FOCUS ON: THE CDFI BOND GUARANTEE PROGRAM

Capital Then and Now

CDFIs have 30 years of expertise deploying capital to underserved urban, rural, and Native markets in innovative and productive ways, and with demonstrable results. Throughout these 30 years, CDFIs’ capitalization has evolved in partnership with civic-minded investors who work with us to reach markets left out of the mainstream financial system. The CDFI Bond Guarantee Program (BGP) is a new source of capital that offers CDFIs a unique opportunity to create better loan products and reshape their balance sheet.

CDFIs have successfully deployed more than $50 billion in financing, relying principally on short term debt, despite the need from some of their borrowers for long term financing. CDFIs have made do with short term debt because that is all that was available. While incredibly helpful in getting us this far, CDFIs are now outgrowing the capacity and constraints of these traditional sources of capital.

The CDFI Bond Guarantee Program can help move us forward.

The BGP offers up to 30 year terms at near US Treasury fixed rates (the most affordable capital available in the capital markets). Imagine not having to worry about negotiating rates and rolling over your entire debt structure every three to five years!

The Bond Guarantee Program and the Future of CDFIs

Many CDFIs can benefit directly or indirectly from this transformative source of new capital. It will require some CDFIs to borrow money in new ways, but it can contribute to the longevity and growth of the industry.

On a macro level, the BGP is the single largest source of long term, entity-level debt available to the industry. On an individual CDFI level, it offers up to 30-year, fixed rate money at affordable rates that rival the cost of financing of some of the largest and most credit-worthy corporations in the world.

CDFIs can for the first time break free from a reliance on short term debt. They can now offer financing terms based on their borrowers’ needs instead of their lenders’ maturity requirements. They can finance long term assets with long term debt. And with longer repayment terms, CDFI borrowers can better afford the increased cost of long term debt and devote more of their resources to operations instead of debt service.

Access to long term debt in significant volumes under the BGP complements our partnership with banks and other financial institutions and diversifies CDFI balance sheets. It may also pave the way toward raising capital from institutional investors if the BGP can establish a positive track record showing positive outcomes and financial performance.

Major banks and foundations have long supplied the majority of CDFI industry capital, but usually for maturities of less than ten years. To accomplish our growth objectives, CDFIs must continue working with existing partners while exploring new sources of civic-minded capital, including the CDFI Bond Guarantee Program.
Is the BGP for My CDFI?

While the BGP offers great possibilities as a catalyst for CDFI industry growth, some CDFIs may have questions about whether it’s appropriate for them. Below are some commonly asked questions and topics that you should consider.

The BGP means a change in the way my CDFI borrows; I am not used to having to pledge collateral.

Many CDFIs already pledge collateral on some of their debt, but for many pledging collateral under the BGP will represent a change in the way they currently borrow. To grow and expand in a way that ensures access to affordable, responsible financing for all, CDFIs must be prepared to raise and deploy capital in many different ways. Just as they have over the past 30 years, CDFIs need to evolve by building flexibility in their capital structures to channel capital in ways that meet the needs of their communities.

The pricing of this capital is higher than what I typically see.

We all know that long term capital is priced higher than short term capital due to the time value of money. If you are used to borrowing short term, your long term debt under the BGP will be higher. However it will almost always be lower than what you could borrow from any other source for the same length of time. That is because BGP debt is priced near US Treasury rates, which are the most affordable rates available for most any borrower globally.

So, on a relative basis, you know that BGP debt is very affordable, but you may not think your borrower can afford the higher rate. That is true if you require your borrower to repay over the same period as your current products require. But what if you were able to extend the repayment terms over a longer period of time? You will likely be able to actually lower your borrowers’ required debt service payment. Since you can match longer term assets with longer term debt, you and your borrower could be better off despite the rate being higher. Your borrower may have a lower debt service payment and you both would avoid refinance risk and the time and effort associated with replacing maturing debt.

I have heard the application process can be arduous—is it worth it?

The application process for an Eligible CDFI is a significant undertaking, similar in scope and time to a NMTC or CDFI Fund Financial Assistance Award application. However, for those creditworthy CDFIs that have need for more than $10 million in capital over the next two years, the process can be worthwhile. Qualified Issuers, including OFN, are available to help you assess the viability of an application and to assist you through the application and underwriting process.

I’m a smaller CDFI and unable to deploy more than $10 million within a two year period.

OFN has worked hard to make the BGP work better and work for more CDFIs. To extend the reach to CDFIs that could benefit from long term, fixed rate, affordable capital but choose not to apply directly, OFN is considering borrowing directly as an Eligible CDFI under the program to pass on long term financing in smaller amounts to creditworthy Member CDFIs. After the 2015 application period opens, OFN will decide whether to borrow directly in addition to acting as qualified issuer on behalf of its credit-worthy members.

Partner with OFN

OFN has led industry efforts in helping to create this transformative source of capital for CDFIs and their borrowers. We are committed to helping this program reach its full potential. We invite you to talk to us. There are opportunities now to participate directly with OFN as a Qualified Issuer and, potentially, indirectly with OFN as a lender of Bond proceeds. Contact us now to learn more.

Cathy Dolan at cdolan@ofn.org, or call 215.320.4307
Robin Odland at rodland@ofn.org, or call 215.320.4328

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