A Report on the Study Trip to CDFIs in the US in March 2009

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[1] Purpose of this study trip

The purpose of this study trip is to understand the present situation of community investment, especially the activities of CDFIs in the US. I hope the study trip will give some practical hints to community finance organizations in Japan and will help advocates of the community investment policies in Japan.

Basically I believe that loans for nonprofits/social enterprises could significantly help their management as a funding source. Social service agencies and social enterprises must have their offices, service units, facilities, working capital, and so on.

We have very small cases of loans for nonprofits/social enterprises in Japan, partly because that most of commercial banks don't understand the management of nonprofits/social enterprises.

We can find other reasons of that. At first, Japanese tend to have negative attitudes against borrowing money. Most of nonprofits have short operating history and their management skills are not robust enough to borrow in order to enhance their business. The number of consultants who understand nonprofit management is very small and not enough to support nonprofit management well.

Japanese social finance institutions are called "NPO banks", which usually gather capital from individuals who want to make a difference by investing in NPO banks and lend to nonprofits/social enterprises. NPO banks have emerged since 1994 and gradually grew up in size and number. There are about ten NPO banks all over Japan but the number of loans closed is not so many. NPO bank officers feel difficult to manage. We have neither tax credit program nor public grant to support nonprofit community financial institutions in Japan. Community financial institutions including NPO banks are severely regulated by FSA (financial service agency) as a commercial money lender, which is a serious problem for NPO banks. NPO banks managers hope to introduce a tax credit program and public grant for community investment.

Based on the present situation in Japan, I wanted to know how CDFIs and community investment policies work in the US. My major interests are: (1) the demand of loans by nonprofits, (2)the loan program, (3) the technical assistances, (4) attracting investors, and (5)the community investment policies by the government.

[2] Overview of this trip

I made a plan of this short study trip. I wanted to visit the government (policymaker/ regulator), national association of CDFIs, individual CDFIs and advocacy organization/ research institution.

I visited ten institutions in total. The itinerary was:

March 3rd: left Tokyo and arrived in Washington DC.

4th: visited Calvert Foundation and met Lisa Hall, James Radja and Amber Kuchar.

5th: visited Opportunity Finance Network and met Mark Pinsky.

visited The Reinvestment Fund and met Margaret Berger Bradley and Sara Vernon Sterman.

6th: visited the Office of the Comptroller of the Currency and met Barry R. Wides and Kristopher M. Rengert.

8th: moved from Washington DC to Chicago.

9th: visited Chicago Community Ventures and met Susan Alnaqib.

visited Chicago Community Loan Fund and met Calvin L. Holmes.

10th: visited Woodstock Institute and met Dory Rand, Geoffrey Smith and Tom Feltner.

visited Shore Bank Corporation and met Michelle Collins, Joseph Uttech and Scott Kenemore.

11th: visited National Community Investment Fund and met Saurabh Narain.

visited Illinois Facilities Fund and met Trinita Logue and Lucy Tuck.

12th: left Chicago to Tokyo.

I really appreciate all of you listed above. You willingly gave me their precious time for my interview although you are very busy doing your jobs. In addition, I also appreciate the staff members who kindly assisted/coordinated my visit. I wouldn't have accomplished this study trip without your sincere help. Thank you very much.

[3] Results

(1) The demand of loans by nonprofits

[Why is the demand of loans increasing?]

Most of interviewees pointed out that the demand of loans by nonprofits is increasing now. Why? The main reasons lie in the recent credit crisis on the one hand and the increasing demand of social services on the other hand.

1) The affect of credit crisis and economic recession. Banks are too cautious to lend to nonprofits now because banks are afraid of taking risks. Nonprofits receive fewer amounts of donations than usual therefore they need to find another source of fund. Nonprofits which undertake social services receive fee from the government, but the prolonged fee payment forces nonprofits to borrow bridge-loans. Obama administration tries to create employment by providing more social services, which might generate more demand of loans by social service agencies.
2) The increasing demand of social services. We can see the increasing demand for affordable housing and charter schools. Nonprofits tend to earn more income rather than getting donations and/or grants. Social enterprises are increasingly paid attention to recently. These factors also affect to increase the demand of loans.

[The sense of resistance against loans]

Managers and board members should be prudent and cautious about borrowing money, but, according to interviewees, Americans don't hesitate to borrow. "It's okay to borrow" if you have cash-flow. In contrast, Japanese have usually negative image against loans and are very afraid of failing to paying back. The difference of basic attitude about borrowing money between Americans and Japanese might affect nonprofits' behavior of fundraising. Most of Japanese nonprofits try to avoid borrowing money.

