

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS

Investing in People and Communities



**More for Our Money:
A Primer on
Public Deposit Programs**

By
Valjean McLenighan

with
Malcolm Bush

January, 1994

©

**Woodstock Institute
407 S. Dearborn
Chicago, IL 60605
(312) 427-8070**

Woodstock Institute's Public Deposit Project

Public deposit programs support a state's, county's or municipality's economic development policy by using public funds to promote economic activity that would be less likely--even unlikely--to occur otherwise. Linked deposit programs make a specific deposit of public funds, in a financial institution to leverage a particular loan or lending program that supports a development goal like small business growth or low-income housing. Incentive deposit programs reward financial institutions with a local government's banking business if the financial institutions have a good track record of community reinvestment lending.

More for Our Money is intended to encourage state, county, and municipal governments and community-based organizations to think seriously and creatively about how public deposit programs might serve their development goals.

Related Woodstock publications include:

- o **Banking in the Public's Interest: Promoting Community Development with the Public Deposits of Cities and States**
- o **Commercial Lending Disclosure and Economic Development: A Plan for Action.**
- o **Tracking Chicago's Business Bucks: Commercial Lending and the Chicago Municipal Depository Ordinance.**

Acknowledgements

Woodstock Institute is pleased to acknowledge the following for participating in discussions about public deposit programs and for commenting on drafts of this report. Woodstock Institute is, however, solely responsible for the contents of this report.

Lynn Bedford, Investment Officer, State of Iowa
Robert Osmanski, Investment & Financial Services Director, City of Milwaukee
David Chanko, Contract Manager, City of New York
Nancy Pena, Treasurer, City of Cleveland
Sue Hamilton, Linked Deposit Director, State of Ohio
B.K. Perkins, Linked Deposit Administrator, State of Missouri
Jack Lavin, Deputy Treasurer, State of Illinois
Greg Rattler, First Assistant Treasurer, State of Louisiana
Joe McGrail, Council to the Collector-Treasurer, City of Boston
Bob Stumberg, Associate Director for Policy, Center for Policy Alternatives, Washington, DC

Thanks to the following Woodstock staff for advice, editing, and the production of this report: Beverly Berryhill, Dan Immergluck, Ernestine Jackson, Elise Kroll, Kathryn Tholin and Patricia Woods. Jennifer Healey was the staff associate for the project.

More for Our Money was funded by grants from the Charles S. Mott Foundation and the Ford Foundation.

During work on this project, Woodstock Institute received general operating support from the Chicago Tribune Foundation, the Richard H. Driehaus Foundation, the John D. and Catherine T. MacArthur Foundation, the Prince Charitable Trusts, and the Sylvia and Aaron Scheinfeld Foundation.

Cover design: Estelle Carol

Table of Contents

	Page
Putting Public Money To Work	1
o Linked Deposit and Incentive Programs	2
o Costs and Benefits	3
Linked Deposit Programs: Linking Public Revenue with Targeted Loans	5
o Getting a Program Off the Ground	6
o Flexibility is Key	7
o Marketing Linked Deposit Programs	7
o Sources and Amounts of Deposits	8
o Selecting Depositories	9
o Who May Borrow?	10
o Packaging and Loan Approval	10
o Terms	11
o Interest Rates	11
o Collateral	12
Incentive Deposit Programs: Being Selective About Where the Government Banks	13
o Laying the Groundwork	14
o Know your Market	14
o Disclosure is Powerful	15
o What Resources are Needed?	15
o Collecting Data	16
o Evaluating and Using Data	17
Legislative Do's and Don'ts	19
o Make the Process Inclusive	19
o Allow for Both Types of Programs	20
o Clarify Responsibilities, Policies, Standards	20
o Be Flexible	20
o Allocate Sufficient Resources	21
Maintaining and Strengthening Public Deposit Programs	23
o Monitoring	24
o Evaluating Economic Impact	24
o Key Questions and Benefits	25
Appendix I: Sample Municipal Incentive Deposit Ordinance	
Appendix II: Sample Legislation for Small Business Linked Deposit Program	

Putting Public Money to Work

"We've extracted a lot of rewards simply from the process of designing a public deposit program. Today we enjoy the best relationships with the banking industry we've ever had. Every bank in town has promised increased support for reinvestment."

Nancy Pena, City Treasurer, City of Cleveland

In Louisiana, a discounted loan through a state public deposit program recently enabled a small meat packer to upgrade his equipment and boost productivity sufficiently to create four new jobs. In all, more than 900 positions have been created or retained in Louisiana through public deposit programs. The state treasurer estimates that for every \$15,000 salaried position, Louisiana receives approximately \$1,350 in various taxes.

In Iowa, a public deposit program enabled a near-bankrupt veal calf operation to finance an alternative (and profitable) crop, transformed a losing business into one netting up to \$45,000 per year, kept a family on their farm--and off the welfare rolls. Altogether, about \$7 million in development financing has been leveraged through Iowa's "Linked Investments for Tomorrow" program.

City governments, too, are putting public money to work in support of development goals. Boston's decision to bank only with institutions that meet the administration's performance criteria for community economic development encouraged \$35 million in new commitments to affordable housing and mortgage lending targeted to first-time buyers and low-income purchasers.

In Chicago, a city-state partnership helped to persuade a major employer to stay in town. Tootsie Roll Industries, Inc., financed a \$20 million plant expansion through a low-interest loan made possible by a state deposit. State and city tax exemptions and \$200,000 in state job training funds will allow the company to hire an additional 200 workers by 1996.

Each year, state and local governments take in nearly \$902 billion in taxes and other revenue. In turn, they deposit this money in banks or other financial institutions until it is needed, usually employing two criteria for selecting a depository: First, will our money be safe? And second, will we earn a decent return?

Faced with dwindling resources and an urgent need to stretch every dollar, many officials are taking a fresh look at their return on investment from public funds. Growing numbers are putting part or all of this money into public deposit programs that encourage private investment meeting development goals, such as minority

business financing, small business and agricultural development, job creation and affordable housing. In 1990, Woodstock Institute identified at least 17 states and 16 cities with some type of deposit program targeted at development. Public deposit programs expand the definition of return on investment to include the uses to which government deposits are put, as well as the interest earned.

Public money can be put to work to serve a variety of policy objectives:

- Inducing banks with low Community Reinvestment Act (CRA) ratings to develop affirmative lending plans.
- Encouraging banks to enter new markets, including Small Business Administration-insured loans, nonprofit facilities development, housing rehabilitation, and reverse-equity mortgages.
- Filling a capital gap by persuading banks to make smaller loans--for example, reducing minimum loan amounts from \$50,000 to \$25,000.
- Encouraging partnerships between financial institutions and community-based organizations through loan marketing, origination, counseling or servicing programs.
- Creating peer pressure or competition among banks for favorable publicity to strengthen community lending.

Homelessness, a shrinking job market, the demise of small farming and manufacturing, the feminization of poverty--these and other economic problems often seem overwhelming, or at least beyond the capacity of local government to address. No single strategy--whether federal, state, or local--will solve all these woes. But state and local governments do not have to wait for federal action. Around the country, carefully crafted public deposit programs are already having a positive impact on troubled neighborhoods and economic sectors.

