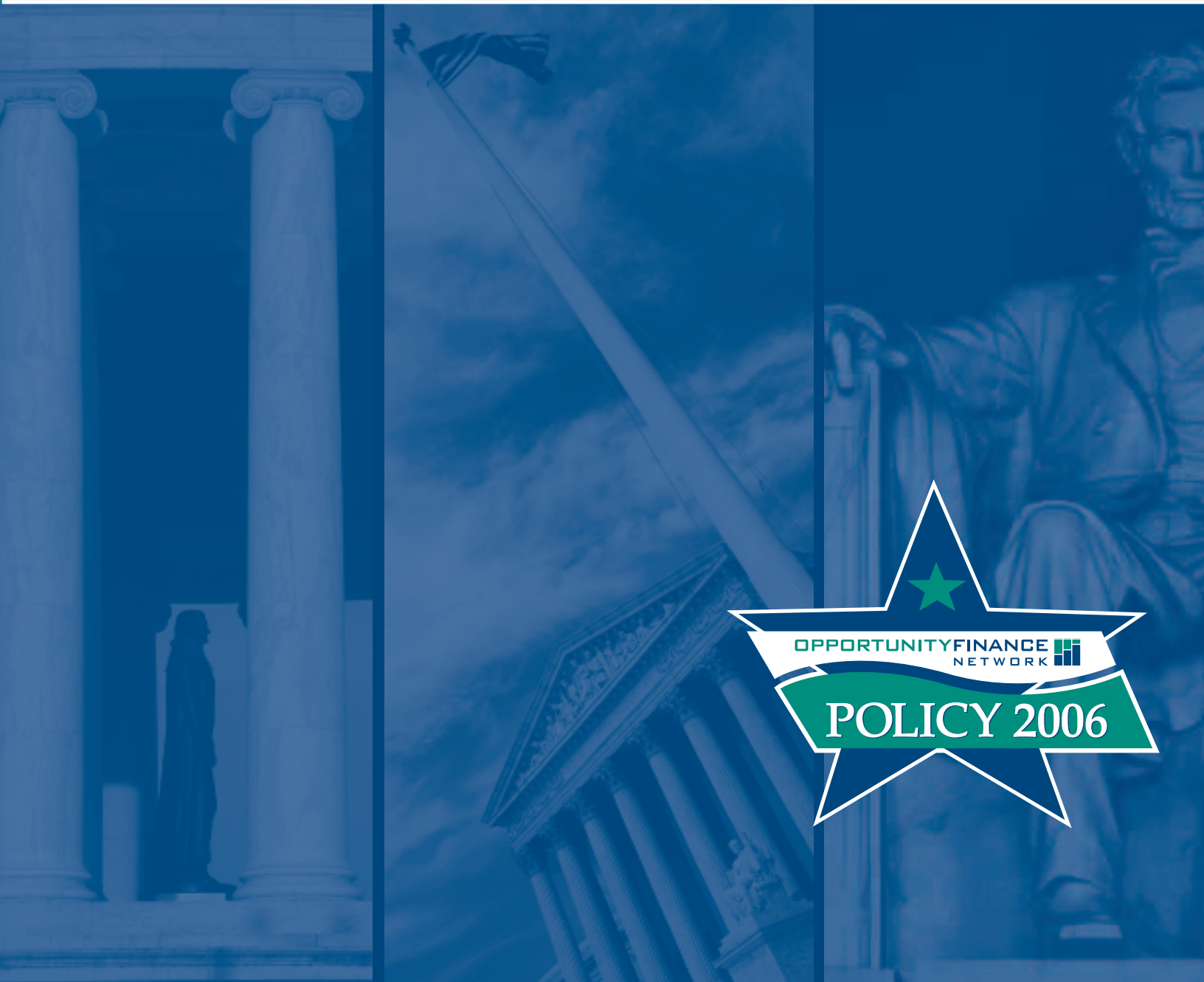


INTO THE ECONOMIC MAINSTREAM

A Platform for Opportunity Finance Policy

AUGUST 2006



■ A Platform for Opportunity Finance Policy

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Access to capital can give all Americans the ability to enter the economic mainstream to own a home or business, pursue economic well being for their families and communities, and secure a safe and more prosperous future. Providing equal economic opportunities is fundamental to any effort to create an inclusive prosperity where all people will have the opportunity and ability to act in the best interests of their communities, themselves, and future generations.

