NCIF Annual Development Banking Conference
Strategies for the Next Millennium
Conference Summary

November 13-14, 2006
Chicago

National Community Investment Fund
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Acknowledgements

We, at National Community Investment Fund (NCIF), would like to thank the Federal Reserve Bank of Chicago and the Federal Deposit Insurance Corporation as key Event Partners as they provided significant mind-share and logistical support for the Conference and in convening the Community Development Banking Institutions (CDBI) industry. In particular, we want to thank Mike Berry and his team at the Chicago Fed and Bob DeYoung at the FDIC. We are grateful to Director Tom Curry, Vice Chair Marty Gruenberg, Barbara Ryan and Bob Mooney at the FDIC for their ongoing support to the CDBI and the Minority Depository Institutions industry.

We would like to thank Linda Davenport, Deputy Director, CDFI Fund, for her leadership in guiding the CDFI industry forward. There is a lot to be done and we look forward to enhancing this partnership.

We are delighted to have the involvement of Barry Wides, Deputy Comptroller, Office of Comptroller of Currency. He has been a keen and regular participant at the NCIF Conference, which reflects his personal belief in the work that is being done by the CDBI Industry.

NCIF would like to thank its Event Sponsors – Bank of America, JP Morgan Chase, Sandler O’Neill and Ryan Beck for their support of the event.

We are privileged to have the leadership of Ron Grzywinski and Mary Houghton at ShoreBank, who are key mentors in taking the industry forward through action, more than words.

Finally, we value the ongoing guidance and support from NCIF Trustees – David McGrady (Chair), Mary Tingerthal, Phyllis Caldwell and Nick Smith. They have been very deliberate in taking forward the NCIF mission over the last several years.

The NCIF Conference is organized primarily to support the CDBI Industry and its usefulness grows exponentially with the industry’s active participation. We are delighted and honored to have hosted about 43 Chief Executive and other Officers of CDBIs for these two days. Industry leaders flew in from all over the country – California, Oregon, New York, Atlanta, Louisiana and Arkansas – and actively contributed in the conference proceedings. We believe that this strength in working together for the ultimate client – the underprivileged in the country - is critical.

Finally we would like to acknowledge support of a few key individuals at NCIF – George Surgeon, Joe Schmidt, Valarie Carroll, Mary Hedderman, and Aric Shimek – without whom the Conference would not have taken place. George, makes stuff happen with his inimitable smile, while Joe is the workhorse. We also want to acknowledge Sumeet Swarup and Yvonne Chao who took copious notes of the conference proceedings.

Saurabh Narain
and the NCIF Fund Advisor Team
December 12, 2006
Agenda

Monday, November 13, 2006

Introduction – Introduction on Industry, NCIF and Themes for Conference
Saurabh Narain, Chief Fund Advisor, National Community Investment Fund

Investor Perspectives Panel
Understand investor perspective as they invest in community development financial institutions. Is there a tradeoff between financial return and development impact? What do Community Development Banking Institutions (CDBIs) need to do to attract more capital from investors?

♦ David McGrady, Chairman, NCIF & Director, City First - Moderator and CDFI perspectives
♦ Katy Lindblad, Community Development Director, Fannie Mae, private equity perspectives
♦ Dudley Benoit, Community Development, JP Morgan Chase, commercial bank perspectives on equity and debt investing
♦ Luther Ragin, Heron Foundation, on foundation perspectives on CDFIs
♦ Paul O’Connor, Ryan Beck, on equity and quasi equity capital market instruments available for CDFIs

Small is Beautiful or Economies of Scale – CD Banks
Should CDBIs grow in size or remain relatively small? Understand how CDBIs have addressed this question and the challenges they face as they grow, attract capital and make decisions on remaining private or going public

♦ Dan Letendre, Director, Merrill Lynch CDC - moderator and investor perspectives
♦ Debbie Wright, Chairman and CEO, Carver FSB, NY - growing to compete in the market; managing mission with growth.
♦ Paul Hudson, CEO, Broadway FSB - Opportunities, challenges and costs associated with a small publicly listed bank
♦ David Reiling, CEO, Sunrise Banks, MN – pros/cons of growth vs. remaining small but with exceptional returns

Development Impact - Historical perspective and Future Direction
Research commissioned by NCIF historical financial and developmental performance of the CDFI bank sector and NCIF’s ongoing work to identify a larger subset of institutions that could qualify as CDBIs based on account of their strong development performance.