Linked Deposit and Incentive Programs

Public deposit programs support a state's, county's, or municipality's development policy by using public funds to promote economic activity that would be less likely--even unlikely--to occur otherwise. There are two broad categories of public deposit programs: linked deposit and incentive programs.

Linked deposit programs make a specific public deposit, often at below-market rates, to finance a particular loan or lending program that supports a development goal. By reducing the cost of funds to the financial institution, the government's deposit enables the bank to reduce the cost of loans to borrowers. Linked loans are

often made for purposes that would otherwise be difficult, if not impossible, to finance.

Incentive programs either screen out as depositories or service providers banks that fail to meet certain criteria or reward banks with government deposits and/or service contracts for economic behavior deemed desirable: hiring local residents, for instance, or lending to targeted groups. Whether the incentive is a carrot or a stick, substantial money is often at stake. New York City, for example, pays some \$40 million a year in banking service fees alone. Florida's municipal deposits total \$11 billion a year.

Costs and Benefits

Although there are significant differences in the way various governments account for program costs, linked deposit and incentive programs produce important benefits by advancing a government's economic development agenda. Jobs and housing created, students educated, farms saved or made more productive, plants retooled, workers retrained, families kept off the dole--the economic activity made possible through public deposit programs often generates tax revenues and savings far in excess of direct program costs.

These costs can be quite low. Boston's incentive program is administered by the counsel to the collector-treasurer; the only substantial out-of-pocket cost was a nominal fee for start-up assistance from a computer consultant. Administrative costs for Missouri's six linked deposit programs run about \$100,000 annually and are absorbed by the regular treasury budget, as are Ohio's staff costs. In the latter state, a one-time start-up appropriation of \$25,000 purchased a personal computer and a couple of reams of paper to administer the program, plus an 800 number and a marketing brochure.

But what about indirect costs? Incentive programs involve no opportunity costs. Public funds are deposited at market rates, and the financial institution assumes all risk. Linked deposit programs may involve a few hundred basis points of foregone interest. But the rewards are often well worth it, especially when linked loans provide development financing that would not be available otherwise. In Iowa, for example, a total of \$6.9 million was lent to 220 borrowers through one of the state's linked deposit programs at a cost of only about \$300,000 in lost interest. "I'll put [our linked deposit program] up against any economic development program in the state," says State Treasurer Mike Fitzgerald.

For many state and local governments, public funds are an underused resource. Public deposit programs provide enterprising officials a valuable opportunity to squeeze extra mileage out of scarce resources. Why should revenue sit in a bank, merely earning interest, when it could also be leveraged to serve the public interest?

Public deposit programs complement the Community Reinvestment Act, providing an added incentive for private sector lending activity. These programs also afford community development corporations and grassroots groups an opportunity to form partnerships with government to promote their common agenda.

More for Our Money is intended to encourage state, county, and municipal governments and community based organizations to think seriously and creatively about how public deposit programs might serve their development goals. This publication won't make you an expert, but it will acquaint you with the basics of designing, implementing, and monitoring linked deposit and incentive programs. We've included lessons learned from discussions with public officials across the country, and sample enabling legislation.

Linked Deposit Programs: Linking Public Revenue with Targeted Loans

"The key to success is to know your market. For linked deposit programs, the market is twofold: banks and borrowers. You have to identify actual credit gaps where a linked deposit program can provide an incentive for banks to lend to borrowers who would otherwise not be able to obtain financing."

Jack Lavin, Deputy Treasurer, State of Illinois

Missouri recently started a linked deposit program to help finance solutions to drought-related problems facing small public or privately-owned water supply systems. "LA Link" is an investment program designed to create and save jobs in Louisiana. Illinois has a program to finance ramps and other building modifications needed to comply with the 1990 Americans with Disability Act, and another program to help medically underserved areas attract physicians graduating from medical school. A program in Ohio offers low-interest loans for EPA-mandated replacement of underground storage tanks.

Linked deposit programs target specific areas of need, then make public money available--usually, but not always, at below-market rates--to leverage loans that meet those needs. Targeted needs may be as general as job creation or much more specific. Agricultural assistance, small business development, job creation, help for women-owned and minority enterprises, student loans, affordable housing--these are some of the more common purposes of linked deposit programs.

For a variety of reasons, linked deposit programs are more often sponsored by states than by municipalities, although several cities have implemented them successfully. State programs focus primarily on agricultural needs or commercial lending to create or retain jobs. City programs usually lend money for housing--specifically, for rehabilitation, construction, or mortgages. Municipal programs are often tied to a specific project or single lending institution and utilize program-specific funds or community development block grants. State programs tend to be larger, involving numerous financial institutions and deposits of general revenues. While state linked deposits commonly earn below-market rates, interest earned on municipal deposits varies widely.

Linked deposits are a way to do more with existing cash management, without diverting tax revenues from their ultimate purpose of funding general government functions.

A 1990 study by Woodstock Institute found that a total of \$1.2 billion was deposited in state linked deposit programs nationwide. Annual funding levels ranged from \$150,000 to \$365 million. Some states allocate specific dollar amounts to their linked deposit programs, while others allocate a percentage of total revenues.

Programs vary, too, in how they are administered. But no matter who is responsible for packaging and loan approval, participating banks assume all credit liability and exposure. Government deposits are never used to collateralize loans; no state or municipal government is at liberty to put its public funds in jeopardy.

Getting a Program Off the Ground

A thorough needs analysis and market survey are crucial to a successful program. For both practical and political purposes, it is important to talk to all major players early on--including banks, borrowers, community development corporations and other grassroots groups, and, of course, politicians.

The first challenge is to identify credit needs of importance to a city, county, or state that are not being met or which require special assistance, such as below-market rate loans. Talk to bankers in this regard. Community development corporations (CDCs) and other grassroots groups--of farmers, environmentalists, women and minorities, for instance--can also be helpful in identifying needs for capital and credit and building a constituency of potential borrowers. CDCs can sometimes play a role in program implementation, e.g., marketing the program, or providing counseling to borrowers, and monitoring loans that are part of a revolving fund.

An inclusive planning process will not only ensure that there really is a need for a given program; it will also help you define goals clearly and ensure that the program design is appropriate for what you're trying to accomplish. The act of soliciting a variety of opinions helps to build support, too. People are more likely to participate in a program that they have helped to design--and to go to bat for it, if necessary, in the political arena.

It is important to determine what level of spread participating banks can live with. The term "spread" refers to the difference between the interest the bank pays to the government and the interest it charges borrowers--essentially, the bank's gross income before calculating expenses. When Illinois was designing a program to encourage banks to package Small Business Administration loans, the state formed an advisory committee of 23 banks. Through interviews and focus groups, planners learned that bankers wanted to earn the market rate on loans made through the program. The state agreed: planners felt that simply facilitating SBA loans would be of considerable help to the state's small businesses and also create jobs. If program designers insisted on a smaller spread, and the bankers were unhappy, the

program wouldn't work. In general, bigger banks can afford to be more flexible on spreads and fees.

Linked deposit programs can help banks develop new markets by enabling them to lend to borrowers they otherwise would not be able to reach. But profit is not the only carrot that program designers can dangle before the banking community. Public relations is another powerful incentive for banking participation in a linked deposit program. Banks can generate considerable goodwill, and positive press coverage, from investing in their community.

