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Community Development Credit Unions: Partners or Competitors?

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When you think about local bank partners, it's likely that non-profit organizations and local governments come to mind. This is true in most cases; but lately, some banks have been "pushing the envelope" by choosing rather unconventional community partners. Consider, for example, the growing number of productive partnerships between credit unions and banks. The majority of these partnerships involve a unique type of credit union commonly known as a community development credit union (CDCU). This article will present examples of current partnerships, highlight the technical aspects of CDCUs and explore how banks can benefit from working with CDCUs.

Serving "Unbanked" Communities

In recent months, Citibank California has made substantial investments in two CDCUs: the Allen Temple Baptist Church Federal Credit Union in Oakland and the Comunidades Federal Credit Union in the Pico Union district of Los Angeles. Why would Citibank California view these CDCUs as partners rather than competitors? According to Jose Arce, Director of Community Investment for Citibank California, a CDCU is a completely "different animal" from a mainstream credit union. Specifically designed to serve low-income people and communities, CDCUs rarely compete for a bank's core consumer market. Instead, CDCUs provide loans and retail financial services to

communities that have traditionally gone "unbanked." CDCU customers are usually people with savings of a few hundred dollars or less, borrowers with no or imperfect credit, and local entrepreneurs who need small loans of a few thousand dollars to jump-start their business.

By partnering with CDCUs, banks not only extend financial services to underserved communities, but they develop potential new customers. CDCUs establish themselves in communities where financial services are sparse, enabling potential bank customers to gain the credit history and banking experience they need to be traditionally "bankable" in the future.

There are approximately 390 CDCUs in the United States, and they are chartered by the National Credit Union Administration (NCUA), an independent federal agency that regulates and insures credit unions. The NCUA designates a credit union as "low-income" (or a CDCU) if it predominantly serves members who earn 80 percent or less of the nation's average median household income.

Playing by Different Rules

Once designated as "low-income," CDCUs play by different rules than "mainstream" credit unions. CDCUs can expand their capital base by accepting deposits from non-members or by receiving equity grants. They also have greater flexibility in determining their membership than do "mainstream" credit unions.

Recently, CDCUs were granted the authority to obtain subordinated debt from philanthropic sources and to count the debt as "secondary capital." This secondary capital is a loan that must be repaid but is subordinated to all other CDCU debt. Using subordinated debt to strengthen their capital position, CDCUs seek additional deposits to expand their lending capacity. Finally, CDCUs are also eligible for low-interest loans, deposits, and technical assistance from NCUA's Community Development Revolving Loan Program.

Partnering with a CDCU

Most bank/CDCU partnerships include non-member deposits by banks for a term of one year or longer, at rates of zero to two percent. Non-member deposits in an NCUA-designated CDCU are insured by the NCUA for up to \$100,000. On average, CDCUs rely on area banks for nine percent of their non-member deposits. The other 91 percent come from foundations, other credit unions, and member deposits.

Banks and CDCUs are continually finding new ways to work together. Don't be surprised to find banks financing secondary capital programs to fund CDCU reserves or providing in-kind assistance such as financial training, donations, and security assessments.

In addition to working with CDCUs directly, banks can opt to support CDCUs through the National Federation of Community Development Credit Unions (NFCDCU). NFCDCU is a 501(c)(3) charitable organization which serves as a national support organization for CDCUs. With a membership of over 150 CDCUs in 35 states, NFCDCU offers three main capitalization products to benefit CDCUs:

- a secondary capital program;
- a non-member deposits program; and
- an equity grants program.
- NFCDCU also provides CDCUs with technical assistance training and organizing assistance such as help with fundraising, business planning and applying for government charters.

Competing for Lending Opportunities?

Banks and CDCUs don't usually compete for lending opportunities. In fact, few banks are interested in making the typical CDCU loan. For example, the Santa Cruz Community Credit Union (Santa Cruz Community) in Santa Cruz,

California, has \$4.7 million in loans to small businesses. The majority of these loans are small enough (\$5,000 to \$25,000) that they are of little interest to larger financial institutions. Similarly, CDCUs rarely compete with banks for large commercial loans since the NCUA limits a CDCU loan to a certain percentage of a CDCU's equity base. Santa Cruz Community has a loan limit of \$402,860 based on its equity base of \$2.7 million.

Rather than competing with banks, CDCUs help develop new bank customers. According to Jim Sudduth, Executive Director of Santa Cruz Community, new businesses often look to his credit union for small, start-up loans of a couple of thousand dollars. Once these businesses become stable and their credit needs grow beyond the Santa Cruz Community's loan limit, they often turn to larger financial institutions for a wider range of financial services.

In Phoenix, Arizona, a partnership between Wells Fargo Bank and a CDCU called Chicanos Por La Causa (CPLC) gives new meaning to the term "cooperative." Sharing a 4,000-square ft. building that was formerly a Wells Fargo branch, Wells Fargo and CPLC will provide financial services to the South Phoenix community beginning in March 1998. CPLC will occupy 3,000-square ft. while Wells Fargo will operate a mini-branch in the remaining 1,000-square ft. Will there be competition for customers? "Probably not," says Edmundo Hidalgo, Vice President and Community Development Officer of Wells Fargo. "Wells Fargo and CPLC won't compete because they serve people with different needs and backgrounds."

This unique one-stop-shopping arrangement provides consumers with a continuum of financial services, which underscores how the services of traditional banks and CDCUs can complement each other. CPLC works with customers who have limited or no credit, helping them take their first steps towards accessing capital. Once they've developed reliable credit histories,

Wells Fargo offers these customers the more traditional financial services of a bank.

CDCUs and the CRA

According to the revised regulation, a bank's partnership with a CDCU will receive consideration under the new Community Reinvestment Act (CRA). Under the CRA Investment Test, regulators will consider investments, grants, deposits or shares in CDCUs as qualified investments. Similarly, a subordinated loan to a CDCU may be considered a community development loan under the Lending Test. Banks providing CDCUs with technical assistance, financial planning, or credit counseling can expect these activities to be evaluated under the Service Test.

Beyond the CRA Benefits for banks that partner with CDCUs extend beyond the CRA. In 1994, Congress enacted the Community Development Financial Institutions Act which included the Bank Enterprise Awards (BEA) Program. The BEA program rewards banks that invest in distressed areas. One way for banks to participate in the BEA program is to invest in a CDCU that has been certified by the federal government as a Community Development Financial Institution (CDFI). To become a CDFI, a CDCU must demonstrate the following:

- its primary mission is to promote community development;
- it has a designated target market that is either low-income or has historically lacked access to credit; and
- it is not an entity of the state or local government.

The majority of CDCUs would qualify as CDFIs, but not all of them have the resources to complete the extensive CDFI application process. Currently, approximately 30 percent of CDCUs have applied for and received CDFI designation. Banks investing in CDFI-certified CDCUs are eligible for BEA cash awards of up to 15 percent of the value of their investments.

When looking for ways to serve communities that have traditionally gone “unbanked,” it makes sense to consider partnerships with CDCUs. These partnerships can improve CRA performance and increase access to BEA grants. They also help financial institutions build bridges into low-income communities by extending credit to underserved populations and, at the same time, developing new bank customers.

If you are interested in learning more about CDCUs, please contact: Joyce Jackson, Director, NCUA’s Office of Community Development Credit Unions at (703) 518-6610; Cathie Mahon, Program Officer, NFDCCU at (212) 809-1850; or, contact CDCUs directly. The following is a list of 12th District CDCUs.