

April 5, 2013

Lisa M. Jones
Manager, CDFI Bond Guarantee Program
CDFI Fund
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Ms. Jones:

Thank you for the opportunity to provide comments on the CDFI Fund's Interim Rule for the CDFI Bond Guarantee Program (the Program). CDFIs across the nation look forward to accessing this new source of long-term financing to better serve low-wealth communities.

As you know, the CDFI industry has a highly successful track record of deploying capital to markets overlooked by mainstream financial institutions in an affordable and responsible manner with minimal credit losses. OFN recommends that Program rules incorporate enough flexibility to allow CDFIs to do what they do best: employ their unique experience in meeting the capital needs of low-wealth, low-income and other distressed markets. We also encourage the Fund to ensure as much geographic and CDFI diversity as is feasible given the emergent nature of the Bond Program.

The CDFI Fund has stated that the Notice of Guarantee Authority and other supporting documents will be released shortly and will present information that will answer outstanding questions about the Program's operation. We recommend that the Fund solicit public comment on these materials while implementing the Program in a way that does not delay execution.

Furthermore, we want to emphasize that an iterative, interactive application process is absolutely essential for the CDFI industry to understand the requirements that will be set forth by the Fund and the Office of Management and Budget, and to understand how these parameters will apply to real world CDFI portfolios, cash-flow projections, and corporate structure. Our specific recommendations follow.

Qualified Issuer

The Interim Rule suggests that the Qualified Issuer will exercise a great deal of discretion and independent judgment. Therefore, in evaluating Qualified Issuer applications, the Fund should place a high priority on the applicant's mission orientation, and allow the applicant to contract with third parties for certain activities in order to meet the Fund's qualifications and criteria for servicing and program administration. We have many questions regarding the roles and responsibilities of a Qualified Issuer. The Qualified Issuer Application and other supporting materials should, at minimum, address the following issues:

- Responsibilities of the Qualified Issuer as differentiated from the Master Servicer.
- Requirements for how the Qualified Issuer will evaluate disbursements of Secondary Loans pursuant to an approved Capital Distribution Plan.
- Requirements for how the Qualified Issuer will evaluate disbursements from Relending Accounts and Secondary Loan substitutions.



- The relationship between the Designated Bonding Authority, if one is chosen by the CDFI Fund, and other Qualified Issuers.

Minimum Bond Threshold

We support the provision in the Interim Rule that provides flexibility for Eligible CDFIs to access Bond Loans in amounts of less than \$100 million. Establishing the lower threshold of \$10 million Bond Loans should allow for a greater variety and number of CDFIs to participate in the program.

Small Business Lending

Based on requirements for hard collateral, and the restrictions outlined in the Interim Rule on the Relending Account, it is difficult to conceptualize how Bond Proceeds may be used for small business lending. We believe that, instead, Eligible CDFIs will group together to partner on bond issuances to support large, long-term, real estate based projects such as affordable housing mortgages, charter schools, community facilities and commercial redevelopment. These are all valuable uses of Bond Loans, however small business financing is a key sector for the CDFI industry. As such, we encourage the Fund to work with the CDFI industry to identify ways to accommodate as many types of financing – including short- and medium-term small business financing – by as many CDFIs as possible.

Timing of Disbursements of Bond Loans and Secondary Loan Uses

We are pleased that the disbursement of Bond Loan proceeds will be on a draw-down basis to take place once Eligible CDFIs execute Secondary Loan Agreements (dry closings). This common sense approach allows Eligible CDFIs to avoid negative arbitrage, and to more easily manage assets and liabilities.

Eligible CDFIs should be able to utilize Bond Loan proceeds to refinance their own debt, as well as to refinance Secondary Loans. In addition, we recommend that the Fund broaden the use of Bond Loan proceeds to include loans and investments other than first lien, senior indebtedness, to include second lien loans and subordinated loans, which are common CDFI loan products, and secondary capital investments in CDFI credit unions and regulatory capital investments in CDFI banks. The latter two accommodations will make it easier for CDFI depositories to access the Program.

We also support the provision in the Interim Rule allowing Eligible CDFIs up to five years to disburse all Bond Loan proceeds. However, within this timetable, we recommend that the Fund adjust the requirement for Secondary Loan commitments so that Eligible CDFIs have three years to commit Secondary Loans (50% by the end of the second year, and 100% by the end of the third year). This adjustment creates a reasonable time table for CDFIs to commit the use of bond proceeds and disburse them in a thoughtful, prudent, and timely manner.