The political climate can have a make-or-break impact on program success. If enabling legislation or an executive order will be needed, be sure to involve the appropriate politicians early on. It is also vital to seek input from any and all government departments likely to be affected. This can be very helpful in sidestepping administrative land mines and building support--nothing can kill a good idea like bureaucratic inertia.

Flexibility is Key

While linked deposit programs target specific credit and investment needs, it's important to remember that these needs change. Ask any of the states affected by the Mississippi River floods of 1993: drought relief might be one year's agricultural development priority and flood relief the next year's. Solicit ongoing feedback from banks, borrowers, community developers and other constituents to ensure that loans are targeted where they're needed. Keep an eye on competing programs, too. If Uncle Sam starts to offer zero-interest loans for a targeted group, demand for state and local programs will be affected.

Missouri designed its linked deposit legislation so that, at the treasurer's discretion, ten percent of any allocation can be borrowed from another program whose allocation is not being utilized. This way, if demand for student loans is down but the small business program is booming, money unused by students can be directed to would-be entrepreneurs.

Remember that interest rates rise and fall, and other market conditions fluctuate, too. Try to stay as flexible as possible on interest rates and the types of collateral that are acceptable.

Marketing Linked Deposit Programs

Mass mailings to financial institutions and targeted borrower groups are commonly employed to get the word out about linked deposit programs. Depending on the

program, a mailing list might include community colleges (for student loans), county extension offices or members of the state nurserymen's association (for agricultural programs), small business development corporations or chambers of commerce.

Most states don't have much of a marketing budget, so they utilize the free media whenever possible. In the early days of Iowa's linked deposit program, the state issued a press release every time a new loan was approved--a practice that persists to this day. "For the first lender, we contacted every paper in that county and surrounding ones and made sure everyone got a pat on the back," says Lynn Bedford of the Iowa Treasurer's Office. Today, out of Iowa's 99 counties, only 12 have not participated in the state's four "Linked Investments for Tomorrow" programs.

Meetings, presentations, and speaking engagements are another popular marketing technique. Louisiana participates in business and SBA seminars and also spreads the word about its programs through the Louisiana Bankers Association. When Ohio launched the Withrow Plan, named after state treasurer Mary Ellen Withrow, the office invited 1,200 bankers to a meeting in Columbus. The state had no marketing budget--and still doesn't--so "We did everything real cheap," recalls Sue Hamilton, Linked Deposit Director. "We gave every banker one set of forms, and told them to photocopy additional sets."

Sources and Amounts of Deposits

Most state programs utilize general revenue funds, which are transferred to a depository as certificates of deposit once a loan is approved. Municipalities are more likely to deposit program-specific or community development block grant funds.

Government bodies may set a ceiling on the amount that can be deposited in any single institution, or the maximum amount of general revenue that can be invested in linked deposits. The ceiling may be a dollar cap or expressed as a percentage. Iowa law, for example, permits up to ten percent of the balance of the state's pooled money fund--mostly tax revenue--to be invested in linked deposits. This balance fluctuates, reports Lynn Bedford of the Iowa treasurer's office. "It could be \$30 million one day and \$50 million another," she says. "But as we're putting money out, we're also being paid back, so we've never run out of money."

Illinois, on the other hand, has no statutory requirement dictating the amount that can be invested in linked deposits. Instead, an investment policy group within the treasurer's office decides how much of about \$3 billion a year in general revenue can be tied to linked deposits without compromising the goal of a balanced portfolio.

Selecting Depositories

Commercial banks, as well as state and federally chartered thrift institutions, are generally considered eligible to receive public deposits. Safety and soundness are common criteria for selecting depositories. A few governments deal only with institutions that have assets in excess of a certain amount. San Diego has a special policy for smaller financial institutions that cannot accept multimillion-dollar deposits but which are otherwise eligible to do business with the city. Such financial institutions must fall above the median in terms of percentage of loans made in low- and moderate-income census tracts.

State, county, or municipal governments may insist on a "satisfactory" or "outstanding" CRA (Community Reinvestment Act) rating as a criterion for a financial institution's participation in a linked deposit program. On the other hand, linked deposits can be used to help banks identified as poor performers to improve their CRA rating. An administration can reward "good" banks through the competitive rating process and, as a counterweight, encourage "bad" banks through a carefully monitored linked deposit process. In this way, linked deposit and incentive deposit programs can work hand in glove to move the entire banking community toward improved lending and community investment performance.

Under the savings and loan bailout legislation, the Federal Home Loan Bank makes grants and low-interest loans available to help savings and loans improve their service to low-income communities. These special programs provide an opportunity for state and local governments to work with S&Ls to leverage public deposits.

More than a hundred community development credit unions across the country are specifically chartered to serve low-income populations and communities. Because they have limited access to large deposits, community development credit unions could benefit greatly from public deposits, particularly uncollateralized deposits. And, of course, their membership constitutes a built-in market for programs targeted to low-income or underserved populations.

Once criteria for participation have been established, who decides on actual lenders? For state programs, the treasurer usually has this responsibility, sometimes with assistance from another financial officer, such as the comptroller, or from a board of advisors constituted for the purpose. Rarely is the legislature or governor involved. In general, states try to make it as easy as possible for targeted borrowers to get loans, so the more participating institutions, the better. City programs are more likely to be tied to a single depository. In addition to the treasurer or other financial officer, the mayor or city council may have a say in depository decision-making. Often a financial officer submits recommendations for approval by the executive or city council.

Who May Borrow?

Obviously, eligibility criteria for borrowers will depend on the economic development goal that the program is intended to support. Business size restrictions, race and gender or income and geographic considerations, job creation commitments--these and other criteria may be used to determine who may borrow under a given program.

The main point to keep in mind when designing eligibility criteria is that the needs of both government and financial institutions must be satisfied if the program is to work. Government's interest is to leverage public funds to support the development policy in question. The bank's interest, of course, is in getting its money back, since the bank assumes all risk. Both parties need to keep paperwork manageable. In order to cast as wide a net as possible into the pool of potential borrowers, try to identify the minimum standards that will satisfy all concerned, and use these for the program's eligibility criteria.

Packaging and Loan Approval

Loans may be packaged by the financial institution, the government, or an intermediary such as a community development corporation. There seems to be universal agreement on the need to keep the process simple; application forms are generally no longer than a page or two--just enough to ensure that public policy objectives are in fact being met by the loan.

Banks must decide on a borrower's credit worthiness, since it is the financial institution that assumes the risk of nonpayment. Programs vary in the degree of government involvement in borrower approval.

For Missouri's linked deposit programs in agriculture and small business, the treasurer's office deposits funds in a bank once the financial institution certifies that the applicants are eligible. At the end of the period, the bank sends in a data summary. For job-creation loans, however, the Missouri Treasurer's Office reviews applications to ensure that at least one job is created or retained for every \$25,000 lent. (Job creation loans range from \$90,000 minimum to a maximum \$5 million.)

For Ohio's job-creation program, "Basically, a business would go to a bank that's an eligible depository and obtain a loan as they normally would," says Sue Hamilton, Linked Deposit Director. "If the proceeds would help save or create jobs, the bank would request a deposit." Hamilton reviews about 20-40 linked deposit requests every two weeks. "We'll fund whenever the bank is ready," says Hamilton. "We do it all by wire transfer over the phone. The treasury prompts the bank on all the steps they need to take. We've got over 2,000 loans out right now."

