Memorandum

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From: Michael Banner
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Re: MDI & CDFI Market Trends for Collaboration & Loan Participation Program

The purpose of this memorandum is to outline a few major trends that appear to identify a market opportunity for a synergistic and collaborative relationship between the Minority Depository Institution program (MDI), Community Development Financial Institution program (CDFI) and State Small Business Credit Initiative (SSBCI).

Minority Depository Institutions:

A federally insured depository institution for which (1) 51 percent or more of the voting stock is owned by minority individuals; or (2) a majority of the board of directors is minority and the community that the institution serves is predominantly minority. Ownership must be by U.S. citizens or permanent legal U.S. residents to be counted in determining minority ownership. The FDIC, and other banking regulators make the determination what depository institutions have MDI status.

Community Development Financial Institutions:

A specialized organization that provides financial services in low-income communities and to people who lack access to financing. ***CDFIs include regulated institutions such as community development banks and credit unions, and non-regulated institutions like loan and venture capital fund***s. The U.S. Department of the Treasury Community Development Financial Institution Fund (CDFIFUND), make the determination what organization will be U.S. Treasury Certified CDFIs.

MDI and CDFI Depository Institutions:

As reported by the FDIC on June 30, 2021, there are 143 MDIs and as reported by the CDFIFund there were 1,271 Certified CDFIs in the U.S. The top state for both MDIs and CDFIs is California; where 36 MDIs are chartered. The Los Angeles - Long Beach-Anaheim MSA is home to 31 or 86% of California's MDIs. In Los Angeles MDIs, based FDIC SOD reporting in 2018, held $48,899,198,000 or 11.8% of deposit market share. The ability to determine the amount of lending, by MDIs and other banks, is limited. This lack of lending data highlights need for the new CFPB rule 1071 reporting which will make lending results transparent. In the CDFI industry data collection and reporting is a fundamental objective of a mission driven lender.

The CDFIFUND reports that California has 10 Certified CDFI banks & thrifts. The majority of these MDI-CDFI operate in the greater Los Angeles region and only 1 of the 5 institutions is headquartered in Northern California. This is an indication of demographic market characteristics and potentially greater unmet needs.

Given then number of Banks that maintain the MDI status these are institutions the FDIC wants to provide assistance through the MDI program to foster the growth and expansion of MDI bank and enhance there ability to meet the credit needs in underserved and low-income markets. This will include FDIC promoted activities in the following areas:

- Promoting collaboration
- Partnership
- Learning best practices

Other MDI focused regulatory agencies are the Office of the Comptroller of the Currency ("OCC") and Federal Reserve Board ("FRB"). Both agencies have a very robust commitments to assist MDI banks and support their involvement with the CDFI industry.

- FDIC is standing up the Mission Driven Bank Fund
    - Mission-Driven Bank Fund - Helping Communities in Need (fdic.gov)
- OCC Project REACh
    - OCC Announces Project REACh to Promote Greater Access to Capital and Credit for Underserved Populations | OCC
- FRB Partnership for Progress
    - About Us - Partnership for Progress (fedpartnership.gov)

The above programming represents a recognition of the need to support MDIs as a tool to bring plausible and sustainable financial solutions to communities in need. With this interagency regulatory support for the growth and expansion of MDIs it has helped to bring greater collaboration from much larger and better capitalized financial institutions (SiFIs) and other socially responsible corporations. Given this current regulatory environment, to support MDIs, which fosters a greater awareness allowing MDIs to have a more understanding of the benefits of joining CDFI industry. This CDFI industry knowledge will increase collaborative opportunities that meet the needs of borrowers in markets that need greater access to capital and advisory services.

CDFI Eligibility Criteria

A CDFI must demonstrate that the applicant meets each of the following requirements:

- Is a legal entity at the time of Certification application;
- Has a primary mission of promoting community development;

- Is a financing entity;
- Primarily serves one or more target markets;
- Provides development services in conjunction with its financing activities;
- Maintains accountability to its defined target market

It appears that most MDI Bank will meet the above eligibility criteria and are likely to receive a CDFI certification from the CDFIFUND. The business case to pursue CDFI certification should align with the primary goal and objectives of any MDI Bank. The review of the performance data from the CDFIFUND dated 2019 indicates the collaboration is valuable:

CDFI,CCME Joint Presentation at LA MDI Conference (cdfifund.gov)

With their past track records, many MDI Banks are in a position to attract the socially motivated capital that is looking expand the impact of both MDIs and CDFIs which adds to the value proposition for the business case to add the CDFI certification.