Secondary Loan Parameters

The parameters that the Fund expects to set for different asset classes of Secondary Loans are not yet known. We urge the Fund to avoid being overly prescriptive in its guidance on Secondary Loan requirements. The CDFI industry has successfully financed businesses and projects in low-income communities using different loan parameters than those used by mainstream financial institutions. The requirement to use conventional loan parameters will change the way CDFIs do business and make it more difficult for CDFIs to finance the kind of projects overlooked by mainstream financial intermediaries.



The Fund has explained that at the time of approval of a Guarantee, it will establish a minimum and maximum spread by which the Secondary Loan Rate can exceed the Bond Loan Rate. We believe that these “pricing collars” are unnecessary. This collar does not improve the probability of repayment and may actually restrict CDFIs’ ability to appropriately manage risk. Again, we recommend the Fund rely on the successful track record of the CDFI industry in providing affordable capital to at-risk markets while maintaining very low rates of default.

Recourse, Financial Covenants, and Collateral Requirements

The Interim Rule establishes that the guarantor will have full recourse to the Eligible CDFI, and that the Eligible CDFI must pledge to the Master Servicer/Trustee all Secondary Loan receivables and the debt service payments associated with said Secondary Loans. In addition, the Interim Rule requires additional collateral to be pledged on Secondary Loans.

At current industry net asset ratios (averaging more than 30%), CDFIs will have difficulty absorbing the amount of debt authorized by this Program if it is 100% recourse. It would require CDFIs to raise \$30 million of net assets to absorb every \$100 million Bond Issue if current net asset ratios were to be maintained. Moreover, CDFIs have existing unsecured debt with banks and foundations with covenants that limit unsecured debt and prohibit or limit the incurrence of secured debt. Therefore, the proposed Interim Rule requirements to pledge hard collateral as security and agree to 100% recourse debt would severely limit CDFI participation in the program and breach existing debt relationships with private capital providers. It could also potentially push out private sector lenders if CDFIs used Bond proceeds to repay bank and foundation lenders to avoid covenant defaults or restructurings.

To address this structural problem, we encourage the Fund to allow the utilization of Affiliates, and other limited recourse structures, to allow CDFIs to participate in the Bond Program while honoring their existing lender covenants. Specifically, we believe it is essential that the Fund allow existing or Newly-Formed Affiliates of Eligible CDFIs (NFAs) to be Eligible CDFIs under the program. Under this concept, the parent CDFI would be obligated to capitalize the Affiliate or NFA with sufficient funds to pay the 3% Risk-Share, and provide additional Credit Enhancement as needed to fully protect the Guarantee. The Bond Loan would be fully recourse to the Affiliate or NFA so that all of their “equity” would in effect support Bond Loan repayment. The creditworthiness of the Affiliate or NFA would be determined based upon the credit quality of the loans it proposes to make with Bond Loans, its capitalization, and the creditworthiness of its parent Eligible CDFI.

To accommodate Affiliates and NFAs, we recommend that the Fund perform expedited CDFI certification processes for existing Affiliates and NFAs for the exclusive purpose of participating in the Program.

In addition, instead of requiring both hard collateral and 100% recourse lending, we recommend that the Fund allow Eligible CDFIs to utilize a “toolbox” of credit enhancements to compensate for additional risk. Some examples of risk mitigation tools are:

- Over-collateralization
- Affirmative covenants
- Third party guarantees and/or bond insurance



- Increased interest rates on the Bond Loan to Eligible CDFIs, or on Secondary Loans to end-borrowers. This excess spread would then be used to fund reserves that could be used to mitigate losses.
- A supplemental loan loss reserve, similar to the one identified in the Interim Rule, that could be funded by Bond Loan proceeds or other forms of capital.

In addition, as a way to make the Bond Program accessible to more credit worthy smaller and medium sized CDFIs, we encourage the Fund to allow Eligible CDFIs to lend to other CDFIs on a general recourse, unsecured basis. Several existing CDFIs have a long history of making unsecured loans to CDFIs for terms of up to ten years. If the Eligible CDFI establishes enough credit enhancement to protect the Guarantee, the Fund should accept unsecured CDFI loans as an eligible use of Bond proceeds. The Eligible CDFI loan receivables would be pledged on the Bond Loans to meet the requirements of FCRA and OMB Circular A-129.

The covenants that the Fund expects to set for Eligible CDFIs are not yet known. Any covenants required for a Guarantee should be applied uniquely to each Eligible CDFI in a given Bond Issue in response to each CDFI's situation and its proposed use of Bond proceeds. We urge the Fund to avoid being overly prescriptive in setting financial covenants.