In five of seven city programs studied by Woodstock Institute in 1990, city development agencies took applications from potential borrowers; banks processed applications in the other two programs.

Terms

Most, but not all, linked deposits and loans are short-term--usually under five years. Some governments set a maximum deposit term limit, while others do not. The most common instrument is a one- or two-year certificate of deposit, which may or may not be renewable.

State programs tend to be short-term, usually addressing the need for short-term agricultural and small business loans, which lend themselves to the annual budgeting cycles and deposit practices of state government. City programs generally concentrate on residential lending and tend to focus more on short-term rehabilitation loans than on mortgage loans.

Interest Rates

In general, the reduction on the deposit interest rate is matched by a similar reduction on the loan interest rate. Another approach is to specify a maximum allowable "spread," or difference between the deposit rate and the loan rate, usually between 250 and 400 basis points.

While some programs make interest-free public deposits, many state and local governments require by statute that public deposits earn a return. Standards vary for the minimum acceptable rate of return on a public deposit. Some governments link the rate to U.S. Treasury bills or similar instruments, while others award public deposits to the highest bidder. Some governments require public money to be deposited in interest-bearing accounts, but they don't specify an amount or formula. In any event, special enabling legislation may be needed to allow a linked deposit to earn lower than market rates.

Especially in times of budget crisis, politicians and taxpayers alike may express concern about the financial impact of reduced income from a below-market rate linked deposit program. There are two ways to look at this issue. First, the actual cost of foregone interest may be quite low. A government usually invests only a fraction of its total general revenue in linked deposits: ten percent in Iowa's case, for example. If that ten percent earns, say, two percent less than it would if invested in a standard instrument, the effect on the overall portfolio is small. Nonetheless, real money is involved. The second approach is to look at the social benefits of shifting a portion of a government's resources to community investments. Jobs created

through a linked deposit program may ultimately generate far more new tax revenue than the foregone investment income. If a linked loan enables farm families to make a go of it, or provides affordable housing for families that otherwise would be homeless, the savings in welfare benefits alone may offset the cost of foregone interest.

Collateral

The amount and type of collateral required to secure public deposits has a big impact on which financial institutions can participate in linked deposit programs. When public deposits exceed the \$100,000 federal deposit insurance limit, many governments ask for collateral, usually in the form of U.S. Treasury securities. For large financial institutions that already hold a lot of securities, this may not be a problem. But a collateralization requirement may place a smaller bank, thrift, or credit union in a bind. Essentially, the institution must commit twice the funds deposited--not only does it have to fund the linked loan, but it must also purchase the required securities.

Program designers hoping for broad banking participation in a linked deposit program need to give careful thought to the issue of collateral. One way to include more mid-sized and smaller institutions as linked deposit lenders is to broaden the types of collateral that are acceptable to include mortgages, mortgage-backed securities, banker acceptances, repurchase agreements, commercial paper, and/or highly rated corporate bonds. There are other strategies. In Illinois, for example, a deposit in the corporate credit union, Mid States, is used to collateralize public deposit accounts with individual credit unions.

Private deposit insurance offers another solution. Recently, Municipal Bond Investors Assurance Corp. (MBIA), the General Motors of the financial guarantee industry, has begun to offer an assuery product for municipal deposits in states with high collateralization requirements. The company insured an \$8 million municipal account in New York City, for example, which over time had become collateralized with securities in some 300 different accounts. Not only did the MBIA insurance streamline administration for the bank, it also precluded the need to overcollateralize--that is, to put up more collateral than might be strictly necessary in order to cover "high-balance" days for public deposit accounts with fluctuating daily balances.

Incentive Deposit Programs: Being Selective About Where the Government Banks

"We're trying to make explicit the link between policy goals set by the administration and decisions on deposits and banking contracts."

Joe McGrail, Counsel to the Collector Treasurer, City of Boston

In the 20 years before Cleveland started its incentive deposit program, only five or six houses were built in the inner city. Then a new administration decided to look into the lending and employment practices of banks with which Cleveland was doing business. Thanks to the mayor's active interest in the banking community's support--or lack of support--for economic development, 500 houses went up in the heart of town even before a formal incentive deposit program was fully implemented.

Incentive deposit programs have the same goal as linked deposit programs: to promote economic development of disadvantaged groups, communities, or sectors of the economy. But the mechanism is different. Instead of making public money available at below-market rates to leverage targeted loans, a government selects depositories or awards banking service contracts on the basis of a financial institution's actual or promised reinvestment performance.

An incentive program might seek to promote particular types of lending or, more commonly, to stimulate overall reinvestment behavior--that is, to encourage lending and employment practices that benefit the entire community. In either case, one major incentive is the judicious placement of government banking business worth millions, sometimes billions, of dollars. For example, the state of New York alone has some \$30 billion in municipal deposits.

Incentive deposit programs work in one of two ways. Either they screen out institutions that fail to meet certain reinvestment standards, or they reward the best-performing banks and thrifts with deposits or service contracts.

Municipal rather than state governments most commonly sponsor incentive deposit programs. There is no reason, however, that incentives could not be more widely used by state governments to attract private-sector support for economic development policy.

Incentive program goals might include low-income and minority neighborhood development; the promotion of residential, consumer, and commercial lending to

females, minorities, and other groups with historically poor credit access; improving employment opportunities for targeted groups; expanding banking services in poor neighborhoods; and increasing philanthropic support for other needed community services.

To evaluate banking performance in these or other areas of interest, incentive programs need to collect and analyze much more data than is necessary for linked deposit programs. In addition to lending records, a government might want to look at the hiring patterns of local financial institutions, or find out how many branch offices or automatic teller machines are located in certain neighborhoods. The types of data collected and procedures for analysis vary from program to program--and, of course, depend upon what policy goals the program is trying to advance.

Laying the Groundwork

As is true of linked deposits, the goal or goals of an incentive deposit program--the needs it is supposed to meet--should be clearly defined at the outset. It is also important to involve key constituencies--including the banking community, grassroots and community economic development groups, and key government departments--in program design and implementation.

The impetus for incentive deposit programs often stems from local politics. In Boston, for example, a 1992 study by the Boston Federal Reserve Bank documented racial discrimination in lending. The city's vocal housing activist community banded together with numerous community development corporations to put serious pressure on local banks and city government to do something about the problem, particularly in mortgage lending. New York City's program resulted from a redlining study commissioned by the legislature. Other factors included the Dinkins administration's commitment to poorer communities, and an increase in housing and small-business advocacy in 1990, when the project began. Cleveland's program, not yet fully implemented, reflects the interest of the mayor and city council in making the banking community more accountable and responsive to inner city residents.

Know your Market

There must be demand as well as a development need in order for a program to work. One Midwestern city, concerned about redlining, passed legislation in 1992 requiring a bank or thrift to demonstrate lending activity in the inner city in order to qualify as a public depository. Prevailing economics, however, provided little incentive for banks to participate. Loan demand was down drastically, the banks had plenty of capital, and they didn't need the city's money. The city, for its part,

had access to an alternative investment vehicle providing 100-150 basis points more than what local financial institutions would be paying under the program. Political support for the program was too weak to overcome these market conditions; consequently, no money was placed under the program.

