

Strategies for Economic Development in low-moderate income areas (LMI):

- *Small Business Lending*
- *Partnerships with Intermediaries*

Chris Sikes
Executive Director
Western Mass Enterprise Fund, Inc.
4 Open Square, Ste 407
Holyoke, MA 01040
413 420-0183
csikes@wmef.org



Why invest in low-income (LMI) areas?

- *CRA: lending or investment test credit*
- *Investment opportunity in emerging domestic market*



Emerging Domestic Markets: Where is the Real Opportunity?

2005 NCCA Conference

"On the Road to Scale: What's Now? What's New? What's Next?"
Los Angeles, CA
October 20, 2005

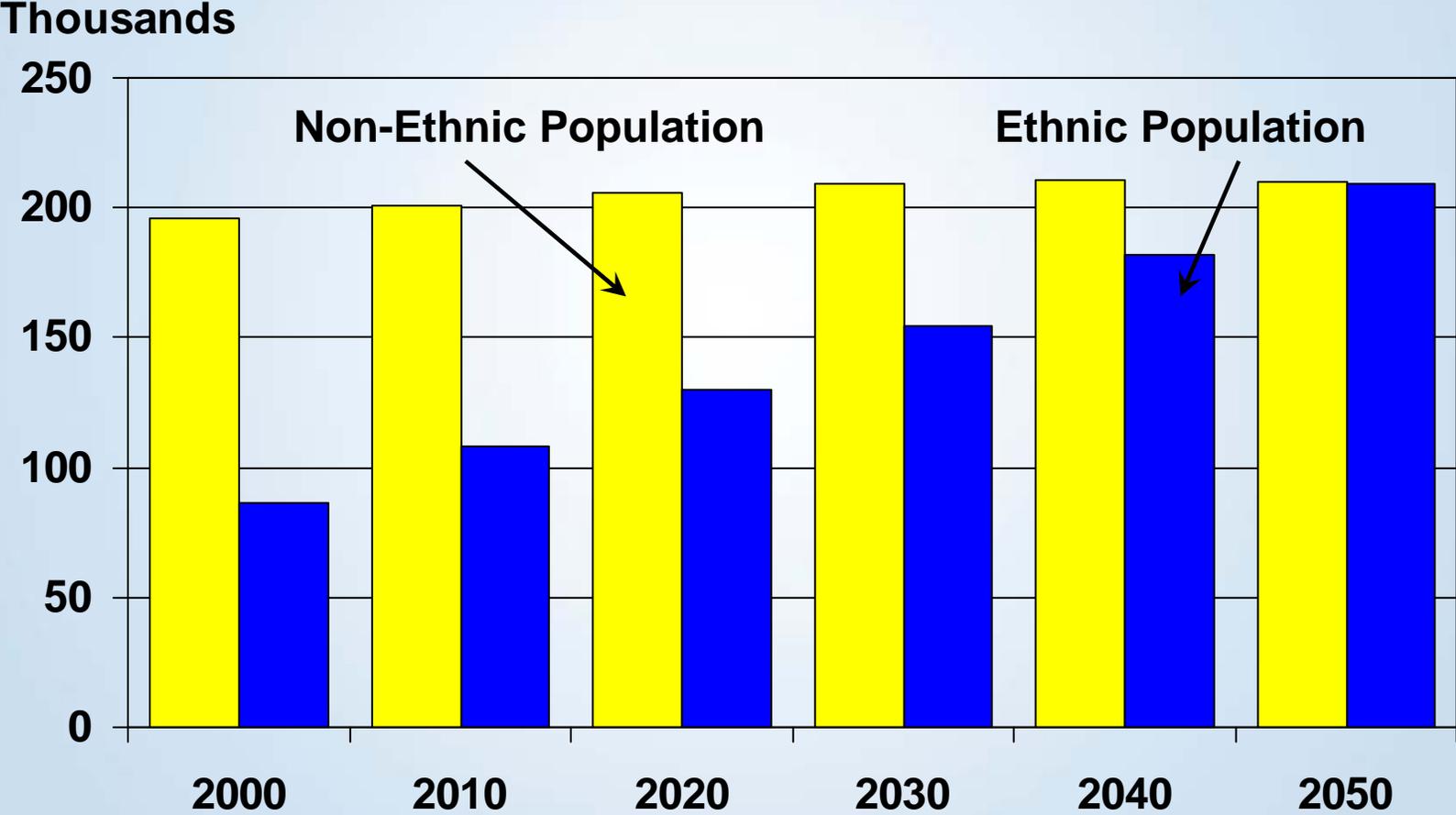
Betsy Zeidman

Director, Center for Emerging Domestic Markets, Milken Institute

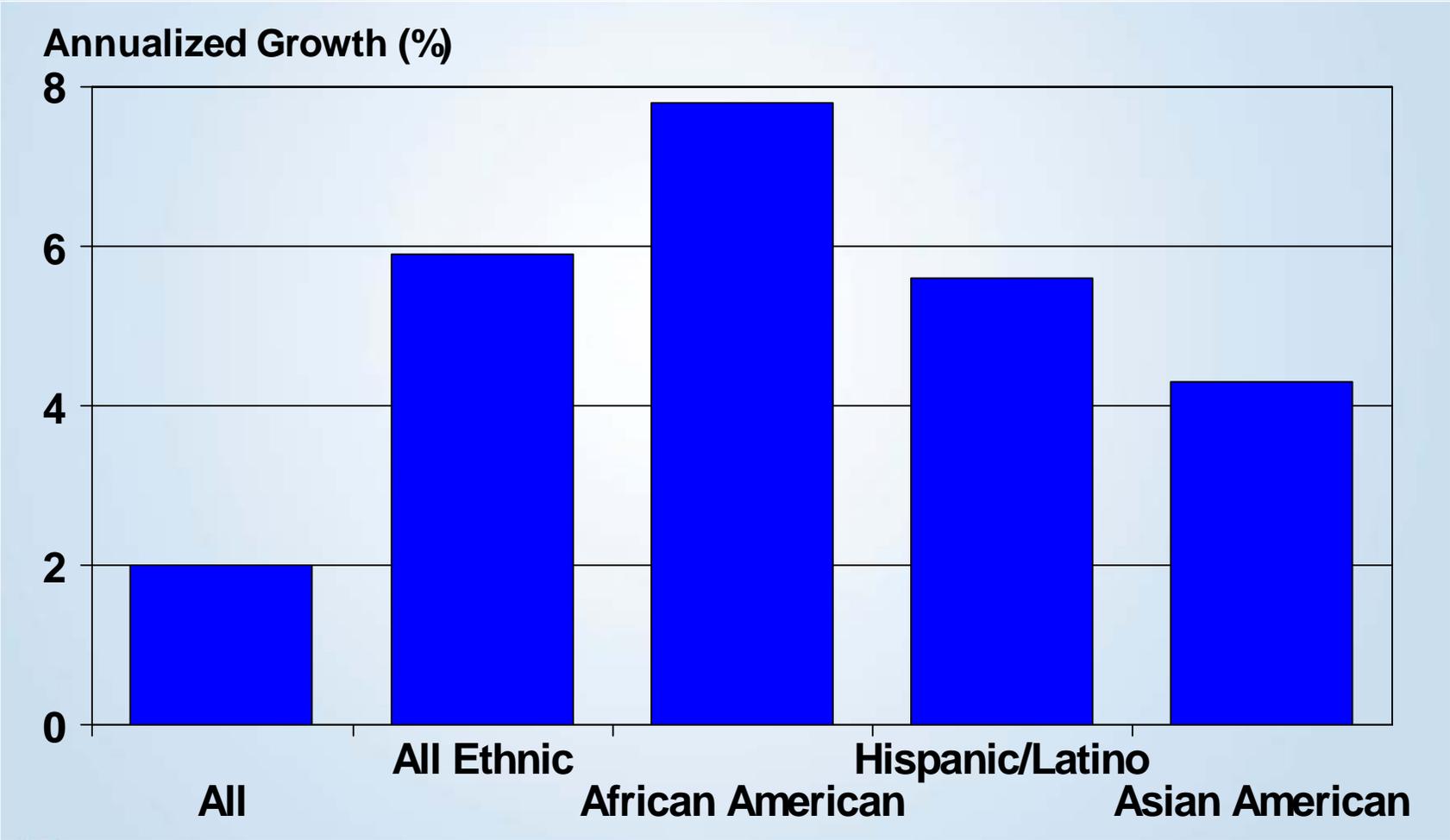
bzeidman@milkeninstitute.org

310-570-4600

Future Population Growth Due to Ethnic Population

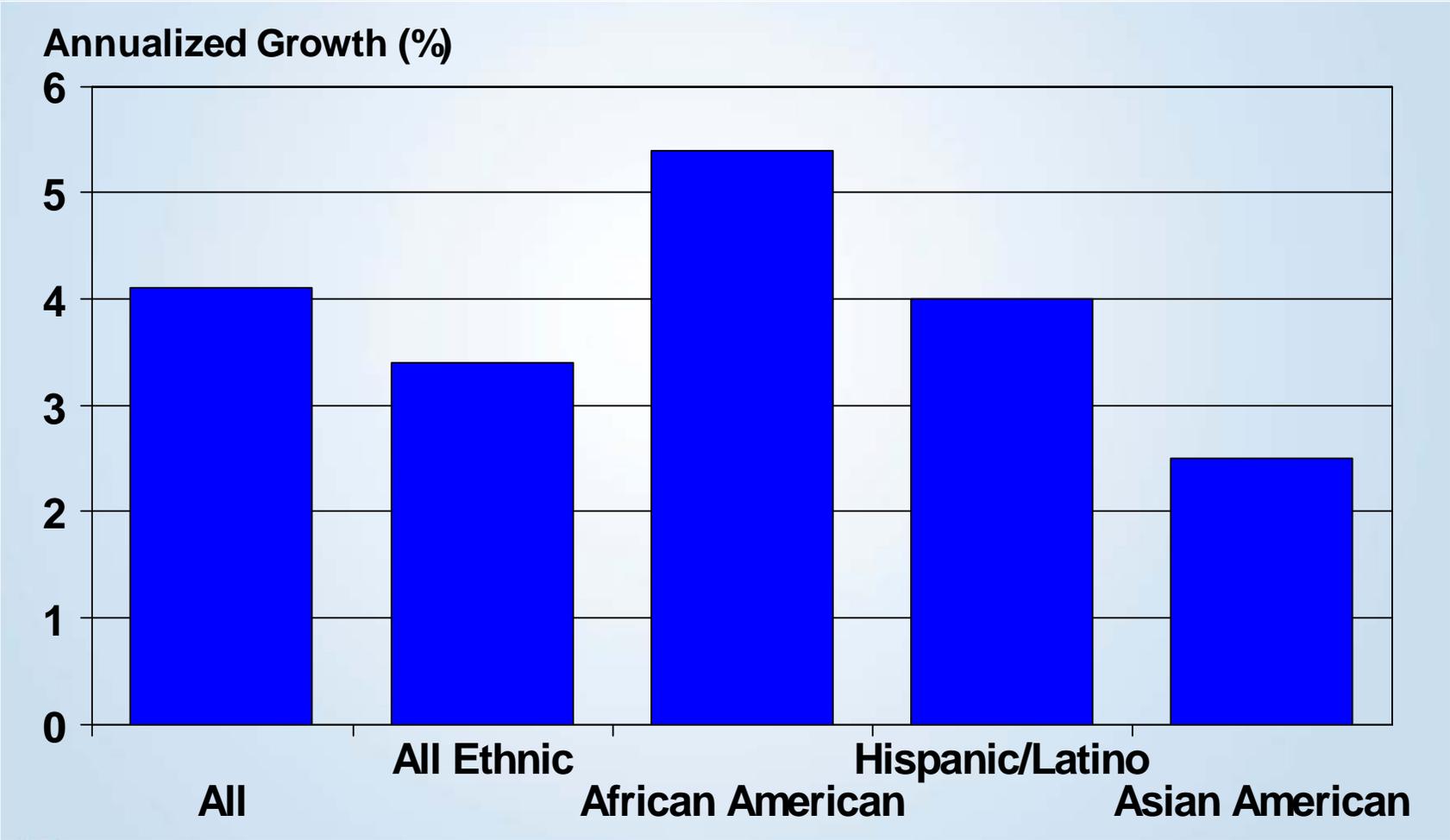


Growth in Number of U.S. Ethnic-Owned Firms 1997-2002



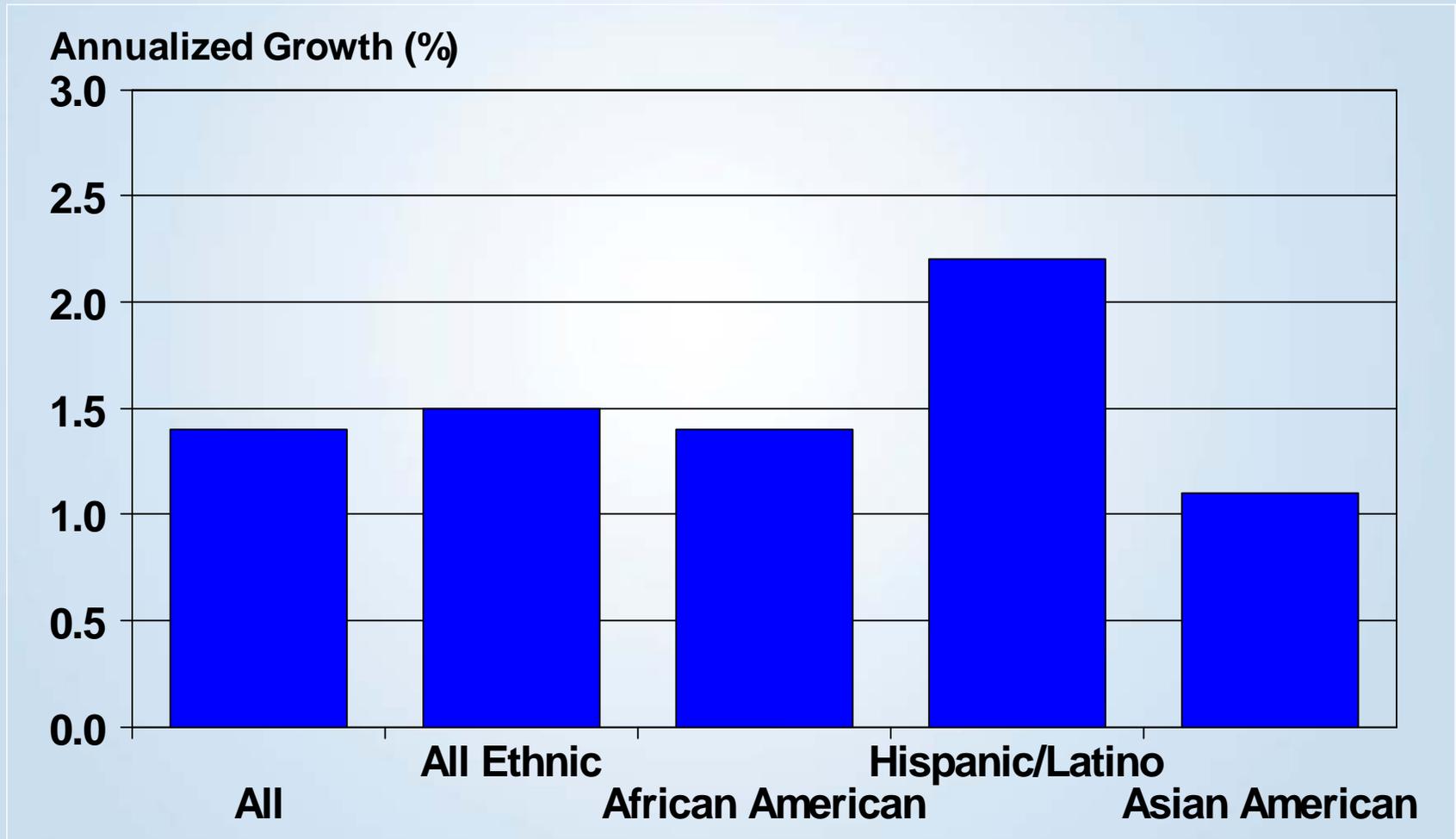
Sales Growth at U.S. Ethnic-Owned Firms

1997-2002



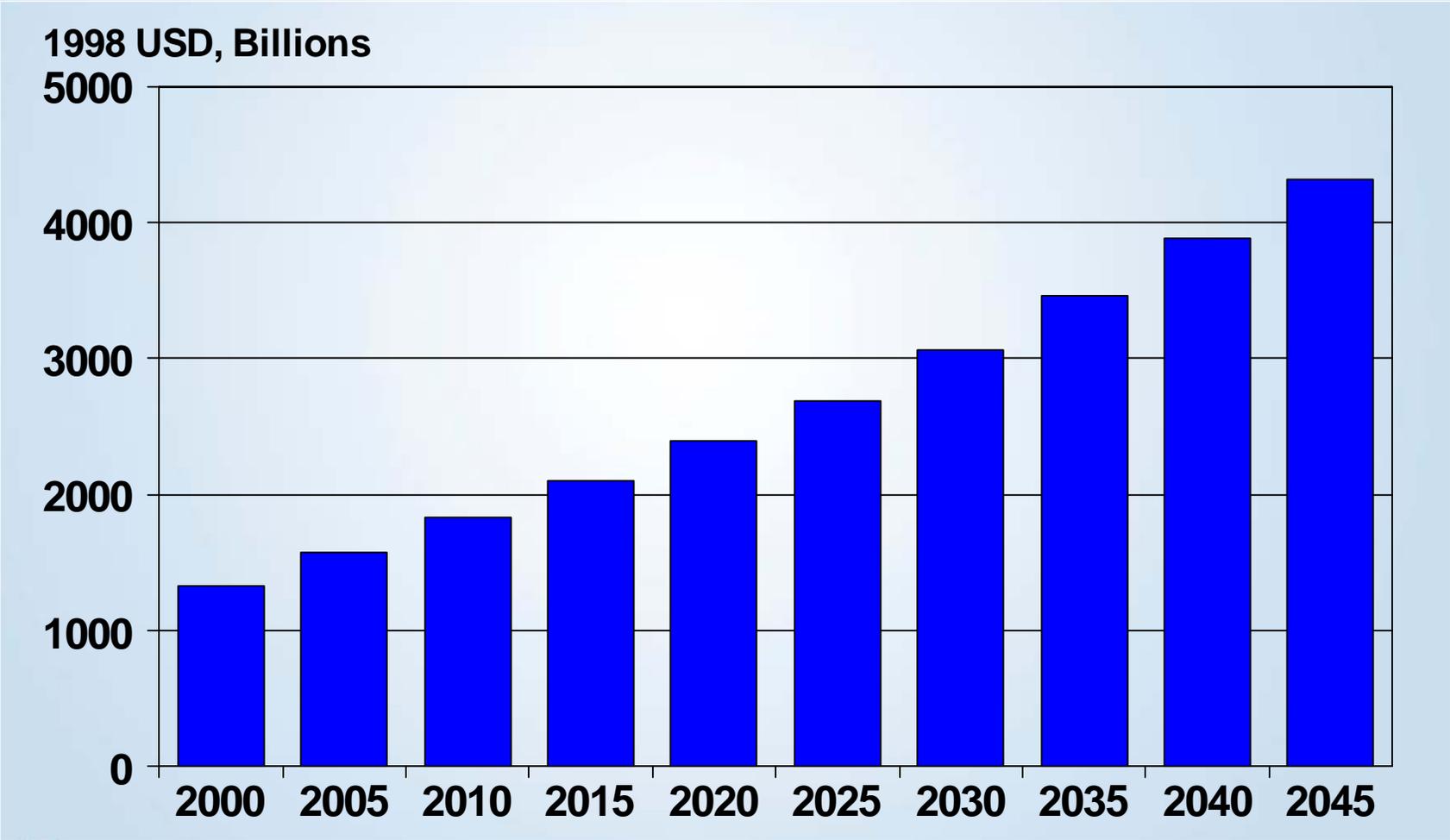
Job Creation by U.S. Ethnic-Owned Firms

1997-2002



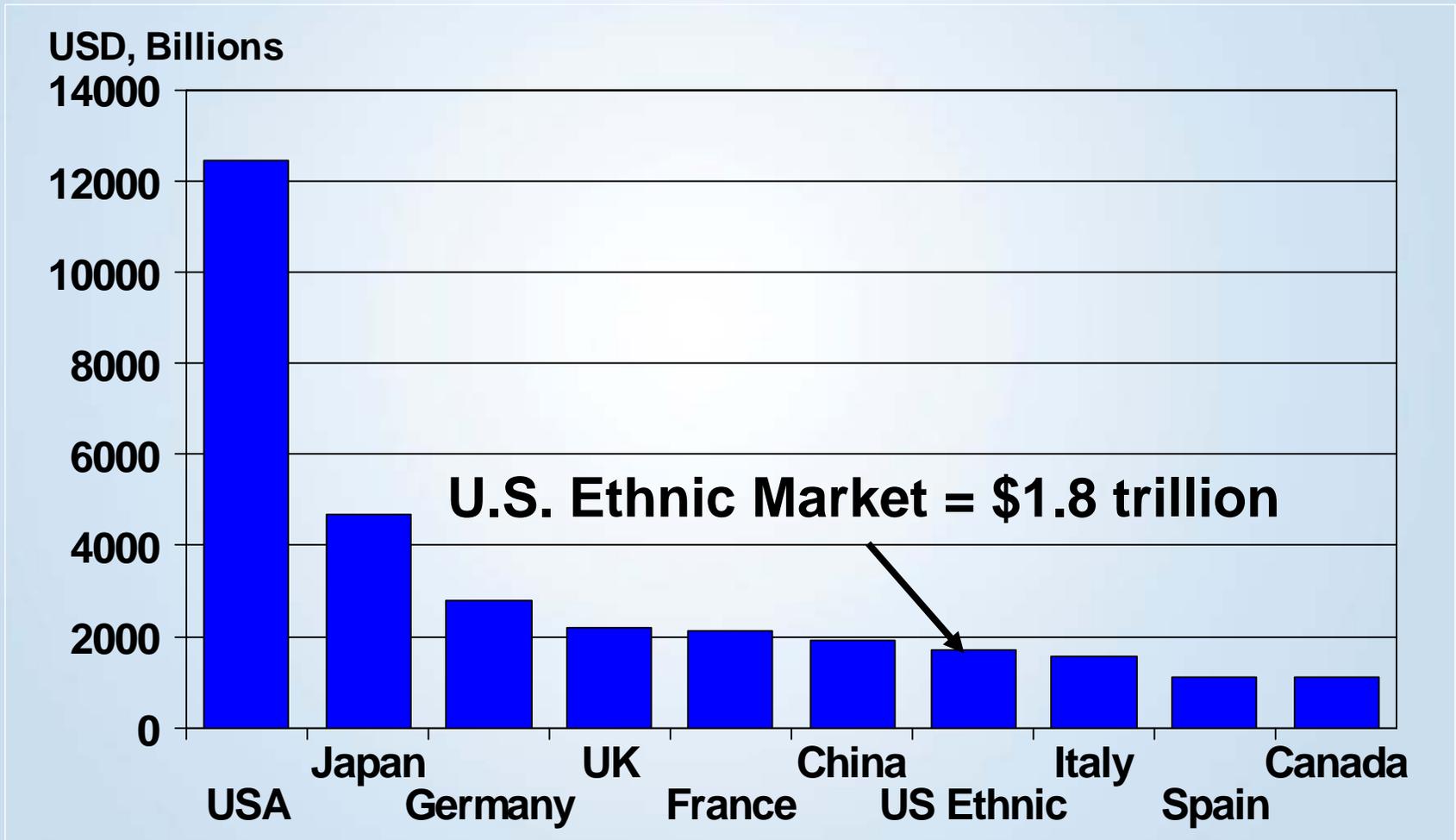