Relending

Per the enabling Statute, "not more than 10 percent of the principal amount of guaranteed bonds or notes, multiplied by an amount equal to the outstanding principal balance of issued notes or bonds, minus the risk-share pool amount" can be in a Bond Relending Account. To enable CDFIs to better manage assets and liabilities, we recommend that the Relending Account be limited to 10% of the principal amount of the Bond Issue. As such, in a \$100 million Bond Issue containing a single Eligible CDFI as the recipient of the Bond Loan, the maximum amount of funds that could be held in the Relending Subaccount would be \$9.7 million, irrespective of how much the Eligible CDFI has "drawn-down." In calculating the Relending Fund, Bond Loan proceeds used for 1% of issuance fee and Loan Loss Reserve funding should be deemed deployed but not deducted from the principal amount outstanding.

In addition, we urge the Fund to address what we believe is an unintended consequence of deducting the 3 percent risk-share pool from amounts permitted to be in Relending Accounts. As presently drafted in the Interim Rule, this deduction results in all monies being required to pre-pay principal after the principal amount of outstanding debt on a \$100 million single issue is \$3 million or below. Such a requirement is reasonable provided that the Fund specifies that no payment premiums will be owing in conjunction with such mandatory payments. Such a provision would be consistent with market practice, which would not typically charge a prepayment premium associated with structured mandatory prepayments or prepayments made towards the end term of a loan. In the alternative, the Fund could clarify that the 3 percent risk-share pool would not be subtracted from amounts permitted to be in the Relending Accounts at any time during which the outstanding principal amount of Bond Loans is equal or is lower than the 3 percent risk-share pool amount.

Further, under the Interim Rule, the Master Servicer/Trustee must notify the Eligible CDFI that the balance in its Relending Subaccount exceeds the Relending Subaccount Maximum. In order to utilize the full relending potential of the Bond Program, we strongly recommend that the measure of the Relending Subaccount be taken at a given time (i.e. on the one year anniversary of the Bond Issue or on a date certain such as 12/31.). This practical approach makes it possible for Eligible CDFIs to adjust their Relending Subaccounts accordingly, and for the Master



Servicer/Trustee to monitor those accounts effectively, without triggering a series of “Notification Dates” and “Calculation Dates,” as outlined in the Interim Rule. In order to further ease the strain of asset liability matching for Eligible CDFIs, we recommend that Eligible CDFIs be given a window of 12 months to reduce Relending Subaccount balances to avoid prepayment of the Bond Loan, similar to reinvestment provisions that exist in the NMTC program.

Community Reinvestment Act

The Bond statute disallows CRA credit to financial institutions for “...any investment in bonds or notes guaranteed under the Program...” We strongly recommend that CRA investment credit be granted for other activity around the Bond Program, for example, the provision of credit enhancement, risk share, or liquidity to an Eligible CDFI or Bond Issue. Such collaboration between a financial institution and Eligible CDFIs is not an investment in the guaranteed bond itself, but an investment in the Eligible CDFI and within the boundaries prescribed by the statute. If done correctly, the Bond Program has the potential to significantly expand the opportunity to expand the type of financing banks are comfortable providing and it should encourage banks to partner with CDFIs to help make the Bond Program successful.

Capital Markets

The Interim Rule states that “...the Guarantee shall be fully assignable and transferrable to the capital markets, on terms and conditions that are consistent with comparable bonds guaranteed by the Federal Government and satisfactory to the Guarantor and the CDFI Fund.”

One of the original goals of the CDFI Bond Program legislation was to allow the CDFI industry to access the capital markets. As such, we were pleased to know that such an option is permitted under the Interim Rule, and we strongly encourage the Federal Financing Bank and the Fund to work with the CDFI Industry to determine the timing and conditions under which such an assignment and transfer of the Guarantee might occur.

Reporting Requirements

The CDFI Fund has a long history of successfully collecting and publishing data received from CDFI Program participants. We strongly suggest that the Fund create reporting requirements for the Bond Program in conjunction with existing data collection systems, and formulated in collaboration with the CDFI industry. Streamlining reporting requirements in this way results in more accurate data collection at the individual CDFI level, provides useful snapshots of CDFI activity at various points in time, and helps to move the industry towards widely accepted metrics of CDFI activity.

Please contact Opportunity Finance Network (Jennifer Vasiloff, jvasiloff@opportunityfinance.net) with questions about these recommendations.

Sincerely,

Mark Pinsky
President & CEO
Opportunity Finance Network