Disclosure is Powerful

Where the political will is strong, considerable rewards can be extracted simply from the process of collecting and analyzing banking disclosure data. Cleveland is a case in point. The city's incentive program, strongly supported by the mayor and city council, is still in the data analysis phase; no money has yet been placed in banks on the basis of reinvestment performance. Besides the new housing that has already been built, Cleveland has negotiated community reinvestment agreements with virtually every bank in town, promising a specific dollar amount or percentage increase in mortgage or business lending to various neighborhoods or ethnic groups. In addition, most Cleveland banks have agreed to participate in the city's new microloan program for small business start-up and expansion.

The "incentive" in an incentive deposit program may take the form of carrot, stick, or both. The banking community's desire for good public relations can be as powerful an incentive as the profit motive.

What Resources are Needed?

Incentive deposit programs need not be costly. In New York City, the Community Banking Project was initiated by the New York City Banking Commission, the entity responsible for deciding which banks and financial institutions may receive public deposits. Most of the staff services are provided by the Department of Finance's Bureau of the Treasury, which periodically sends an extensive questionnaire to all banks authorized to do business with the city. Data from the questionnaires are then transformed into a community service rating. This rating, in turn, is one of several criteria used to award banking service contracts. (Other criteria include safety and soundness, technical competence, and price.)

"Administratively," says David Chanko, Contract Manager, "the program costs are not significant. There isn't that much manpower committed to the project. We have a couple of people doing computer analysis along with their other responsibilities, so the marginal costs are minimal. And there are no foregone interest costs--all of our public deposits are invested at market rates."

The typical procedure is to send a questionnaire or disclosure form to every bank doing business with the government, then to analyze the data and prepare a

community reinvestment report comparing banks' performance in various categories. In New York City and Cleveland, reinvestment criteria are relevant only when banking service contracts are awarded--for example, contracts for lock-box services needed to process the more than \$15 billion a year that banks collect in taxes for New York. In Boston 100 percent of deposit decisions are subject to community service ratings. Even in Boston, however, the entire program is staffed by one person, the counsel to the city's collector/treasurer.

Collecting Data

Whatever the goals of an incentive deposit program, three central questions have to be resolved in the program design. How much and what kind of data should we collect? What standards should we use to evaluate it? How do we integrate our evaluations into day-to-day decision-making on depositories and service contracts?

The kind of disclosure data a government requests depends on the policy goals a program is supporting. Boston's goals are fairly typical. The city's program is designed to support equitable mortgage lending; lending for affordable housing construction and neighborhood commercial activity; equitable provision of banking services; and the employment and promotion of women, minorities, and Boston residents. Boston's disclosure form requires information on banking performance in each of these areas.

How much detail to request from banks--and in what format--are key issues. Incentive program designers must strike a balance between collecting sufficient data to make informed evaluations and fair comparisons and burdening financial institutions with unnecessary paperwork. There are no hard and fast rules, except for the obvious: don't ask for data that you don't intend to use. Where feasible, specify reporting format to avoid the problem of trying to compare apples and oranges. Remember that the data you collect can be used as both a decision-making tool and for public education. Strategies for minimizing the burden on banks include using existing federal disclosure data where possible; limiting categories of non-mortgage disclosure; and limiting disclosure requirements to targeted geographic areas.

Home Mortgage Disclosure Act (HMDA) data is generally the basis for analyzing mortgage lending activity. In Boston, banks report this data by census tract, which the city then converts to neighborhood designations. HMDA requires banks to report loan applications, denials, and originations by the gender, race, and income of mortgage applicants.

Currently there is no easy way to collect data on small business lending. In the absence of federal reporting requirements, governments just do the best they can to develop reasonably useful information. New York City, for example, collects data

about bank deposits in a range of city-, state-, and privately-sponsored multibank economic development loan funds, rather than trying to measure direct lending.

Boston asks banks to describe their participation in any small business lending programs, particularly those which facilitate the start-up and sustenance of minority-owned and women-owned businesses. The Boston Community Banking Commission also relies on the city's three major development agencies for help in assessing local banks.

Reliable information on community banking services is less difficult to obtain. Boston asks for branch and automatic teller machine locations and codes these by neighborhoods. New York, in addition to these criteria, requests notification whenever a designated depository closes, consolidates, or merges a branch; there's a penalty for withdrawing too many services from low-income neighborhoods. For Hispanic communities, Cleveland is interested in the number of bilingual ATMs and branch office managers. In addition, Cleveland collects data on products and services for moderate- and low-income persons and minorities, and also looks at board composition and philanthropic giving to nonprofit community service organizations.

Employment data are fairly straightforward. Most governments are interested in the number of women, minorities, and local residents employed by a bank or thrift, as well as the percentage of minorities and females in managerial positions and programs designed to encourage the hiring and career development of disadvantaged people.

Evaluating and Using Data

There are no hard and fast rules when it comes to analyzing disclosure data. In an effort to keep the process simple and manageable, one approach is to evaluate financial institutions on the basis of only one or two standards. In Minneapolis, for example, the criterion is banks' participation in publicly supported housing and economic development programs, including those sponsored by the Minneapolis Community Development Agency, neighborhood organizations, and local nonprofit developers. This approach has the advantage of comparative objectivity as well as simplicity, but its impact is limited--it provides no incentives for investing in anything other than city-sponsored projects.

Another approach is to develop a more complex scoring system that credits financial institutions for a wider variety of activity. While a multi-dimensional, composite scoring system permits more detailed evaluation of reinvestment performance, it is open to charges of arbitrariness, since it relies more heavily on evaluators' judgments. Such programs often utilize fairly complex formulas to arrive at a numerical score for each bank.

Boston gives different weights to mortgage lending, affordable housing and economic development lending, banking services and hiring practices. New York has some categories similar to Boston's but also includes support for community development credit unions, child care programs, educational programs, and charitable contributions.

It is one thing to evaluate community reinvestment performance. It is another to use the evaluations as the basis for selecting public depositories. How are day-to-day banking decisions actually made?

In New York City, the Banking Commission sets the criteria for depository selection. The Finance Commissioner is one of three Banking Commissioners; the others are the mayor and the comptroller (or their representatives). The Deputy Finance Commissioner for Policy has a lot of day to day control over the project, as well as the Assistant Commissioner for Treasury. Oftentimes staff from all three commissioners' offices form a working group that presents various options for awarding service contracts to the decision-makers.

In Boston, the Collector-Treasurer has the final say in deposit decisions and contract awards. In practice, the Collector-Treasurer has delegated a First Assistant to be the city's money manager. A working group of staff from the First Assistant's office does the analysis for contract decisions.

Cleveland has been refining its data gathering and evaluation techniques since the city council established legislation requiring the Finance Department to set up and implement an incentive deposit program. No public money has yet been awarded under the program. Finance department staff analyzes disclosure data and presents the results to a committee comprising the directors of community development and economic development, a banking representative, two community representatives, and the finance director. The advisory committee makes recommendations on depositories to the city council. Once the council approves depositories, the treasurer and finance director will decide on service contract awards.

While it is true that simply evaluating and publishing data on banking performance can have a dramatic impact on private-sector reinvestment, for maximum impact an incentive program needs to institutionalize the connection between performance evaluations and day-to-day government banking decisions. New York City does this by factoring in community service ratings at ten percent of total points on which banking service contracts are awarded. Because most banks score within a few basis points of one another on the business component, the ten percent community service factor can significantly alter winners and losers in New York's bidding process. Other programs are more informal--in these, the personal commitment of city treasurers and other decision makers has a major impact on overall program effectiveness.

