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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

MANPOWER AND WELFARE  
DIVISION



November 9, 1973

Mr. Louis Ramirez  
Associate Director  
Office of Economic Development  
Office of Economic Opportunity

Dear Mr. Ramirez:

We have reviewed selected activities of the Opportunity Funding Corporation (Corporation) a grantee of the Office of Economic Opportunity (OEO). In June 1970 the Corporation, a private, nonprofit institution, received a \$7.4 million grant from OEO to carry out demonstration programs designed to attract capital to low-income communities. The Corporation or OEO, based on the results of the demonstration programs, can seek to modify existing legislation or to establish new Federal programs relating to economic development. OEO, through its Office of Economic Development, is responsible for approval and evaluation of the Corporation's programs and their related budgets.

We believe our observations may be useful to OEO and the Corporation in determining future strategy of programs carried out by the Corporation.

Although the OEO grant to the Corporation was made in June 1970, the Corporation's first employee (the president) did not assume his duties until December 1970. The Corporation's first demonstration program was approved by OEO in February 1971 and through June 30, 1973, the Corporation had established five demonstration programs--banking, bonding, financial assistance to local development corporations (local injection), flexible loan and equity guarantees, and real estate development. A Corporation official advised us that through June 30, 1973, costs of about \$930,000 were incurred in administering these programs. Our efforts were directed primarily toward reviewing the Corporation's first three programs. Only four projects had been initiated under the latter two programs as of June 30, 1973.

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We examined OEO and the Corporation's program records and held discussions with representatives of OEO, the Corporation, the Small Business Administration (SBA), and the Department of Commerce's Office of Minority Business Enterprise (OMBE).

#### OBSERVATIONS

The Corporation has

- deposited about 80 percent of its OEO grant funds in minority-owned and poverty-area banks with the intent that the banks would use a substantial portion of the funds to make loans to area businesses, community organizations, and/or consumers,
- assisted eight minority contractors in obtaining surety bonds,
- used guarantees to encourage an increase in the flow of private sector capital to two minority-owned banks, and
- assisted 16 local development corporations in meeting the requirements to qualify for SBA loans.

After almost 3 years of operation the Corporation has achieved limited success in demonstrating ways to improve economic conditions in low-income areas. We noted that

- one of the Corporation's banking program demonstrations and its bonding program are closely related to activities carried out under other Federal programs,
- the Corporation has been slow in implementing demonstration projects under its banking, bonding, flexible loan and equity guarantee, and real estate development programs,
- a sufficient data base has not been developed under its bonding, local injection, and certain components of the banking program to enable the Corporation or OEO to ascertain the need for legislative changes, and
- the Corporation has not in all cases coordinated its programs with other Government agencies or determined whether there are any legal restrictions which would preclude it from carrying out intended objectives under the programs.

Details follow.

## BANKING

The banking program was initiated in June 1971 and includes activities such as direct and indirect deposit support, management development, liquidity enhancement, and capital support. Its objective is to develop and test the effectiveness of a variety of approaches in helping poverty-area and minority-owned banks to grow in strength, viability and usefulness to their communities. As of June 30, 1973, however, the program's accomplishments have been limited.

### Direct deposit support

The purpose of the direct deposit support is to demonstrate that an infusion of funds into minority-owned and poverty-area banks will result in new loans to businesses, community organizations, and consumers in the communities served by the participating banks. The Corporation hopes that this demonstration will influence Federal and State agencies, and private institutions to make similar deposits in poverty-area banks which hopefully will stimulate economic development.

The Corporation proposed to deposit about \$5 million in poverty-area banks in the form of 6-month certificates of deposit and demand deposits. At June 30, 1973, the Corporation had deposited about \$5.4 million in 45 minority-owned and poverty-area banks throughout the country. Deposits, which average about \$120,000 per bank, ranged from \$34,000 to \$386,000, and were divided about equally between 6-month certificates and demand deposits.

As a condition to receiving these deposits, the participating banks were to attempt to loan at least 60 percent of the deposits within the poverty community, and submit semi-annual reports describing the attempts made to invest these funds. Our review of the nine narrative reports submitted by the banks through September 1972 showed that although loans were made to minority groups and/or businesses within the communities, the reports did not provide sufficient information to determine whether 60 percent of the Corporation's deposits were actually invested in the poverty community.

A Corporation official advised us in October 1973 that the banks narrative reports have improved somewhat, but that

the majority of these reports were still not providing sufficient information to determine whether Corporation deposits were invested in the poverty community.

