Micropolitan Community Reinvestment Trusts

By Kevin O'Brien, President, Sovereign Capital, Inc.

Financial Institutions face unique challenges in complying with the CRA in smaller "micropolitan" communities where there are few investment opportunities with acceptable portfolio risk. Opportunities that can be found tend to be characterized by high levels of distressed infrastructure.

Small municipal governments face their own challenges in financing community facilities and making physical improvements. The costs of debt rating and issuance of debt are frequently prohibitive because of relatively small-sized bond issues in micropolitan areas.

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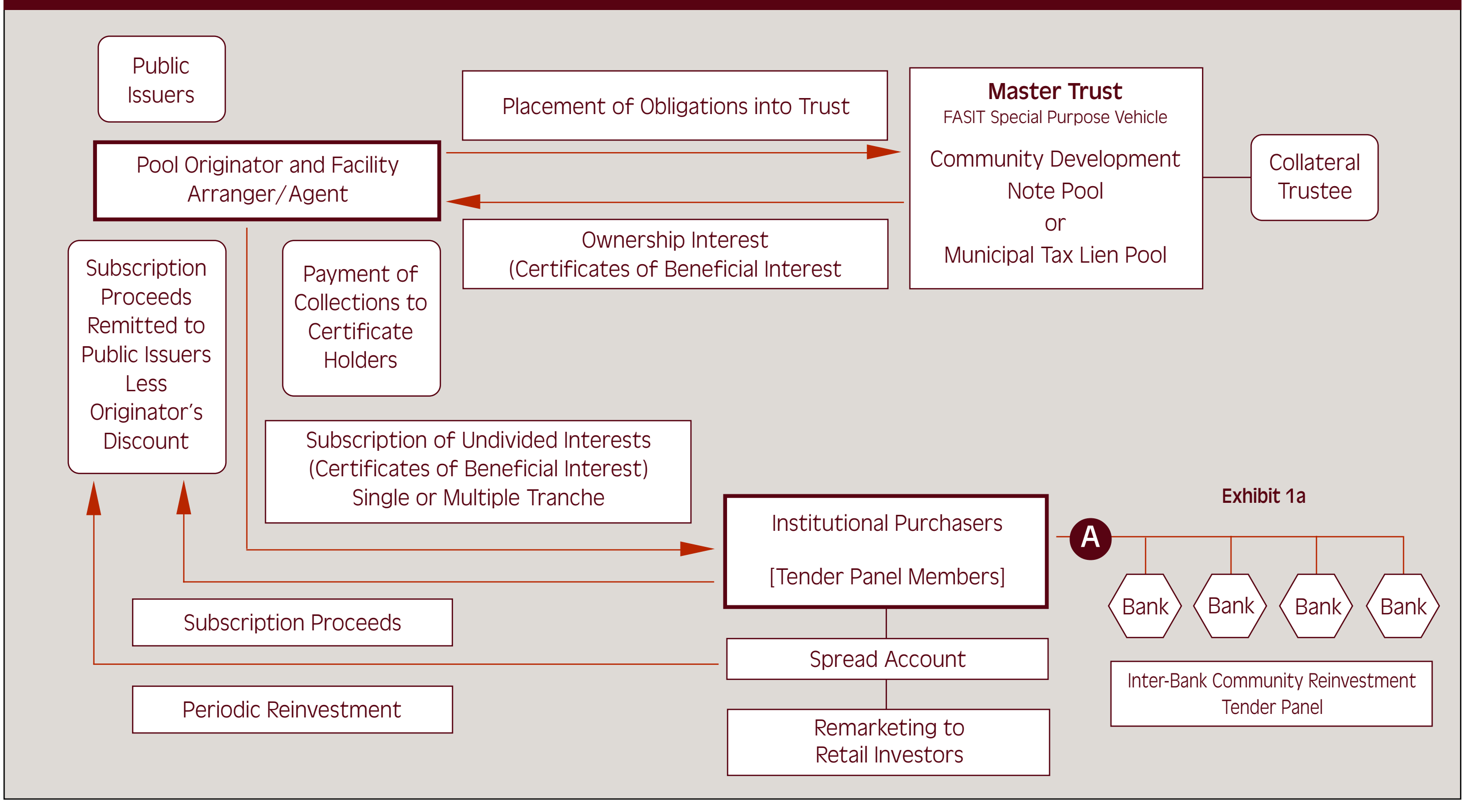
This article offers a potential solution for both financial institutions and small community governments: special asset securitization trusts. These trusts, while still in a conceptual phase, could operate as revolving debt pools for small cities.[1] Small city governments, special districts, schools, hospitals and other taxing jurisdictions could collectively issue debt obliga-