Legislative Do's and Don'ts

"You have to know specifically what you're trying to accomplish, ensure the vehicle is appropriate, and understand what legislative changes are required. Then take an active role in drafting the legislation. Make sure it's written flexibly enough so that you don't paint yourself into a corner."

Sue Hamilton, Linked Deposit Director, State of Ohio

In cities and states where the treasurer or chief financial officer is elected, or where there is strong political support for a public deposit program, enabling legislation may not be strictly necessary--although it may prove useful in the long run to protect against a change in administration. Enabling legislation is most desirable--and may be required--in states and cities where the chief financial officer is appointed or lacks the authority to implement a program.

Whether or not it is technically necessary, thoughtfully written legislation can assure administrators of a clear mandate, well defined goals and responsibilities, and adequate resources to implement an effective program. Sample enabling legislation for a city incentive deposit program and a state linked deposit program can be found in Appendices I and II.

Make the Process Inclusive

Whether a program is created by statute, ordinance, or executive order, input from all key constituencies is vital. Consider forming a committee or advisory group comprising bankers, community developers, legislators, development agency staff, plus representatives from targeted groups such as farmers, small business owners, women and minorities. These advisors can then serve as an ongoing oversight committee. Coordinating with development agencies is especially important to simplify monitoring and also provide additional staff resources.

A word to the wise: an all-inclusive process could give reluctant bankers enough initial leverage to kill a new public deposit program. Make sure that the political commitment to promoting reinvestment is strong and secure before setting up the advisory committee. Otherwise, the committee could turn into a death squad for the program.

Allow for Both Types of Programs

Incentive and linked deposit programs can be complementary efforts to address different reinvestment needs. Legislation incorporating both approaches can help to ensure that even if money gets too tight to fund a linked deposit program, private reinvestment can still be encouraged through a screening or reward program.

Clarify Responsibilities, Policies, Standards

Enabling legislation needs to establish clear authority for implementing a program. For state linked deposit programs, depending on existing statutes, it may be necessary to authorize the treasurer to set deposit policy and make below-market deposits to pursue economic goals.

The executive order establishing Boston's public deposit program lays out the program's policy goals and evaluation categories; establishes the authority of the Collector-Treasurer for implementing the program; specifies measures the city may take to reward or pressure financial institutions; mandates the cooperation of all other city agencies and departments; and requires the Collector-Treasurer to report to the mayor from time to time on the progress and impact of the program. This report puts hard data on bank-by-bank performance in the public realm and creates a tremendous incentive for banks with poor performance to improve. But what really puts teeth in Boston's program is that it links the collection and evaluation of reinvestment information to day-to-day decisionmaking on depositories. The city is committed to putting its money where its policy is; this link between bank performance and public deposit decision-making is essential to a successful program.

Be Flexible

Flexibly written legislation makes it easier to adjust programs to changing needs of banks, businesses, and government, as well as to respond to market conditions. Missouri's 1986 linked deposit statute specified that the deposit rate would be three percentage points below the one-year U.S. Treasury bill, while borrowers' rates would be three points below the normal lending rate. By 1992, prevailing low interest rates made it necessary to rewrite the legislation: now the deposit rate is up to three percentage points below the one-year T-bill. In 1993, legislation further amended this language to specify that the deposit rate would be no less than two percent.

Caps on allocations for each of Louisiana's four linked deposit programs proved problematic. When demand for small business loans outpaced the market for agricultural loans, administrators had to go to the legislature for permission to use farm program money to finance small businesses. To avoid this sort of problem, Missouri's legislation permits ten percent of any allocation to be borrowed at the treasurer's discretion from another allocation that is not being utilized.

Enabling legislation should be flexible regarding the type and size of institutions eligible to become public depositories. If possible, it should permit community development and other credit unions to receive public funds. For these institutions, however, collateral requirements may pose a formidable barrier to participation (see page 12). One solution is to allow for deposits at or less than the insured maximum. Where collateral is necessary, flexibility and creativity regarding the amount and types of collateral acceptable is highly desirable. Illinois has modernized its collateral statutes to make it easier for financial institutions to take public deposits--for example, doing term repurchase agreements instead of time deposits, thus allowing banks to avoid FDIC insurance costs. Legislation may need to provide for less than 100 percent collateralization in order to make linked deposit programs attractive to some segments of the financial community.

Allocate Sufficient Resources

Public deposit programs--especially incentive programs--are not necessarily expensive to run. But without input from development agencies or adequate staff, it can be difficult for financial officers to administer a program. Financial officers need development expertise to wend their way successfully through the thickets of data collection and analysis for incentive deposit programs, and to identify unmet credit needs and design linked deposit programs attractive to both borrowers and lenders. Coordinating public deposit programs with other government agencies can help to ensure that adequate resources will be available to design, market, and administer a program effectively. If enabling legislation mandates an annual review or periodic evaluation of program results, it should also allocate the necessary resources.

Maintaining and Strengthening Public Deposit Programs

"I'm a big believer in the power of the annual report. It puts hard data in the public realm on a bank-by-bank basis, not just aggregate totals, which provides a real incentive for slower banks to get moving. And writing a report forces you to think about ways to improve your program."

Joe McGrail, Counsel to the Collector Treasurer, City of Boston

Once a program is up and running, it is valuable to step back periodically to see how it is working. Is the program's original purpose still valid? If so, how well is the program meeting its goals? Are there ways to improve it? Do new or changing market conditions need to be addressed? How do costs compare with benefits?

Illinois' "Fresh Start" linked deposit program was initiated to help Midway Airlines employees who suddenly found themselves out of work when the airline went bankrupt. "Many of them needed short-term loans to get over the hump," recalls Jack Lavin of the Illinois Treasurer's Office. "We leveraged over 100 loans, and we thought we could expand the program to the rest of the state. But it didn't work very well." "It's important to keep the focus on what your goal is, who you're trying to help," Lavin continues. "Be willing to admit when something doesn't work and back away from it."

Sometimes one or two adjustments can get a program that isn't working back on track. When Missouri designed its linked deposit program for small business, the state imported a guideline from its agriculture program restricting borrowers to no more than 60 percent equity in the business. While the rule was appropriate for farming, it drove potential borrowers away from the small business program. Once the equity ratio guideline was dropped, utilization improved.

Ongoing feedback from borrowers and other key constituencies can help to keep existing programs responsive and identify new or unmet needs. An oversight committee can be useful in this regard. Iowa sent a survey to every borrower and lender who had participated in the state's four linked deposit programs asking for changes or new programs they would like to see.

Most programs evolve--and often expand--as time goes on, the environment changes, and administrators gain experience. Missouri, for example, began with two linked deposit programs, in agriculture and small business, in 1986, then added programs for student loans, drought relief, job creation, and, most recently, housing.

Missouri's agriculture and small business programs proved so successful that the state had to implement a "five year and out" rule; a given borrower's participation is limited to five years, so that funds can be freed up for others to use.

Monitoring

State linked deposit programs usually mandate program monitoring at two levels: first, the bank's performance in executing linked loans; and, second, the borrower's proper use of loan funds, including job creation. In practice, most monitoring occurs during the loan application process, and relatively little afterwards. Banks may be required to submit an annual report, but seldom is this information verified. A couple of states make it a misdemeanor to falsify loan applications or use linked loans improperly.