♦ Michael Berry, Federal Reserve Bank of Chicago - moderator and setting the stage
♦ David Porteous, Bankable Frontier and Saurabh Narain, NCIF - History of financial performance and development impact of CDFI industry - new frontiers for screening
♦ Bob DeYoung, Associate Director, FDIC on comparison of CDFIs with community banks
♦ Joe Schmidt, Fund Advisor, NCIF - impact analysis at NCIF

Keynote Speech
Linda Davenport, Deputy Director CDFI Fund, Department of Treasury

Keynote Speech
Tom Curry, Director, FDIC and Chairman, NeighborWorks®

Keynote Speech
Linda Davenport, Deputy Director CDFI Fund, Department of Treasury
Implications of new Guidance on Commercial Real Estate Lending
The regulators are coming out with guidance on the size of commercial real estate on the books of community banks, asking for enhanced risk management and possibly more capital. This is one of the most important new regulations which will affect community banks. This panel will discuss the issues associated with this guidance.

♦ Ellen Seidman, former Director OTS/EVP, ShoreBank - moderator and CDBI perspectives
♦ Denise Dittrich, Federal Reserve Board - perspectives on commercial real estate concentrations
♦ Bill Dana, CEO, Central Bank of Kansas City, on impact of regulation on community banks

Catastrophe Risk -- lessons from Katrina
Hear perspectives on survival, hope and opportunity from Liberty Bank and Trust Company, New Orleans and lessons for CDBIs in planning for such catastrophes.
♦ Alden McDonald, CEO, Liberty Bank and Trust Company, LA

NMTC, CRA and Government Programs Opportunities
Learn about recent changes in government regulations, the value of NMTC subsidized transactions and the complexities of setting up the program. Role of intermediaries in maximizing value-to-cost ratio for CDBIs.
♦ Mary Tingerthal, Senior Vice President, Community Reinvestment Fund - moderator and CDBI perspectives
♦ Linda Davenport, Deputy Director, CDFI Fund, NMTC Program
♦ Barry Wides, Deputy Comptroller, OCC on changes in CRA and regulatory approach to investing in minority banks
♦ Ed Furash, CEO, City First Bank of DC - experiences, opportunities and challenges in executing NMTC transactions
♦ Richard Fuchs & Chris Memoli, Sandler O'Neil on repackaging and sale of single family, multi family and commercial loans for deriving CRA value

Valuation of CDFIs and Minority Banks
Valuing an institution is the most important tool in understanding the key drivers to business. Periodic valuation of an institution helps in identifying trends, opportunities and weaknesses.
♦ George Surgeon, EVP and CFO, ShoreBank Corporation on capital raising for minority and community development banks
♦ Bill Lyman, Managing Director, Sandler O'Neil on valuation for internal business and for external investor management
♦ Louis Prezeau, CEO, City National Bank of New Jersey on dilution of minority ownership issues, growth issues

Advantaged Businesses - Product Market Niches
Understand how some CDBIs have created ‘advantaged lines of businesses’. Learn from these experiences how to enhance CDBI's returns on equity and hence increase the ability to grow.
♦ Greg St. Etienne, Vice Chairman, First Independence Bank - commercial real estate lending and lending to charter schools.
♦ Gordon Hellwig, ShoreBank, on successful strategies for multifamily lending
♦ Anita Robinson, CEO, Mission Community Bank, CA on successful strategies in small business lending

Immigrant Populations, Rural Poor and FDIC Unbanked Initiative
Can banks make money in serving immigrant and lower income rural markets? Hear the experiences of bankers who are successfully working in these sectors and the challenges that they face. Also hear about technologies and fee based products that can help enhance fee income to offset margin compression.
♦ Michael Frias, National Coordinator, FDIC, Alliance for Economic Inclusion
♦ Matt Brophy, Regional Manager, Second Federal, IL, on serving Hispanic Markets
♦ Al Lau, CEO, First American International Bank, NY on serving Chinese immigrant populations
♦ Phil Baldwin, CEO, Southern Bancorp, AR, on serving rural poor
♦ Alice Greenwald, Director Capitalization, National Federation of Community Development Credit Unions (NFCDCU)
Overall Summary

NCIF differentiated its 2006 Annual Development Banking Conference by concentrating on Actionable Strategies for the Community Development Banking Institution (CDBI) sector to achieve following objectives:

♦ Share business strategies for **enhancing profitability** and creating new product lines by replicating successful experiences from one geography and business environment into another

♦ Measure and commemorate the **development impact** that is created by the CDBI sector, including institutions that are not currently certified CDFIs.