(2) The loan program

[What are the main target clients of CDFIs?]

There are a variety of CDFIs including banks, loan funds, venture capitals and credit unions. These CDFIs could be categorized in other way by different criteria. What kind of clients does the CDFI lend to? What kind of loan products does the CDFI provide? Where does the CDFI serve? How does the CDFI focus in specific industries/ areas?

Some CDFIs only lend to nonprofits, others lend to social enterprises which provide services in deprived area. Some CDFIs only provide long-term real estate loans,

whereas others provide short-term working capital loans. Some CDFIs only lend to large-sized and established organizations, whereas others lend to smaller and younger organizations with hands-on technical assistances.
According to a survey conducted by OFN, only 7 CDFIs primarily lend to community service nonprofits. Interestingly, some CDFIs are really committed to support specific industries like child care, charter schools, health clinics, housing and so on. We have a few NPO banks in Japan which are focused in ecological businesses, but we don't have NPO banks which are committed to real estate loans.

[Collaterals and co-signers: the difference between America and Japan]
CDFIs always request collaterals to loan applicants and don't usually need co-signers. Lenders think much of the organization's track record and the performance and don't rely on members' guarantee. They don't adopt character lending, which refers to manager's character during reviewing process. In contrast, Japanese NPO banks request co-signers instead of collaterals and do character lending. In other words, American CDFIs think much of organizational factors whereas Japanese NPO banks think much of individual/human factors.

[Loan interests]
Loan interests are a little different among CDFIs and depend on each CDFI's policy, but tend to be lower than those at commercial banks. In addition, some CDFIs don't charge origination fee or technical assistance fee. The clients of CDFIs can enjoy these fringe benefits when they borrow money and get assistance services.

(3) The technical assistance

[What kind of technical assistance services are provided?]
Technical assistance is said to be one of the major features of CDFIs. CDFIs' main target was thought to be too risky to lend and less profitable. CDFIs have succeeded in lending to their clients by providing hands-on technical assistance services. In other words, technical assistance might be a key factor to be successful.
It is quite interesting that most of CDFIs I visited provide a variety of assistance services including seminar and consulting. Some CDFIs focus on specific field: management of charter schools, real-estate trading and so on.

[Management support for nonprofits is provided by consultants]
I'd guessed that management support organizations (MSOs) provide support to

nonprofits in the US. However, MSOs are not so popular and most of nonprofits are not likely to make use of MSOs. Instead, consultants (individual/ firm) are much more popular among nonprofits. We have a lot of MSOs in Japan, and have only a few individual consultants.

(4) Attracting investors

[What benefit do investors pursue by investing in CDFIs?]
I was wondering what benefit investors are pursuing by investing CDFIs. Investing in CDFIs doesn't seem to be more profitable or safer for banks than in for-profit companies.
Some CDFI officers pointed out social return is the most important benefit for investors. It is sure that investing in low- and moderate- income area through CDFIs will generate social impact, but do investors sincerely want to do that?
I'm interested in socially responsible investment (SRI) movement, which is the most popular in the US among the world. SRI is getting more popular also in Japan after 2000. However, few investors are willingly to commit to community investment and there are only a few cases of community investment in Japan. Most of responsible investors are interested in eco-businesses and corporate governance of big companies in order to avoid investment risks.
Other CDFI officers pointed out financial return is also important benefit for investors. If a CDFI has a robust management style and long-term excellent operating history, a bank might think that investing in the CDFI is safe and less risky.
After the credit crunch, commercial banks are very cautious to lend to CDFIs, therefore CDFIs can't easily get capital from banks. The situation must be much harder for uncertified CDFIs. Relationship of trust between banks and CDFIs is needed in this hard time.

[Rating system: is it useful for CDFIs?]
The role of national association of CDFIs—Opportunity Finance Network—has changed in its 23 years history. OFN (formerly National Community Capital Association) provided information for its members and peer review at the beginning. Now OFN provides a variety of services including capital, consulting service, matching between investors and CDFIs. Above all, the national association started a rating system called CARS recently. The purpose of the rating system is very clear: to attract investors by improving the transparency of individual CDFIs' performances.
The basic idea of CARS is shared and supported by CDFI managers. However, I found a

little difference about the effect of CARS among managers. Some managers think the outstanding effect is to analyze the organization's strengths/weaknesses and to help improve the management. Other managers said that CARS rating result is helpful when they ask a bank to invest in the CDFIs and therefore CARS might promote investment, but the bank wouldn't omit direct reviewing process.