Opportunity Finance Network increases access to capital in “opportunity markets”—the people, communities, and markets that are outside the economic mainstream today. Often overlooked because of demography, geography, or bias, these critical markets will drive U.S. economic growth in the decades ahead. Connecting these opportunity markets to the economic mainstream will expand the scope of opportunity to include people and places that have long been excluded. At the same time, opportunity finance broadens and deepens the pool of innovation and ideas that will foster long-term economic well being. Mainstream markets need opportunity markets, too.

Opportunity Finance Network's policy platform seeks to make connections that help people and communities enter the economic mainstream and help mainstream institutions enter opportunity markets. This paper describes opportunity finance, discusses its role in the American market economy, and outlines key ways that the government can support its work and, through that support, grow the economy and increase inclusion for all.

■ What is Opportunity Finance?

The opportunity finance industry of Community Development Financial Institutions (CDFIs)¹ and other private sector financial intermediaries is a critical engine for the nation's economic growth and inclusion. CDFIs are public purpose institutions that combine private market discipline with public missions. They are committed to identifying market gaps and delivering products and services to people and communities not adequately served, and to providing technical assistance that makes customers better able to function in the market economy.

What distinguishes opportunity finance from *conventional finance* is that it is profitable but not always profit maximizing. What differentiates opportunity finance from *community development* is that it is accountable to financial and consumer markets—that is, to its investors and its consumers—it is not subsidy driven like many government programs.

And what it sets it apart is results—we find and finance opportunities that others miss. Our financing has resulted in significant numbers of new jobs, jobs preserved, quality, affordable housing units, and new commercial and community facility space in all 50 states. Investors get solid fixed-income returns. People and communities that want to succeed get the opportunity to do so. And critical market segments, many of which will drive our future economic growth, will expand and prosper. CDFIs target these critical market segments including inner cities, remote rural communities, Native American reservations, first-time homebuyers, minority, and immigrant populations.

Opportunity finance uses private-sector business disciplines and market-rooted strategies to produce results that incorporate both individual gains and public goods. Over the past 30 years, the opportunity finance industry has provided more than \$19 billion in financing that would not otherwise have happened in markets that conventional finance would not otherwise reach. **Through fiscal year-end 2004, opportunity finance results included:**

- Financing and other assistance for 28,900 businesses that created or maintained 141,000 jobs;
- Building or renovating 317,000 units of affordable housing;
- Building or renovating 4,700 community facilities in economically disadvantaged communities;
- Providing 20,653 alternatives to payday loans and helping 122,755 low-income individuals open their first bank account;
- A net charge-off rate of just 0.55 percent, rivaling the net charge-off ratio of 0.56 percent for all U.S. financial institutions;
- Customers who in 2004 were 53 percent female, 58 percent minority, and 70 percent low income, indicating that CDFIs are reaching new and emerging markets.

NORTHEAST ENTREPRENEUR FUND

DULUTH, MN

Small Business Financing

Don Young and his wife were long-term welfare recipients struggling to support a large family. The Northeast Entrepreneur Fund, an Opportunity Finance Network Member, offered financing and one-on-one assistance, which allowed Don to turn his hobby of making woodcrafts into a business. Since then, Don has started his own manufacturing business, Enclosures & Cases, which created 10 jobs and provides sustainable income for his family.

¹Opportunity finance includes CDFIs and other private sector financial institutions that work just outside the margins of conventional finance to link opportunity markets to the mainstream economy, and vice-versa.

■ Why is Opportunity Finance Important to our Nation's Economy?

Markets are the mechanism for wealth creation in our nation and determine which people, places, and assets get included. Economics is not a zero-sum game—when one person gets richer, it does not mean that another must get poorer. Having more people and places participate in the market economy contributes to the country's overall economic condition. As long as significant numbers of assets are left out, the market economy is not performing to its full potential.