CA MDI-CDFI Banks – 2019

Name	Total Assets	Minority Status
Royal Business Bank	$2,783,284	Asian or PIA
First Choice Bank	$1,690,431	Asian or PIA
First General Bank	$ 977,318	Asian or PIA
American Plus Bank	$ 563,445	Asian or PIA
Broadway Federal (City First)	$ 438,033	Black
Community Commerce Bank	$ 279,859	Hispanic

At $6,732,370, the above MDI Banks are NOT significant institutions, based on total assets, in comparison the California banking industry as reported by the FDIC at September 30, 2021 with:

FDIC State Banking Data	All Institutions	< $100 Million	>$100 Million
# of Institutions	141	5	136
Total Assets	1,197,936	364	1,187,572
Leverage Ratio	10.06%	32.29%	9.25%

It appears the federal regulatory focus on MDIs is warranted to drive their ability to scale and serve the overlooked and underserved markets in California.

Looking back to 1996, we have reviewed the history of funding activities with these CDFIFUND programs:

- CDFI Core Program
- CDFI Bank Enterprise Award

MDI CDFI banks have been recipients of substantial resources or subsidies totaling over $69 Million under the BEA program and the Core program has infused over $243 Million into the Los Angeles MSA to eligible CDFI organizations. It appears this trend of substantial federal resources being targeted toward CDFIs is going to continue.

State Small Business Credit Initiative 2.0:

In 2010, President Obama signed into law the Small Business Jobs Act, which created the State Small Business Credit Initiative (SSBCI). Functioning as a recovery response to the Great Recession, it delivered $1.5 billion in capital to small businesses. The California allocation was $169 million and the federally funding was phased out in 2017. ("SSBCI 1.0")

MDI Banks should be incentivized to aggressively engaging with the SSBCI 2.0 Program and the $895 Million federal that has been allocated to California. During the SSBCI 1.0 operating period no California based MDI-CDFI Bank was a nationally ranked top 15 lenders by units or dollars:

Lender	# of Loans	Amount Loaned	Average Loan
Pacific Enterprise Bank	216	$93,449,832	$438,008
Opportunity Fund (CDFI)	4700	$57,437,952	$12,221
Pacific Premier Bank	154	$34,932,845	$226,837

As the U.S. Treasury is finalizing the SSBCI 2.0 program guidelines, the California response includes the following:

Capital access programs (CAPs) provide a portfolio loan loss reserve for which the lender and borrower contribute a share of the loan value (up to seven percent) that is matched on a dollar-for dollar basis with SSBCI funds. Losses may be recovered from the reserve until there is no additional funding in the reserve. CAPs operate in 24 states, which allocated $40 million toward them. CAPs expended 71 percent of their allocated amounts (includes administrative expenses) by making 13,965 small business loans.

Collateral support programs (CSPs) provide cash to lenders to boost the value of available collateral. A collateral shortfall is a common issue in many areas where the economy has not fully recovered from the Great Recession. CSPs operate in 17 states, which collectively allocated $269 million toward them. States have expended 89 percent of the funds allocated to CSPs, totaling $238 million. The average total financing per small business loan in a CSP was $866,200.

Loan guarantee programs (LGPs) provide an assurance to lenders of partial repayment in the event a loan goes into default. Guarantees typically support businesses that do not fit standard lending criteria. States allocated $246 million toward LGPs operating in 22 states, and have expended $182 million of that amount, or 74 percent. State LGPs supported 2,779 loans averaging $501,900 per loan.

At this point California is NOT preparing to offer a **loan participation program**; however, there is an opportunity to propose new other credit support programs during later rounds of the 1/3 tranches of the disbursement administrative procedures of the SSBCI grant from the US Department of Treasury.

We would recommend that MDI Bank management take on a leadership role to engage the IBank and CPCFA to submit a loan participation options as soon as possible. In the 2016 SSBCI 1.0 annual report, it was reported, by the U.S. Treasury Department that the loan participation programs (LPPs) - purchase a portion of a loan that a lender makes or make a direct loan from the state in conjunction with a private loan (companion loan). The state typically is subordinate to the lender's loan. LPPs operated in 40 states, which allocated \$474 million—the largest allocation of SSBCI funds for any program type—toward them. States have expended \$419 million of the allocation. California did not offer this product and it is likely to be a solution for borrowers that are looking to expand and find conventional bank lending a challenge.

Secondly, this loan participation will be easily understood by banks and lenders that have experience with the SBA 504 lending structure; additionally, private equity investors should find this debt instrument structure to be familiar asset class.

The Los Angeles LDC has demonstrated how an alternative small balance CRE loan product can be effective in the marketplace:

Los Angeles LDC, Inc.: Programs

It is our desire to work with MDI Banks, IBANK, and CPFA to evaluate the content of this correspondence to determine it there is an interest to move forward, with development of a **Loan Participation Program** (LPP) that motivates more MDIs to seek the CDFI certification and raise capital to serve the lending markets in California.