♦ Foster **peer-to-peer networking** which is key for ongoing business and growth.

In the following are session summaries of the individual panels and the presentations are available on the NCIF website ([www.ncif.org](http://www.ncif.org)).

We walked away with optimism that the 62 CDFI banks and thrifts are marching ahead in being profitable while creating spectacular and leveragable development impact. We believe that we have the potential of creating an asset class which will be interesting enough to the mainstream investors. More capital can be thus be raised and leveraged to serve the ultimate client – the underprivileged.
Session Summaries

**Keynote speech - Linda Davenport, Deputy Director CDFI Fund, Department of Treasury**
Ms. Davenport looked ahead into the future for actions to be taken by the CDBI Industry and challenges that it could face given how young the industry is (the CDFI Fund has been in existence for 10 years); she urged the industry to plan for growth over the next 10 years and also think about how it could differentiate itself and demonstrate its impact. She mentioned that the CDFI Fund will be putting reports from the Community Investment Impact System (CIIS) on their website; to get feedback from CDFIs, a survey has been mailed to all members to evaluate the effectiveness of the Fund’s programs and is also in the process of evaluating the NMTC program and its reach. Ms. Davenport also talked about the need to increase the number of CDFI banks and thrifts, since only 62 out of 8200 banks currently qualify as CDFIs, even though they have almost 40% of the total assets of the industry. Finally she talked about the personnel challenges faced by the Fund, and the fact that certain vacancies need to be filled quickly.

During the question and answer session, Ms. Davenport mentioned that they have and will continue to try to make the government programs more predictable. She did not expect any changes in the mandate of the CDFI Fund on account of changes in the Congress given that the Fund has bipartisan support. She did not have a view on the reauthorization of NMTC though she mentioned that there is a lot of interest for reauthorization from the industry.

**Session 1 - Investor Perspectives Panel**
The Investor Perspectives Panel talked about what investors are looking for in providing capital to the CDBI Industry. To help raise capital, they would like to see formal valuations by the institution, an expectation of a reasonable annual return (dividend and capital appreciation), a strong business plan, a strong management team and a plan and timeframe for liquidity and exit strategy.

The difficulties in generating timely exits and reasonable returns from equity investments were the key factors in the low attraction of common equity as an investment product. For a small company to go public is expensive (5% to 7% of offering) and high cost of ongoing compliance. However as an institution becomes larger this cost can be spread out.

**Other strategies and tips** for raising funds are: if high return on equity is not possible institutions should look at raising debt, trust preferred securities and non-cumulative perpetual preferred stock (NCPP). While some investors want market returns from their investments, there are others who are able to accept lower equity returns if the CDBI can demonstrate strong impact in the targeted communities. Return expectations from equity investments ranged from as low as 6% per annum to as high as 15% per annum.

**Editorial footnote** – The key to achieving above financial returns is not the return itself but a timely exit strategy with a reasonable price to book or price to earnings multiple. For example:

- Assume an annual Return of Equity 12% per annum
- Retention rate: 70%
- Annual accretion to Total Shareholders Capital 8.4% per annum
- Assumed Price to Book on exit 2.0 times
- Total annualized return 16.8% per annum

**Session 2 - Small is Beautiful or Economies of Scale – CD Banks**
The panel explored the pros and cons about being relatively small and focused vs. the advantages of growing. There are several examples of small banks that generate high returns on equity to their shareholders through dividend payouts by remaining very focused on local markets and products that they know well. By definition these institutions have a small and privately held shareholder base. Most institutions face issues with being small as their investor base broadens since the need for timely exits
increase; there are economies of scale associated with government programs (and hence smaller banks are unable to take advantage of these programs like NMTC); competition from the larger banks for deposits leads to lower margins and the cost of regulatory compliance.

On the other hand issues with seeking growth that were identified include – difficulty in finding appropriate growth areas (inner city, rural areas are not necessarily fast growth) that also provide reasonable return on equity and mission orientation; need for expensive infrastructure (physical space, technology) etc. The advantages with growth are typical - operational efficiency through standardization; constant innovation of new products and services and an increasing ability to hire/retain good people. When the institution becomes publicly owned it can provide liquidity to investors and use stock as currency for M&A transactions. On the other hand being public has its disadvantages too – this will probably reduce a broad based community ownership and may result in investor concentrations, there is greater time and energy spent on investor relations and disclosing information; high annual cost of being public (ranging from $250,000 to $500,000 depending on size of the organization); there may not be coverage by stock analysts if the institution is not providing high returns and there is a constant threat of hostile tender offers and proxy contests.