Rating system has a function of natural select: it must be helpful for excellent CDFIs whereas it might harm badly rated ones. If CDFI managers are not confident to win excellent scores, they will hesitate whether they should take part in the rating system. I'm wondering that's why the number of CDFIs which are already rated by OFN.

The effect of attracting investors has not surely proven yet, but I hope rating system will be helpful for all of CDFIs.

On the other hand, NCIF developed its own metrics to attract investors: NCIF Social Performance Metrics. NCIF was settled by Shore Bank and Bank of America, and created an original category, Community Development Banking Institutes (CDBIs). NCIF intends to identify CDBI sector by its own objective metrics. Although there are a few differences between CARS and NCIF metrics in terms of target, data used, process and criteria, the basic purpose of attracting investors seems to be common.

(5) The community investment policies by the government

The community investment policies by the government including Community Reinvestment Act (CRA) regulation, New Market Tax Credit (NMTC) program and CDFI Fund award surely boosted community investment in the US. These governmental policies are not seen in Japan, so much attention has been paid to by community finance institution managers and researchers.

All of interviewees strongly agreed that the governmental policies had huge positive impact on community development. In some cases, most of the capital of a CDFI comes from banks as "CRA-money". A CDFI manager pointed out CDFI sector wouldn't exist now without CRA regulation.

CRA regulation and NMTC have been criticized of insufficiency. The problems about these policies seem to be a little complicated and based on the uniqueness of US political background. However, it is quite interesting that FRB branch office is leading the discussion about modernizing the CRA regulation. I hope the CRA Modernization Bill will be passed at the Congress and be implemented soon.

[4] Discussions

I found a huge gap in many points on community investment between the US and Japan through this study trip. Japanese nonprofits tend to avoid borrowing money whereas American nonprofits don't hesitate to borrow. Japanese nonprofits rarely try to raise capital to purchase their offices whereas American nonprofits positively borrow real estate loans. Japanese community finance institutions, which are called NPO banks, prefer character lending and require co-signer whereas American CDFIs think much of 'organization' factors rather than 'individual' factors in the reviewing process. American CDFIs provide much more technical assistance services to their clients than Japanese NPO banks do. Japanese NPO banks still heavily rely on individual investors who want to commit to social change whereas American CDFIs collect most of capital from institutional investors including banks and foundations which seek financial return. American CDFIs are supported by governmental community investment policies whereas Japanese NPO banks suffer from the recent harsh regulations on lending and investment activities. NPO banks are really afraid whether they can survive under these regulations. We don't have charter schools or affordable housing in Japan whereas these are the main drivers to promote nonprofit loans in the US.

These differences are too huge to compare situations in two countries. Because of the difference of cultural and political background, it might not be so meaningful to make an easy comparison of two countries. However, I believe there are some common points despite of the differences.

1) The necessity of loans for nonprofits/ social enterprises as a means of fundraising. In general, nonprofits/ social enterprises which earn income by providing social services need capital to start/ advance their businesses but they are less likely to rely on donations or philanthropy. We can recently see the trend of commercialization of nonprofits worldwide although the speed of commercialization is not the same by country, and the role of community finance institutions must be getting more important.

2) The effect of technical assistance for clients. Community finance institutions usually provide their clients technical assistance (TA) services. Despite of small differences of TA services, TA will help the clients improve their management and decrease the risks of default. In addition, TA can empower the clients and sometimes make a path to commercial banks. Some clients which are now helped by CDFIs TA program will grow up and be able to borrow from banks in the near future. TA might be very important especially for social entrepreneurs who can't find appropriate management support by

themselves.

3) The importance of governmental supportive policies. Community finance activities/ institutions couldn't keep going and grow up without public support scheme. The bigger the size of community finance capital is, the more CDFI should receive capital from banks instead of individual investors. Financial return will be inevitable to attract institutional investors in terms of fiduciary duty. Tax credit program and regulation to big banks could play a key role to collect capital from banks in Japan, although historical and social background in Japan is quite different from those in the US.

[5] Conclusion

This study trip showed me the necessity of further research. The three points listed above are no more than my hypothesis. I would like to consider these points from the viewpoints of borrowers and to know how they evaluate the effect of TA and governmental policies. In addition, I would like to assess the possibility of introducing community investment policies to Japan.

My colleagues who work for Japanese community finance institutions, NPO banks, love to study the experience of CDFIs in the US. I will come back with them to visit CDFI offices. I might ask you to accept our visit to your office again in September. I heard that CDFIs have a hard time now because banks are reluctant to invest in CDFIs after credit crisis, but I hope everything will be fine for you in the near future.
Thank you very much for your cooperation.