonprofit community loan funds, community development venture capital funds and credit unions, and microenterprise lenders. Allyson B. Randoph, director of external relations at NCCA, said that "the banks make the final loan or investment decision and get to keep the transaction

NCCA Starts Asset-Management Services for Bank Investors in CDFIs *...continued from page 24*

on their books, but they can also get helpful intervention from NCCA if the loan or investment runs into difficulty."

In another relatively new service, NCCA analyzes the number and types of CDFIs in different markets. Randolph explained that this analytic service is useful for banks that are entering a new market or for those that have worked with one or two leading CDFIs and want to know about others in that market. In this service, NCCA provides information on the focus, activity levels, and investors and funders in CDFIs. Users pay an hourly consulting fee.

This analytical service is useful for banks that are entering a new market or for those that have worked with one or two leading CDFIs and want to know about others in the market.

Meanwhile, NCCA is developing an assessment and rating system to help investors evaluate the financial risk and return as well as the social impact of prospective CDFI investments.

Since 1991, NCCA, which is primarily funded by banks, foundations, churches, and the CDFI Fund, has provided $22.6 million in loans and $4.1 million in equity investments and program-development grants. It had 102 members as of mid-November.

For further information, contact Allyson B. Randolph at (215) 923-4754 or allysonr@communitycapital.org.

Murex Investments I, L.P. Plans to Invest in Businesses Located in Very Low-Income Areas

By Keith Rolland, Community Development Advisor, Community and Consumer Affairs Department, Federal Reserve Bank of Philadelphia

Murex Investments I, L.P. (MI), a conditionally approved new markets venture capital company (NMVCC), wants to establish an $11 million fund for investments in businesses located in very low-income census tracts of eastern Pennsylvania, southern New Jersey, and northern Delaware. MI will also invest in some businesses that are located outside of those tracts but that employ a majority of low-income individuals.

MI is a subsidiary of Resources for Human Development (RHD), a nonprofit organization based in Philadelphia that has over 2600 employees in six states. MI, founded in 1998 and certified as a CDFI by the U.S. Treasury Department in the fall of 2000, has 5.5 full-time equivalent employees, consisting of Joel Steiker, a business developer with MI; an operations manager; a fundraiser; a certified public accountant; and a venture capitalist.

MI is seeking to raise $5.5 million in order to trigger a matching investment by the U.S. Small Business Administration (SBA). To date, MI has received nearly $4 million in commitments. In addition, MI is raising $1.65 million in technical assistance dollars, which the SBA will match 1 for 1. Such funds will be used to provide technical assistance in finance, marketing, operations, and workforce development. An MI subsidiary will be the general partner, and investors will invest in a 10-year limited partnership, which will be managed by Katalyst, a venture capital firm located in Conshohocken, Pennsylvania. Steiker stated that he expected that the 10-year limited partnership would be fully invested within four years and would begin to provide returns by its sixth year.

In explaining the fund's differentiating factors, Steiker explained that MI has a "double bottom line investment philosophy — it seeks

...continued on page 26

Murex Investments I, L.P. Plans to Invest in Businesses Located in Very Low-Income Areas *...continued from page 25*

strong financial returns from companies in which it invests, and it wants returns to be shared with employees through profit-sharing and employee ownership.

"We believe that if you tie performance to profit-sharing, you'll build strong companies. Profit-sharing will motivate employees to be thinking when they do their job, and they will behave like owners."

In furthering its social goals, MI at present invests only in manufacturing and service companies that pay "living wages" (at least $7.90 an hour) and provide health-care benefits for each employee and that enable the workforce to own at least 10 percent of the company. MI will continue this investment approach as an NMVCC.

To date, MI has invested nearly $3 million in seven companies, and one investment is pending. CitySort, a mail-fulfillment business located in the American Street Empowerment Zone of Philadelphia, was on the verge of bankruptcy at the time of MI's investment. As a result of MI's investment, CitySort has leveraged $2.7 million in financing from Prudential Insurance Company and has since stabilized, Steiker said. CitySort has 50 employees and annual sales of about $3 million. MI also invested in Sun & Earth, a Norristown, Pennsylvania, manufacturer of nonchemical household cleaning products.

MI has a "double bottom line investment philosophy" — it seeks strong financial returns from companies in which it invests, and wants returns to be shared with employees throgh profit-sharing and employee ownership.

MI's board of managers and investment committee include Michael Forman, senior partner of Klehr, Harrison, L.L.P.; Larry Chimerine, director and chief economist of the Economic Strategy Institute; Robert McCord, managing director of Pennsylvania Early Stage Partners; James Steiker, founder of Steiker, Fisher and Olson; and Robert Fishman, executive director of RHD.

MI is also establishing an additional fund that will invest in businesses that primarily employ low-income individuals and that are located in low-income census tracts of northern New Jersey and central Pennsylvania, as well as the target geographic areas of its first fund. This venture capital fund will follow the "double bottom line investment philosophy," but it will not be an NMVCC, Steiker said. He said that MI has begun to raise funds for this second fund and he expects that it will close in December 2002.

For further information, contact Joel Steiker at (215) 951-0300, extension 3183, or joel@rhd.org.

Calendar of Events

Microenterprise Tools and Techniques

A program developed by MicroNet (Maine's association of microenterprise lenders), Massachusetts Microenterprise Coalition, and the Federal Reserve Bank of Boston

January 17-18, 2002, Providence, Rhode Island
March 5-6, 2002 Hartford, Connecticut
For information, call Arneese Brown, Community Affairs Department, Federal Reserve Bank of Boston, 617-973-3174

2002 Community Reinvestment Conference

A conference sponsored by the Federal Reserve Bank of San Francisco, in cooperation with the FDIC, OCC, and OTS

January 30-February 1, 2002
San Francisco, California
To be added to the mailing list for the conference, call Bruce Ito at 415-974-2422. For information about the agenda, call Lena Robinson at 415-974-2717.

Tools for Building Sustainable Rural Communities

A conference sponsored by the Federal Reserve Bank of Philadelphia

April 25-26, 2002, The Woodlands Inn & Resorts, Wilkes-Barre, PA
For information, contact Vera Bowders at 215-574-6570 or vera.bowders@phil.frb.org

2003 Community Affairs Research Conference: "Sustainable Community Development: What Works, What Doesn't, and Why"

A conference sponsored by the community affairs officers of the Federal Reserve System
March 27-28, 2003, Capitol Hilton Hotel, Washington, DC

Call for Papers
Individuals interested in presenting research should submit a completed paper, detailed abstract, or proposal by April 22, 2002, to:

William C. Hunter
Senior Vice President and Director of Research
Federal Reserve Bank of Chicago
230 South LaSalle Street
email: Academic-Systems-Conference@chi.frb.org
phone: 312-322-5810

Do we have your correct address? Please check the mailing information below. If it's not correct, please let us know so that we can update our mailing list. Do you want to get on the *Cascade* mailing list? Let us know. Send corrections or requests to be added to the *Cascade* mailing list to betty.c.floyd@phil.frb.org. Or call 215-574-6458.

Cascade is published three times a year by the Community and Consumer Affairs Department of the Federal Reserve Bank of Philadelphia.

Editor ____________________ Sally Burke
Designer ____________________ Melissa Kinney

CASCADE
Federal Reserve Bank of Philadelphia
100 N. 6th Street
Philadelphia, PA 19106-1574

FORWARDING & ADDRESS CORRECTION REQUESTED

PRESORTED STANDARD

U.S. POSTAGE PAID
Philadelphia, PA
PERMIT No. 529