Some of the strategies for growth are – buy another company; apply for government programs like NMTC and BEA to raise funding/capital; take advantage of local and state banking development programs like Banking Development Districts, special provisions in CRA Act for specialty banks and entering into alliances with other organizations.

**Lunch keynote speaker - Tom Curry, Director FDIC**

Mr. Curry spoke about his perspective on CDBIs – CDBIs are increasing in lending and strategic importance for low to moderate income communities; they have many advantages such as relations with community leaders, products and services being tailored to the community, easier credit requirements and better relationship building abilities. He mentioned that there is a need to increase the number of institutions in the industry and to recognize their development impact.

He mentioned that the challenges for the CDBI industry (and the banking industry in general) include the risk of default due to greater exposure to real estate markets and some concentrations of and so-called ‘innovative, interest only or optional’ mortgage products. He complimented the work being done by CDFIs in reaching out to unbanked communities.

Mr. Curry talked about future steps for the industry – NeighborWorks® America is making a coordinated approach to foreclosures; FDIC is consulting experts to help with financial mainstream access for low income people by starting the Alliance for Economic Inclusion; increased CDFI certification is needed especially for banks with strong community development focus; and finding new methods to raise capital from mainstream investors so as to leverage the money received from government programs like NMTC.

**Session 3 - Development Impact – Historical Perspective and Future Direction**

This panel focused on a historical development impact analysis being done at NCIF as well as new methodologies being explored for measuring social performance. The new approach is much more quantitative and has the potential for creating an inverse correlation with cost of funds - involves calculating Development Lending Intensity (DLI) and Development Deposit Intensity (DDI) which measures the lending/deposit activity in low to moderate income communities. This new measure has the potential of identifying new CDBIs and commemorating their impact. Please check [www.ncif.org](http://www.ncif.org) for copy of the initial paper co-authored by David Porteous and Saurabh Narain.

Bob DeYoung also presented an initial analysis of historical financial performance of the CDFI sector compared to other community banks. There is an increasing proportion of real estate lending – especially commercial real estate lending – which has contributed to higher net interest margins for CDFIs. It was noted that home mortgage lending in LMI areas was less profitable than commercial or business lending in the same areas. A copy of Bob DeYoung’s paper will be available on the NCIF website soon. The panel
highlighted the need for the CDBI industry to **share private data** to demonstrate to investors the substantial impact that they create in the local communities.

**Session 4 - Implications of new guidance on Commercial Real Estate lending**

The panelists talked about the **need of the new guidance** on concentrations in commercial real estate (CRE) lending practices at community banks. This guidance is being proposed to be proactive in managing a perception of increased risk in the portfolios. Heightened scrutiny of institutions with concentrations will include an analysis of (a) board and management oversight (b) portfolio management, (c) management information systems (d) market analysis (e) stress testing and sensitivity analysis (f) credit underwriting standards and (f) creating a credit risk review function. There is a possibility that the regulators may also ask for greater capital coverage.

CDFI banks have expressed a concern about these regulations due to lack of clarity on the definition of “real estate” loans and the fact that the smaller community banks have, by definition, greater concentrations in geography and products. CDFI banks claim that they are careful in assessing these risks with low LTV ratios and high debt service coverage.

The panel discussed some **strategies for managing real estate portfolios**. These include - evaluating overall bank strategy and risk tolerance; ask the question – “do you want to be a community bank or real estate bank”; measuring exposure and keep track of risk metrics; setting up internal policies and procedures; and doing ongoing risk analysis and management of the portfolio as well as the borrower’s cash flow streams.

**Session 5 - Catastrophe Risk – Lessons from Katrina**

Liberty Bank (Alden McDonald) gave a sobering account of the impact of Katrina and the operations of the bank. The **lessons** Mr. McDonald mentioned were - plan, plan, plan, plan and plan some more!! He emphasized preparing for the worst (New Orleans lost all utilities); reading your disaster site contract and policies; reading all insurance policies for any carve outs; think about disaster policies on reinventing even basic things like manual cash management; think about getting flood insurance coverage for all customers if in a flood zone; prepare for alternate site housing (when the crisis hits, where will you operate out of); prepare for a run on the bank (during Katrina, Federal Reserve bank was down for almost 10 days); prepare for a fire, photocopy or image all documents. Plan some more.