1 *The IRS allows for the creation of trusts that securitize pooled debt obligations. These obligations are treated as debt for federal income tax purposes so that interest is deductible.*

Community Reinvestment Trust Operating Structure



tions and realize substantial savings in debt rating fees, underwriting costs, and interest expenses, since such costs would be shared among pool participants. Collectively, these municipalities could reduce their interest costs since diversification would improve their credit profiles and since "quality of life," indicators, which are generally high for small cities, could be considered as rating criteria.

Financial institutions could choose either to sponsor or invest in these trusts. Sponsors would create the trusts and could originate bridge loans, secured by tax anticipation notes, which would initially fund the trusts. Municipalities would, of course, place their yet-to-be-subscribed obligations into the trusts.

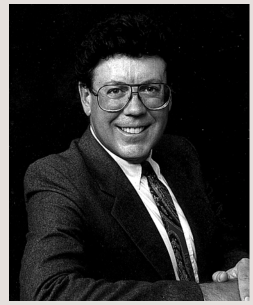
Investors, including financial institutions, would then purchase "community reinvestment certificates" issued by the trusts, much as they would purchase securitized packages of credit card receivables or automobile loans. This same process could apply for the sale of securitized municipal tax liens, which are projected to grow at $5 billion per year.

Besides sponsoring trust obligations or investing in certificates, financial institution representatives could choose to serve on "inter-bank tender panels" which would periodically review certificates issued by the trusts or review offering memoranda describing specific issues.

In addition to favorable customer and public perception, financial institutions could benefit from CRA investment test consideration since products designed to finance community and economic development initiatives sponsored by local governments qualify. Also, investment interest income from subscription of community reinvestment certificates and reduced portfolio volatility through diversification of credit risk would be advantages. Sponsoring financial institutions would also have the capability to earn financial advisory and facility fees. Finally, sponsoring banks could create bridge funds to provide small city issuers with interim financing before obligations are securitized, generating an additional source of fee revenue. Investing institutions could hold these obligations for their own accounts or could re-price them for retail distribution as individual investor account products.

Through participation in this program, financial institutions could directly and profitably facilitate community development projects within targeted lending markets, creating foundations for future profitability from population and business growth through development of local and regional credit markets. The trusts could also improve access to capital for economically disadvantaged communities and ensure availability of financial resources for small communities across America. ***CI***

If you are interested in pursuing this idea, please contact Kevin O'Brien at Sovereign Capital, Inc. in Tucson, Arizona. Tel: (520) 615-4525 / Fax: (520) 749-3304.



About the Author

Over the past sixteen years, **Kevin O'Brien** has worked in both corporate and economic development finance. As an investment banking professional in California, Mr. O'Brien specialized in emerging market transactions, debt conversion finance and special situations, and participated in the creation of special purpose vehicles utilized in the issuance of asset-backed securities and other specialized financial structures. As president of Sovereign Capital, Inc., Mr. O'Brien pioneered the creation of First Nations and small city economic development finance programs, including creation of a regional air service program to benefit underserved communities. He also developed the Exitbond® program for increasing private investment on Native American reservations. Mr. O'Brien holds a Bachelors degree in Finance from Northern Arizona University.