For linked deposits aimed at job creation, a regular review of employment data from recipient firms is desirable. Baseline data on work force characteristics at the time of application can be compared with post-loan employment. Site visits to companies with linked loans are an option for verifying employment, although this, of course, requires field examiners.

For incentive programs, monitoring and comparing banks and evaluating ongoing reinvestment performance is time-consuming. While numerous cities and states have some form of anti-redlining legislation on the books establishing minimum reinvestment reporting requirements as a prerequisite for doing business with the government, not all governments bother to evaluate the data, and fewer still use reinvestment performance as a criterion for selecting depositories. Chicago has a municipal ordinance requiring disclosure data, but the ordinance has no provisions for evaluating the data or comparing banks on the basis of their performance. The same is true in New Mexico. So-called incentive programs that don't evaluate the data they collect do a disservice to their governments and undermine the whole notion of public deposit programs.

Evaluating Economic Impact

Most cities and states can cite specific examples of borrower successes (in the case of linked deposits) or (for incentive programs) new reinvestment commitments from financial institutions. For linked deposit programs, the number or dollar value of loans made or percent of allocations that are actually disbursed are often used as benchmarks of program success. Some states require an annual report documenting deposits made, loans and their uses, and jobs affected.

Iowa points to the fact that of 99 counties, only 12 have not participated in the state's linked deposit programs; the two most popular programs have leveraged over \$47 million in private-sector loans. Ohio has made linked loans in all 88 counties. In Missouri, 300 of the state's 500 banks are program depositories. Illinois' agriculture program has grown from \$160 million to over \$240 million.

There is no reason why impact measures should be restricted to the number, size, geographic distribution, or total dollar value of loans made, however. Governments could also collect data on number of houses built, businesses expanded, jobs saved or created with public deposits. A well-designed program should include provisions for measuring actual economic impact.

Key Questions and Benefits

To ensure that a public deposit program will actually produce the economic benefits for which it is intended, program designers must give careful thought to some key questions:

- What are our goals for a public deposit program? Are they carefully researched and defined? Are there any other public or private sources of credit for the purpose(s) we've identified?
- Which approach is best suited to accomplishing the goals we've defined: a linked deposit program, incentive deposit program, or both?
- Is the program feasible? Have we talked to key players--banks, potential borrowers, community-based groups, politicians--to ensure that our program design really meets the needs it is intended to serve?
- Is the program flexible enough to accommodate changing market conditions?
- Is a linked deposit program designed to promote loans that would otherwise not be made?
- Is there sufficient political support for our program? If not, can we generate it?
- Have we allocated sufficient resources to ensure success? For incentive programs, have we built in a system for regular evaluation of disclosure data, and for linking day-to-day banking decisions to community reinvestment performance? For linked deposit programs, have we included periodic reviews that ensure loans meet program goals?

- What enabling legislation is necessary or desirable?
- Are projected program benefits sufficient to justify the costs?
- Have we made provision for measuring the program's actual economic impact?

Program designers who are willing to work through these questions can look forward to advancing their government's community development agenda in several ways:

- By meeting unmet development credit needs and promoting economic activity that would be less likely, or unlikely, to occur otherwise
- By squeezing extra mileage out of scarce government resources
- By providing the financial community with incentives for community reinvestment
- By financing job creation, housing, or other projects that generate new sources of tax revenue or significant savings in excess of program costs.

While public deposit programs are not a panacea for all the economic ills plaguing state and local governments today, they have amassed enough of a track record to be given serious consideration by anyone interested in fresh approaches to enhancing the effectiveness of their public administration.

Appendix I

Sample Municipal Incentive Deposit Ordinance

Whereas the City of _____ ("City") desires to promote healthy reinvestment in all its residential and commercial neighborhoods particularly lower- and moderate-income neighborhoods; and

Whereas the City desires to link the deposit of the City funds and its award of contracts for banking services to an evaluation of financial institutions' contribution to the development, economic health and viability of the City's neighborhoods particularly those suffering from high unemployment, shortages of affordable housing, underdevelopment and other ills that threaten neighborhood viability;

Be it ordained by the Council of the City:

Purpose

In its ordinary course of daily operations, the City shall determine which financial institutions it considers are eligible financial institutions for the purposes of doing business with such institutions in the form of investments and deposits of city monies and other financial contracts in accordance with the information required to be disclosed in section_____.

Definition

- (a) For the purpose of this section, "community development" is defined as: An organized community-based effort involving government, non-profit neighborhood groups, financial institutions, private individuals and resident leadership with the purpose of revitalizing residential, commercial and industrial areas in urban neighborhoods.
- (b) Financial institution shall mean any commercial bank, savings and loan association, credit union, cooperative bank, mutual bank, or other entity which makes mortgage, consumer or commercial loans.

Annual Lending Disclosure

- (a) Any financial institution desiring designation as a public depository shall submit to the City Treasurer prior to *month, day*, the following information needed for evaluation of policies and practices regarding housing and economic development of said financial institutions. The data shall be disclosed on forms approved by the City Treasurer for each census tract

within the City of ____ and the County of ____ and include the number and total dollar amount of the loans including loans made directly by the financial institution and through intermediary organizations. The data shall include:

- (i) Conventional residential mortgage loans and;
 - (ii) Mortgage loans which are insured under Title II of the Housing Act of 1949, or which are guaranteed under chapter 37 of Title 38, United States Code (FHA, FMHA, or VA loans).
 - (iii) Mortgage loans which are insured or financed by the State Housing Authority.
 - (iv) Home improvement and home equity loans.
 - (v) Commercial mortgage and other commercial loans.
 - (vi) Community development loans.
 - (vii) Student loans.
- (b) The financial institutions shall file a statement documenting new initiatives created by the institutions with the purpose of affirmative participation in community development.
- (c) The financial institutions shall file a copy of the most recent federal supervisory agency CRA examination summary report, a copy of the most recent CRA or expanded CRA statement submitted by the bank to the federal regulators, and the most recent federal CRA rating for the bank.

Affidavit

Prior to the deposit of any City monies in any financial institution, the City shall obtain a sworn affidavit from an authorized official of the institution affirming the institution's promise:

- (a) Not to discriminate against any individual or group seeking a mortgage, commercial, consumer, home improvement or community development loan in the fixing of the amount, interest rate, duration, down-payment, or other terms or conditions of such loans because of the race, color, religion, age, sex, national origin, or marital status of such individuals or groups; and
- (b) Not to indulge in redlining activities against any city neighborhood, including arbitrarily rejecting mortgage loans for residential properties within a specific geographic area in the city because of the location and/or age of the property in all neighborhoods of the City within the limits of legal restrictions and prudent financial practices.

Annual Submission and Review of Information¹

- (a) On an annual basis, each financial institution seeking to be, or designated as, a public depository shall submit to the City Treasurer the data, statements and affidavit described above.