Economic expansion primarily occurs through increasing productivity of individuals, businesses, and institutions. Growth can also occur through increasing *inclusiveness*—bringing more people, places, and assets into markets. In order to bring people and communities into the economic mainstream and tap “opportunity markets,” we must find ways for them to participate in these markets. This idea—that an enhanced market can provide additional opportunities that benefit us all—is called *market inclusion*.

Market imperfections caused by the external environment, information imbalances, or other factors keep markets from deploying all possible assets or prevent some people and communities from participating fully in the market economy. Correcting market imperfections and improving market inclusion *increases overall economic growth and productivity*.

SHOREBANK ENTERPRISE PACIFIC

ILWACO, WA

Community Facilities Financing

ShoreBank Enterprise Pacific made a loan to the Shoalwater Bay Indian Tribe (Tokeland, WA) that resulted in the development of a Wellness Center serving low-income tribal members and non-members in this remote coastal community with no health care facilities. Services to the Chinook Indian Tribe, Lummi Tribe, and Affiliated Tribes of NW Indians are helping them to build their capacity as CDFI institutions as well.

Another investment in the Shoalwater Bay Indian Tribe resulted in a water quality-testing lab on the reservation used to determine the cause of high-infant mortality rates, which were being investigated by the Center for Disease Control.

Specialized institutions with expertise in these emerging markets and assets can play a key role in increasing market inclusion.

Opportunity finance and CDFIs correct market imperfections in several ways, including:

- **Expanding the boundaries of viable markets.** CDFIs and other opportunity finance institutions often are the trailblazing investors for inner cities, immigrant markets, rural America, first-time homebuyers, and start-up entrepreneurs. They are the first to see and support the potential of these emerging domestic markets and change other private investors' perception of the risk involved in working there. Banks and other mainstream financial services often move into CDFIs' markets after opportunity finance has proven their worth.
- **Correcting the information flaws in markets,** allowing more people to participate effectively. CDFIs couple their financing activity with technical assistance to their customers—they provide financial education to individuals, business counseling to entrepreneurs, management assistance to nonprofits and childcare centers, and homeownership counseling to potential homebuyers. Often, CDFIs' assistance continues even after a loan or investment is closed. By providing education and technical assistance, opportunity finance enables people and institutions to be active participants in the economic system and to contribute better to the nation's productivity.
- **Making assets “market ready.”** In addition to the technical assistance that prepares people and communities for fuller economic participation, opportunity finance leads people and communities into the economic mainstream. A microenterprise that receives its first loan from a CDFI, for example, can turn to a conventional bank for its expansion projects. A homebuyer to whom a CDFI provides downpayment assistance can refinance with a mainstream financial institution.

In sum, opportunity finance both prepares assets for market and stretches the margins of the markets, “moving the stream” as well as bringing people and places into the economic mainstream. To maintain the county's overall growth and productivity, mainstream markets need opportunity markets as much as emerging markets need mainstream opportunities.

■ What can the Federal Government do to Support Opportunity Finance?

Because market imperfections are, by definition, shortcomings in the market, it is appropriate for the government to intervene and promote the public good of increased productivity and inclusiveness. The government can regulate activity to encourage activity in new markets, adopt tax policies that correct for the “true” cost of market activities, and invest in organizations that contribute to market inclusion.

Though the government has a role to play in identifying and correcting market imperfections, we believe that its appropriate role should only bridge gaps between mainstream and opportunity markets, not supplant market activity.

The Opportunity Finance Network supports policies that focus government on two goals:

1. Enabling, improving, and fixing the market environment and making markets more inclusive; and
2. Developing assets to make them “market ready.”

The success of opportunity finance involves a rare form of government support—investment in skilled, proven financial intermediaries rather than conventional community development grants in isolated projects or programs. As a result, *investments* in opportunity finance through the CDFI Fund and other government strategies create virtually unprecedented levers for attracting, deploying, and returning private investment. As special purpose, private financial institutions, CDFIs put their own capital at risk to maximize the amount of private capital they can put to work in opportunity markets.