We noted that OMBE had initiated a minority-owned bank deposit program in October 1970 under which it requests Federal grantees and contractors to place deposits in minority-owned banks. Also, through a nonprofit foundation, deposits were requested from the private sector.

An OMBE official informed us that the program was designed to (1) strengthen the loan capability of minority-owned banks by increasing their deposit bases, and (2) provide these banks with the opportunity of dealing with groups and organizations outside the poverty community. At December 31, 1971, under the OMBE program \$242 million had been deposited in 38 minority-owned banks. In contrast, the Corporation has placed deposits totaling about \$4.5 million in 28 of the above banks. An OMBE official stated that based on the latest information available (as of June 30, 1972), total deposits resulting from its program had increased to about \$400 million.

#### Indirect deposit support

The purpose of indirect deposit support is to demonstrate the effectiveness of deposit guarantees and interest subsidies in attracting private sector deposits to poverty-area banks. Deposit guarantees are to be used to guarantee selected deposits for an additional \$30,000 above the Federal Deposit Insurance Corporation (FDIC) \$20,000 insurance limit, and the Corporation was to determine the extent to which these additional guarantees would induce depositors to place funds in poverty-area banks.

Interest subsidies are also to be used to make interest rates paid by poverty-area banks comparable to that paid by nonpoverty-area banks and to provide premium yields to investors to compensate for the additional risk of depositing funds in poverty-area banks.

Neither deposit guarantees nor interest subsidies were being utilized as of June 30, 1973. A corporation vice-president stated that there were problems which must be resolved before either deposit guarantees or interest subsidies are used. For example, the Corporation had not yet determined whether it can legally insure deposits above the FDIC \$20,000 limit nor had it determined whether it can legally pay interest subsidies.

### Management development

The purpose of management development is to demonstrate the effectiveness of training programs in improving the abilities of poverty-area banks' lending officers in their roles as organizers, not only of bank resources, but of other community resources as well. Management development was approved by OEO in June 1971, with the direct deposit support program, and is funded by interest earned on 6-month certificates of deposit held in minority-owned and poverty-area banks.

After more than 2 years, the Corporation was involved in only one project--a management development seminar conducted in July 1972 by the National Bankers Association. This involvement consisted only of a \$25,000 contribution to pay for about one-third of the cost of the seminar. The seminar, attended by 250 participants from 45 banks, included topics such as the operating experiences of minority banks, developing sound banking policy, and lending and profitability in a low economic market.

A Corporation vice-president stated that the Corporation was considering providing on-site management development under which the participating banks would receive individual attention addressing their particular problems. However, as of June 30, 1973, the Corporation had not developed written procedures explaining its plans for the on-site management development idea.

### Liquidity enhancement

The purpose of liquidity enhancement is to test the Corporation's ability to increase the lending capability of poverty-area banks by purchasing portions of their loan portfolios, thus providing the banks additional money to reloan to the poverty community. The Corporation hopes that as a result of its efforts a financial institution, similar to Federal National Mortgage Association, will be established to buy commercial paper of poverty-area banks for repackaging and resale.

In October and November 1971 the Corporation contacted 32 minority-owned and poverty-area banks to determine the banks' willingness to sell portions of their loan portfolios. Of 12 responses received, only one bank showed an interest in the program. A Corporation official informed us that the remaining banks were not interested because the interest rates on the loans then held by the banks were higher than the then

prevailing market rate at which new loans could be made by the banks. He further informed us that the Corporation plans to again contact a number of banks in early 1974 regarding the purchasing of loan portfolios.

#### Capital support

The purpose of capital support is to determine the effectiveness of the Corporation's guarantees and interest subsidies in attracting investments and loans to poverty-area banks which lack sufficient capital.

Through June 30, 1973, the Corporation had received only 13 inquiries regarding capital support and had provided guarantees assisting only two banks, one in July 1971, and the other in May 1972. Of the remaining 11 inquiries, 4 were withdrawn or deferred, 3 raised the needed capital without the Corporation's assistance, and 4 were still under consideration by the Corporation.

#### BONDING

One objective of the bonding program--approved by OEO in February 1971--is to test various types of guarantees which can be used to assist minority contractors in obtaining surety bonds. Another objective is to establish a minority owned and/or oriented surety agency or company to deal with the special bonding problems of minority contractors.