**Session 6 - NMTC, CRA and Government Programs Opportunities**

The **NMTC Program** is a flexible program in terms of its applicability in a broad range of economic development areas. While the initial cost of setting up the program is high once set up it can be replicated easily, CDBI banks and thrifts can apply directly for the credits or work with an intermediary who can reduce the costs for deal structuring, compliance and monitoring. It also increases fee income for CDBIs which can offset net interest margin compression. It also gives CDBIs the opportunity to do innovative and transformational projects in distressed communities.

While the CRA rules have changed recently – increase in “large bank” size threshold, and the tests associated with intermediate banks (between $250 million and $1 billion) – total Part 24 investments by national banks have increased significantly. Additionally the community development definition has been expanded to include affordable housing and community services for low or moderate income individuals, activities that promote economic development by financing small businesses and activities that revitalize or stabilize certain distressed or underserved areas (including disaster areas). CDBIs are very well positioned to originate and strip out the value of the CRA component of their lending. Various strategies were suggested to originate single family, multi family or commercial real estate loans which can then be repackaged and sold to derive this premium.
Session 7 - Valuation of CDFIs and Minority Banks
The panelists spoke about the importance and challenges of subsidizing the development mission at the corporate level, the challenges of managing growth and finding new sources of capital for minority-owned banks. They also talked about the importance of aligning the bank’s internal measurement with the metrics that investors look for when investing. Investors typically look for profitability, liquidity and growth. It is important for banks to really understand their investors, so they can tailor their message to them – that is, “sell” the part of their story that would be most relevant and appealing to a particular investor. The most critical criterion for funding is having a strong track record of profitability, and banks should first and foremost focus on this effort.

The panel also discussed a formal approach to valuation of CDBIs so that they not only raise capital but understand the various drivers to the business. This will help bank management tweak the bank’s business practices to enhance shareholder value.

Session 8 - Advantaged Businesses – Product Market Niches
The panelists spoke about the benefits and key ways in which they serve niche markets. Mission Community Bank serves a small but very competitive local small business lending market, First Independence Bank leverages local government relationships in serving Detroit and focuses on commercial real estate lending while ShoreBank operates a real estate lending business focused on specific neighborhoods. Mission has benefited greatly from its SBA preferred lender relationship, and has also undertaken active marketing and advertising campaigns (e.g. coupons, promotions). It pays referral fees in many cases and partners with technical advisors and local economic development organizations to attract new customers. First Independence took the first step of offering to help the city of Detroit with economic development and has maintained strong relationships with public officials in continuing to do business with the local government. ShoreBank emphasized the importance of treating customers with dignity and respect from day one – which pays off when its customers become repeat customers for larger and larger real estate loans. One of the challenges with operating in a niche market is lack of availability of human capital, which each of the panelists continues to address on a daily basis.

Session 9 – Immigrant Populations, Rural Poor and FDIC Unbanked Initiative
The panel opened with an overview of the unbanked and underbanked in the U.S. Forty million households are un- or underbanked, totaling $1.1 billion in transactions outside the formal banking system. This group includes 40% of African Americans, 50% of Latin American immigrants, 30% of US-born Mexicans, 20% of Asian Americans, and 17% of European immigrants, with a high concentration in farming communities (the “new Appalachia”).

Panelists commented that Chinese American immigrants are different from Hispanic Americans in that they are generally comfortable dealing with banks. A main challenge for First American International Bank is retaining its Chinese American immigrant customer base once they have more banking options. It has addressed this by focusing on serving three sub-populations of immigrants, including (1) new immigrants, (2) established immigrants, (3) 2nd generation immigrants. Second Federal has faced the challenge of adapting its business plan to address the fact that half of its potential customers are undocumented. It has led efforts by accepting Mexican Consulate issued Matricular Consular Cards and ITIN numbers to open deposit accounts and establish loans for such customers. Southern Bancorp’s challenge lies in serving a rural population marked by high poverty, low education, high unemployment and low investment. It has addressed this challenge by choosing to go deeper (into existing communities) rather than wider (into new communities). It has invested in affordable housing, education, agricultural storage and community revitalization in the communities it serves. Lastly, the NFCDCU spoke about the importance of knowing your customer’s culture and languages, accepting alternate IDs, partnering with organizations who better understand the community, and fulfilling all the financial needs of your customers.