



Raising and Managing Capital for Development Finance Institutions

- Strategy & policies to raise and preserve capital to achieve mission and scale
- Impact of capital structure and sources:
 - Shapes the type of financing that can be supplied
 - Determines lending/investment volume and scale
 - Ability to fund TA and development activities
- Impact of capital management policies:
 - Source of capital via profits and retained earnings
 - Financing products, terms & losses shapes the ability to raise capital from investors
- Three aspects of capital management
 - Pricing, loss management, securing capital sources

Pricing Loans and Investments

- Set market-rate interest rates/investment returns: preserves capital, provide access to more sources; helps avoid capital substitution.
- If below market:
 - Floor rate = cost of capital + expected loss rate + operating cost percentage.
- Reduce risk of losses from fixed rate and long-term loans:
 - Variable rates for short-terms loans and when interest rate risk can be absorbed by borrowers; rate caps can limit borrow risk.
 - Sell or securitize fixed-rate loans
 - Match fund large fixed-rate loans or new programs, via FHLB Community Investment Program, negotiated loan, or development deposits. Risk of losses from prepayment exist.
- Consider using tools to accelerate loan repayment:
 - Medium term with long-term amortization;
 - Call provisions when borrower or project becomes “bankable”
 - Interest rate kickers

Managing and Funding Loan Losses

- LA Community Development Bank: loan losses of 40%
- Sound investment standards, policies and process
- Base annual loan loss reserve on the greater of expected losses or average losses over an economic cycle to build up reserves in good times and avoid “catastrophic” losses.
- Establish mechanisms to fund losses
 - Set interest rates to cover expected losses
 - Charge a loss insurance fee, e.g., Capital Access Program
 - Raise grants to fund loan loss reserves, especially important for small and start-up entities or programs
 - Use of loan guarantees for depository institutions



Raising Capital & Expanding Funding Sources

- Four components of capitalization
 - Secure core grants and equity
 - Cultivate stable debt sources
 - Manage funds for others investors
 - Pursue loan sales and asset securitization
 - Community Reinvestment Fund
- Seed Corporation Example

Diagram of a Loan-backed Securitization