The Corporation entered into its first bonding project in September 1971, and through June 30, 1973, assisted eight minority contractors in obtaining bonds. The Corporation's president informed us that requests for assistance were less than anticipated by the Corporation. A Corporation official advised us that through June 30, 1973, 24 requests have been received from contractors.

In six of the eight cases, the Corporation provided letters of credit to assist minority contractors in obtaining surety bonds. Letters of credit are backed by the Corporation's deposits at various banks and are used as collateral security for bid, payment, and performance bonds. The letters of credit, generally equal to 10 to 20 percent of the sum of a given bond, authorize a bonding company to draw drafts against the bank issuing the letter in the event that the bonding company incurs losses because of working capital deficiencies on the part of the contractor. The Corporation

demonstrated the use of other guarantee techniques in two cases, but has not established the proposed minority owned and/or oriented surety agency or company.

In addition, we noted that SBA initiated a surety bond guarantee program at about the same time the Corporation initiated its bonding program. The SBA program guarantees up to 90 percent of the loss on a bond for contracts of \$500,000 or less. Through June 30, 1973, SBA had received 10,994 requests for bonding and had helped 6,943 contractors to obtain bonding. An SBA official stated that about 35 percent of the contractors assisted by SBA were members of minority groups.

The Corporation in detailing its first year findings, suggested that SBA, under its surety bond guarantee program, be permitted to guarantee letters of credit issued by commercial banks in lieu of bonds or as an inducement to surety companies. However, it does not appear that the Corporation's suggestions will be implemented by SBA because:

- An SBA official informed us that letters of credit are not authorized for SBA by existing legislation and their use would not structurally improve SBA's program, and
- SBA operates a loan program which provides funds to those businesses which lack sufficient working capital.

#### LOCAL INJECTION

The purpose of the Corporation's program is to demonstrate that the SBA local injection loan program can be a significant source of capital for small businesses in urban poverty areas. Also, a Corporation official stated that based upon the program the Corporation hopes to show that the local injection requirement--the funds which the local development corporations (LDCs) must provide--can be eliminated for urban LDCs or that guarantees should be provided for local injection loans made to such LDCs.

SBA provides plant and equipment loans to LDCs for relending to small businesses located in poverty areas in order to promote and assist the growth and development of such concerns. To qualify for these loans LDCs are required to provide a share (between 10 and 20 percent) of the total project cost. The SBA program has made over 4,700 loans to LDCs nationwide through June 30, 1973.

Many LDCs, according to Corporation officials, are unable to raise the required local injection funds. As a result, in November 1971 the Corporation and the Presbyterian Economic Development Corporation (PEDCO), a private, nonprofit corporation, entered into an agreement whereby PEDCO would provide the required local injection funds and the Corporation would guarantee 75 percent of the PEDCO loans provided to LDCs. At June 30, 1973, the Corporation had guaranteed 16 loans made by PEDCO to LDCs.

An SBA official stated that the reason for the local injection requirement is to develop local responsibility for the projects which SBA assists, and that in those cases where PEDCO, with the Corporation's guarantee, has loaned the local injection to the LDC, SBA's purpose for the local injection requirement has, to some degree, been defeated. He further stated that to waive the local injection requirement for urban areas would require SBA to also waive the requirement for the entire country which is not believed to be desirable since the SBA program has worked well. Consequently, there still exists a need for this issue to be resolved between SBA and Corporation officials.

#### OTHER PROGRAMS

In addition to the above, OEO approved on March 28, 1972, two other programs.

--The flexible loan and equity guarantee program is designed to demonstrate that the effectiveness and efficiency of such guarantees for poverty-area economic development projects can be increased through flexibility to: negotiate guarantee levels and terms, employ various financial techniques not usually associated with existing Government programs, and provide guarantee protection to financing sources not currently eligible under most Government programs.

--The real estate development program is designed to test new and largely untried methods of attracting the investment needed for community-based real estate development ventures through debt and equity guarantees, including pre-construction guarantees, limited partnership guarantees, net worth guarantees, and mortgage guarantees. The Corporation believes that experience gained from the program may suggest the need to create new Federal, State, or local programs to deal with the particular problems of real estate development in low-income areas.

As of June 30, 1973, the Corporation had entered into only three projects under the flexible loan and equity guarantee program and only one project under the real estate development program.

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We would appreciate your comments on these matters. We wish to acknowledge the courtesies extended to our representatives during this review.

We are also sending copies of this report to the President of the Corporation.

Sincerely yours,



Franklin A. Curtis  
Associate Director