- (b) The annual review process will be administered by the Reinvestment Review Committee composed of seven members, chosen by the Mayor including:
 - (i) The City Treasurer, who shall serve as chairperson;
 - (ii) Two members of the City Council;
 - (iii) One member of the administration chosen from the Department of Economic Development;
 - (iv) Two individuals from community development organizations;
 - (v) One individual from a financial institution doing business in the City.
- (c) The Committee will review the information, statements and affidavits submitted in compliance with the ordinance, and will issue an annual report analyzing, evaluating and rating the submitted bank information prior to the Treasurer's decisions on the deposit of City funds and on contracts for the City's financial business.
- (d) For the purpose of awarding City deposits and other financial business, the Treasurer shall choose among financial institutions rated by the Committee:
 - (i) Those institutions which were rated most highly by the committee and which also satisfy the criteria of safety and soundness of their financial condition and the level of services and interest rates offered.
 - (ii) Consistent with the criteria in (i) above, the Treasurer shall have the discretion to determine the size and the terms of the deposit on the basis of the financial institutions' specific community reinvestment record and/or commitment to specific future reinvestment programs.

Public Disclosure

- (a) All data and information submitted by financial institutions to the City in connection with this ordinance shall be made available to the public upon request to the City Treasurer within three weeks of the submission of the request.
- (b) The City shall store these data and information for a period of at least ten years.
- (c) All reports and proceedings of the Reinvestment Review Committee shall be made available in similar fashion and shall be deposited in the municipal library system.

Severability

Each of the provisions, sections, and subsections of this ordinance are severable, and if any of its provisions, sections, or subsections shall be held unconstitutional or

otherwise invalid by any court of competent jurisdiction, the decisions of such court shall not affect or impair any of the remaining provisions, sections or subsections.

¹ Some Incentive Deposit Ordinances permit scoring systems for the evaluation of the data submitted by financial institutions. A score card would assign a maximum number of points for each criterion listed in the Ordinance. A score card could be definitive by prescribing scores for particular levels of performance or flexible, allowing the scoring committee to exercise judgment within each category. The advantages of a scoring system over the process of assigning one score or grade for a financial institution's overall community reinvestment performance are that the municipality can decide what criteria are priorities, and that such a system allows a finer judgment by breaking down the evaluation process into smaller components.

Appendix II

Sample Legislation for Small Businesses Linked Deposit Program

An Act to create an availability of lower cost funds to eligible lending institutions for reduced rate loans to eligible small businesses sustaining or creating jobs, to authorize the Treasurer of the State to invest in linked deposits, and to set forth the requirements of a linked deposit program.

Be it enacted by the General Assembly of the State of _____.

A. "*Eligible Small Business*" means any sole proprietorship, partnership or corporation that has all the following characteristics:

- 1) Is headquartered in the state;
- 2) Maintains offices and operating facilities in the state and transacts business in the state;
- 3) Employs less than ____ employees, the majority of whom are residents of the state;
- 4) Is organized for profit.

B. "*Eligible Lending Institution*" means a financial institution that is eligible to make commercial loans, is a public depository of state funds, and agrees to participate in the linked deposit program.

C. "*Linked deposit*" means a certificate of deposit placed with an eligible lending institution at up to ____ percent below current market rates, but not to fall below a minimum of two percent interest, provided that the institution lends the value of the deposit at ____ percent below the current borrowing rate applicable to the specific *small business*. Funds deposited with the lending institution for the purpose of linked deposit, that are not being used at any time for such purposes, must receive the current market interest rate for the period which they are not used for linked deposit purposes.

D. The State Treasurer may invest in linked deposits for *small businesses* so long as the total amount deposited at any one time does not exceed ____ percent of the state's total investment portfolio. If demand for *small business* linked deposits exceeds initial allocation, and funds initially allocated to another category of linked deposits are available and not in demand, these excess funds may be transferred to the *small business* linked deposit program. This will be done at the Treasurer's discretion, in an amount not to exceed twenty percent of the initial allocation. The State Treasurer may also

reallocate *small business* linked deposits in the same manner if they are not in demand, and demand for another category of linked deposits have exceeded allocation.

- E. A lending institution that desires to receive a linked deposit shall accept and review loan applications from eligible *small businesses*. The lending institution shall apply all usual lending standards to determine the credit-worthiness of each eligible *small business*. No fees in excess of those ordinarily levied may be applied when handling a linked deposit application.
- F. An eligible *small business* shall certify on its loan application that the reduced rate loans will be used exclusively to create new jobs or preserve existing jobs and employment opportunities. Whoever knowingly makes a false statement concerning such application is guilty of the offense of falsification under Section ___ of the Revised Code.
- G. The lending institution shall forward to the State Treasurer a linked deposit loan package, in the form and manner prescribed by the State Treasurer. The lending institution shall certify that each applicant is an eligible *small business*, and shall certify the present borrowing rate applicable for this *small business*. The treasury reserves the right to deny any application.
- H. Upon acceptance of the linked deposit loan package the State Treasurer may place certificates of deposit with the lending institution, at ___ percent below current market rate, as determined and calculated by the State Treasurer. Or the Treasurer may choose to place the certificates prior to acceptance of the loan package and earn the current market interest rate until the funds are used for a linked deposit.
- I. The Treasurer and lending institution shall enter into a deposit agreement specifying the length and terms of the loan. Loans made to the *small business* must be at a fixed rate and receive the same interest rate reduction as the deposited state monies. The agreement shall include provisions for renewal.
- J. No more than one linked deposit loan may be outstanding at any one time to any individual eligible *small business*. In addition, the maximum amount loaned to any *small business* shall be \$_____. (Or the maximum amount loaned per job created/ retained shall be \$_____.)
- K. Lending institutions must possess the securities which the state has designated as acceptable to be used as collateral of their deposited funds in an amount acceptable to the state.
- L. The Treasurer shall consider criteria targeting loans under the program to geographic areas of financial need, and may establish limits on the deposits

to any one lending institution, further limits on deposits supporting loans to any one borrower, and further restrictions on eligibility.

- M. Neither the State nor the Treasurer of the State are liable to any lending institution in any manner, for payment of principal or interest on a loan made to an eligible *small business*. Any delay in payments or default on the part of an eligible *small business* does not in any manner affect the deposit agreement between the lending institution and Treasurer. The deposits made by the Treasurer under this program shall not, in any way, be considered pledged as security to the eligible lending institution in the event of a loan default by a small business.

- N. The State Treasurer shall take any and all steps necessary to implement the linked deposit program and monitor compliance of eligible lending institutions and eligible *small businesses*. Annually, the State Treasurer shall report on the linked deposit program for the preceding calendar year to the Governor, the Speaker of the House and the President of the Senate. The report shall set forth the linked deposits made by the State Treasurer under the program during the year and shall include information regarding the nature, terms, and amounts of the loans upon which the linked deposits were based.

Woodstock Institute

The Woodstock Institute is a not-for-profit organization based in Chicago. For the past 21 years, the Institute has carried out applied research and developed and implemented programs which increase private sector investment in modest-income and minority communities for the benefit of those who live there. It designs programs which bridge the gap between the needs of communities and the resources of banks, savings and loan associations, foundations and others.

The Institute provides a variety of services to community-based organizations, financial institutions, foundations, and government agencies, including applied research, policy analysis, program design, and evaluation.

Malcolm Bush
President

Kathryn Tholin
Executive Vice President

Daniel Immergluck
Vice President



**WOODSTOCK INSTITUTE
407 SOUTH DEARBORN
SUITE 550
CHICAGO, ILLINOIS 60605
(312) 427-8070**