Growing U.S. Ethnic Purchasing Power

2000-2045



U.S. Ethnic Market

World's 7th Largest Economy in 2005



Strategy for investing in LMI areas: Direct Financing

- *Gap Financing*
- *SBA 504*
- *Loan Guarantees: SBA, USDA, New Markets Tax Credits (NMTC)*



DIRECT FINANCING

Gap Financing

Advantages

- Provides subordinate financing (usually working capital) to fill a collateral gap
- Provides flexibility in tight credit environment
- Provides competitive advantage in tight credit market
- Best for small and regional banks in competitive

Disadvantages

- More complicated deal
- Longer transaction time



DIRECT FINANCING

SBA 504

Advantages

- **Allows bank to make loans where there is a collateral shortfall**

Disadvantages

- **Reduces size of bank loan**
- **Cumbersome process**
- **Increased closing costs**
- **Limited to fixed assets: real estate and equipment**



DIRECT FINANCING

SBA and USDA guarantees

Advantages

- Mitigates risk
- Credit rated loans acts as a gatekeeper for SB loans
- Guarantees up to 80% of bank investment
- Efficient transaction process

Disadvantages

- Difficulty in making loans in LMI area because of low credit score
- Credit rated loans by SBA discourage banks from working with businesses unless there is a delinquency.



DIRECT AND/OR INDIRECT New Markets Tax Credits

Advantages

- Above market return
- Equity component secure bank financing
- Makes unbankable deals bankable

Disadvantages

- Long processing time
- No recovery of any principal for seven years
- Smaller loans (under \$2 million) are difficult to do (but can be done)



Strategy for investing in LMI areas: **INDIRECT FINANCING**

- **Program related investments (PRI's)**
- **Equity Equivalents (EQ2)**
- **Line of Credit**
- **NMTC pool**
- **Microenterprise**



INDIRECT FINANCING

PRI's, EQ2s and Lines of Credit

Advantages

- Provides access to the LMI community without taking on the cost and risk of individual deals
- Strong CRA credit. EQ2s allow for a multiplied CRA lending test credit: that is, the bank gets credit for a pro-rata share of the intermediary's *total lending*.
- PRIs have a term and are repaid

Disadvantages

- Both PRIs and EQ2s are generally made to nonprofits and therefore difficult to foreclose
- EQ2s are evergreen loans, e.g. with a ten year term and a one year annual renewal
- Poor earnings, high risk



INDIRECT FINANCING

NMTC pool

Advantages

- Offers market rate return in LMI areas
- Some control on investment decisions
- Relatively secure loans
- Loan fully repaid in seven years
- Leverages CRA credit
- No due diligence expense

Disadvantages

- No return of principal for first seven years of investment



Why work with CDFIs?

- **Provide systematic access to LMI markets**
- **Provide new innovative flexible products which meet market needs**
- **Provide access to public monies which can leverage private investment**
- **Provide training and business advisory services which strengthen small business investments**