The principles that opportunity finance institutions are important to expanding economic growth and improving markets, and government investment in such institutions is an efficient use of public-sector resources forms the core of our policy recommendations.

OPPORTUNITY FINANCE NETWORK PROMOTES A TWO-PART PLATFORM:

- Invest in opportunity finance; and
- Foster an environment that supports and rewards strategies for inclusive prosperity.

ENTERPRISE CORPORATION OF THE DELTA/HOPE COMMUNITY CREDIT UNION

JACKSON, MS

Hurricane Relief and Recovery

When Hurricane Katrina hit New Orleans in August 2005, Jerry Moore’s family evacuated safely, but was unable to save the truck: a complete loss. HOPE worked with Jerry to settle the insurance claim on the vehicle because he needed to resolve the situation quickly: he had contractors telling him they were short on trucks to help clear away all of the wreckage left by the storm and desperately needed help if Jerry could find a truck.

Jerry applied for a loan from HOPE, this time on two trucks. HOPE made the loan on the new vehicles, and Jerry’s company also obtained financing on two trailers through Enterprise Corporation of the Delta. Jerry is now busy helping his fellow New Orleans residents rebuild and taking on work that was backlogged prior to the hurricane.

The Federal Government Should Invest in Opportunity Finance

Because CDFIs work in a variety of markets and engage in a full spectrum of financing activity, they can tap into a number of federal programs. CDFIs use these small infusions of public capital to leverage large private investment into their markets. The federal government should invest in opportunity finance by supporting programs that promote, encourage, and complement the work of CDFIs. The most important federal funding opportunities for CDFIs include:

- **The Community Development Financial Institutions Fund (CDFI Fund) in the Department of the Treasury.** The CDFI Fund invests in organizations with sound strategies, making awards through a competitive assessment of strategic business plans. According to the Treasury Department, its equity investments in CDFIs leverage \$27 for each \$1 of federal funding, creating billions of dollars in new investment that expands the inclusion of markets, creates individual and community assets, and brings more people and communities into the economic mainstream. The CDFI Fund meets the opportunity finance industry's needs for equity capital and for investment in institutional capacity building. It supports permanent institutions with specialized market knowledge and expertise, and is the only federal source of equity capital available to all CDFIs, regardless of location or lending sector.
- **New Markets Tax Credit.** Passed with overwhelming bipartisan support in 2000, the New Markets Tax Credit (NMTC) is the largest federal economic development initiative to be launched in 20 years, and offers investors a credit of 39% over seven years for investments in certified community development entities (CDEs). CDEs in turn invest in projects and businesses in low-income communities or serving low-income people. The NMTC delivers capital to underutilized markets, facilitating a government role in improving markets and expanding inclusiveness. The Treasury Department will issue \$15 billion in credits through 2007.

The Treasury Department's research indicates that the \$1.3 billion in NMTC-related investments made through FY2004 will create and maintain up to 49,000 construction jobs and up to 12,000 additional jobs; develop or rehabilitate 11 million square feet of office, retail, and manufacturing space in low-income communities; and develop or rehabilitate 1,100 housing units.

This effective tool for investment in emerging markets expires in 2007 and must be reauthorized. Opportunity Finance Network also supports modifications to the NMTC program that would help the program reach deeper into rural areas, and allow for better use of the NMTC program for small business and venture capital financing.

- **Small Business Administration (SBA) Programs.** CDFIs create jobs and opportunities for self employment by financing small businesses and microentrepreneurs. Three SBA programs help these investments in minority, women-owned, and other underserved businesses succeed: the Microloan Program (including the Microloan Technical Assistance Program), the Program for Investment in Microentrepreneurs (PRIME), and the Women's Business Centers.
- **United States Department of Agriculture (USDA) Programs.** CDFIs are a key source of capital in rural areas where traditional credit can be scarce. CDFIs use USDA funding, including Rural Business Enterprise Grants, Rural Business Opportunity Grants, and the Intermediary Relending Program to help meet the unique needs of businesses and communities in rural America.

SELF-HELP

DURHAM, NC

Housing Financing

Self-Help, a Member of Opportunity Finance Network, and local partners are building affordable homes in revitalizing neighborhoods in Durham, NC. Self-Help administers a Land Bank that has acquired 42 lots for redevelopment by nonprofit builders. Its first development, Pauli Murray Place, is named for the accomplished African-American attorney, activist, writer, and Episcopal priest who grew up nearby.

The Federal Government Should Foster an Environment that Supports and Rewards Strategies for Inclusive Prosperity

Opportunity finance touches every area of this nation's economy. Every Member of Congress should support legislation that promotes and strengthens access to affordable capital for all Americans. Some of the ways that Congress can create this environment include:

- **A strong and well-enforced Community Reinvestment Act (CRA).** The CRA is an example of the government's role in exposing and correcting market imperfections. A strong CRA helps fulfill the government's role in growing the economy and in enhancing markets.

The CRA has led banks to discover profitable but overlooked markets, channeling billions of dollars over the last 30 years into market-ready, but undeployed assets. It has helped sustain these markets by fostering partnerships between banks and CDFIs.

In order for the CRA to reach even further into the markets, it should be expanded beyond banks to encompass insurance and securities firms—other sectors of the increasingly consolidated financial services industry.

- **Government-Sponsored Enterprises (GSEs) responsive to their affordable housing mission.** Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System have affirmative obligations to improve housing opportunities for low- and moderate-income people. As government-sponsored entities, their support of homeownership and affordable rental housing helps government fulfill its role in expanding inclusivity and building assets. GSEs can accomplish this goal through the:

- > Creation of an Affordable Housing Fund consisting of 5% of Fannie Mae's and Freddie Mac's after-tax profits, dedicated to the production, preservation, and rehabilitation of affordable housing, including a "Leverage Grant Fund" supporting CDFIs' work.
- > Appointment of qualified candidates to the vacancies of the Boards of the Federal Home Loan Banks. Currently, two-thirds of the seats of Congressionally mandated Public Interest Directors are unoccupied, leaving the FHLB system without needed expertise in affordable housing finance and undermining the soundness of the taxpayer supported entities.

- **Curbing Predatory Lending.** Predatory lending is a real and present danger, not only to low-income and low-wealth people and communities, but to our nation's economy. Predatory lending strips billions of dollars from consumers and communities in the United States. Borrowers lose an estimated \$9.1 billion annually due to predatory mortgages; \$3.4 billion from payday loans; and \$3.5 billion in other lending abuses, such as overdraft loans, excessive credit card debt, and tax refund loans. The information imbalances that make people victims of predatory lending are indicative of a market failure, and abusive lending magnifies that imperfection. As long as consumers lose rather than gain assets, they cannot be full participants in the economic mainstream. Both Congress and bank regulatory agencies should adopt strong, comprehensive standards against predatory lending.

FLORIDA COMMUNITY LOAN FUND

WIMAUMA, FL

Community Facilities Financing

The Beth-El Farm Worker Ministry used loans from Florida Community Loan Fund, an Opportunity Finance Network Member, to dramatically improve conditions for rural farm workers and their families. Together, a network of Presbyterian Churches and the Loan Fund provided the financing for the construction of a daycare center that serves up to 86 migrant farm worker children and the first charter school in Florida for farm worker children.

OPPORTUNITY FINANCE NETWORK
Public Ledger Building, Suite 572
620 Chestnut Street
Philadelphia, PA 19106-3413
www.opportunityfinance.net



About Opportunity Finance Network

The Opportunity Finance Network of 167 financial institutions finds and finances opportunities that others overlook. Its members include CDFIs and other opportunity finance institutions that work just outside the margins of conventional finance to bring those markets into the economic mainstream and to help the economic mainstream flow into those markets.

CONTACT US

If you have questions about opportunity finance or need additional information, please contact Opportunity Finance Network's policy staff:

Sandra Kerr

Senior Vice President & Director, Policy

Phone: 703.370.1991

E-mail: skerr@opportunityfinance.net

Cheryl Neas

Vice President, Policy

Phone: 215.320.4344

E-mail: cneas@opportunityfinance.net