



A PUBLIC-SPIRITED FINANCIAL INFRASTRUCTURE FOR COMPTON, CA

GUARANTEED INCOME AND COMMUNITY DEVELOPMENT

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SECTION 1

INTRODUCTION

The Compton Pledge represents a bold investment in Compton's future and in the development of progressive social policy writ large. Realizing the Pledge's full potential will require an innovative and public-spirited financial infrastructure centered on the sustainable funding of guaranteed income and other community development initiatives.

To seize this opportunity, we propose a financial infrastructure for Compton that supports guaranteed income and makes the city a beacon of racially just, socially progressive financing across LA County and beyond. At its heart stands a new banking entity linked to the City and/or the Compton Community Development Corporation (CCDC) and certified as a Community Development Financial Institution, or CDFI. This new banking entity will offer an infrastructure for the disbursement and financing of a permanent guaranteed income while delivering numerous ancillary benefits to the City and its residents.

The present brief sketches a path toward the realization of this proposed infrastructure. Section 2 offers a brief discussion of the challenge at hand: developing racially and socially just mechanisms for funding a permanent guaranteed income at a time of looming budgetary obstacles for municipalities across the country. Section 3 turns to our proposed banking entity and its three core functions: GI disbursement, GI financing, and ancillary benefits. This section of the brief also includes a cursory description of the requirements for and benefits of CDFI certification, and offers additional revenue-raising options for further consideration. Section 4 lays out the key questions to resolve together in the coming months. Section 5 concludes with a provisional timeline for our work.

SECTION 2

THE CHALLENGE AT HAND

Our proposal aims to create a socially just banking infrastructure through which a portion of the resources required to support permanent guaranteed income can be sustainably funded.

Full funding of a robust guaranteed income program is a substantial lift for any U.S. municipality. We can envision a guaranteed income targeted to Comptonians living in poverty to gain a sense of the scale of the task. According to the Census Bureau, 21.9% of Compton's estimated 96,404 residents live below the federal poverty line. An annual guaranteed income of \$1000 (an amount roughly equivalent to the 2020 Alaska Permanent Fund Dividend payment) for these roughly 21,100 residents would require approximately \$21 million in annual transfers. Substituting an annual payment of \$1000 for a monthly payment of \$300 or \$600 would raise the estimated total to \$78m and \$156m, respectively. Adding a phase-out for those just above the poverty line, as many economists favor, would create an additional cost, as would program administration.¹

Thus, it is reasonable to estimate that a well-designed permanent guaranteed income program targeting all Compton residents living in poverty will entail an annual cost of some \$25-30m at minimum; further targeting of the participant pool (e.g. for those in extreme poverty, households with children, etc.) could reduce costs, substantially if necessary. For a city with an annual budget of \$178m, roughly \$60m of which is discretionary, the establishment of a permanent guaranteed income program will necessarily require innovative thinking and new structures that successfully leverage private capital; philanthropy; federal community development funds; and partnerships with neighboring jurisdictions, public pension funds, and others.

As we seek to build an infrastructure to fund guaranteed income, we will also seek and encounter opportunities to reduce the cost of capital for the City and to create a financial system that is more just and beneficial to its residents. Structural racism in its varied manifestations -- among them white flight, divestment, and marginalization from financial services -- has fostered financial challenges that require an acute response, one cognizant of research findings documenting bond market bias related in the terms offered to Black individuals (see [Bushway & Gelbach 2010](#) on bail bonds) and to HBCUs (see [Douglass et al. 2018](#)). These findings suggest a pattern of disparities that impact the community at multiple levels.

¹ While the costs of a phase-out or of program administration can only be estimated once we have determined the scope and shape of a permanent GI program, a few points of reference are still helpful in the interim. The Earned Income Tax Credit, for instance, features a [complex phase-out](#) beginning at \$19,030 for single filers with children and at \$24,820 for married filers with children (in 2019), with a phase-out rate of between roughly 16% and 21% depending on the number of children, thus ending between \$41k and \$56k depending on household composition. The nature and cost of a phase-out for a permanent GI in Compton will not necessarily be comparable, however, as it will depend on policy design decisions yet to be made. With regard to program administration, the Center on Budget and Policy Priorities [estimates](#) overhead for most anti-poverty programs in the US as between 1 and 9%, though the programs considered are all well established, and none relies on the sort of financial infrastructure we propose. A more precise estimate of the total cost of a permanent guaranteed income for Compton will be prepared as part of the policy design process.

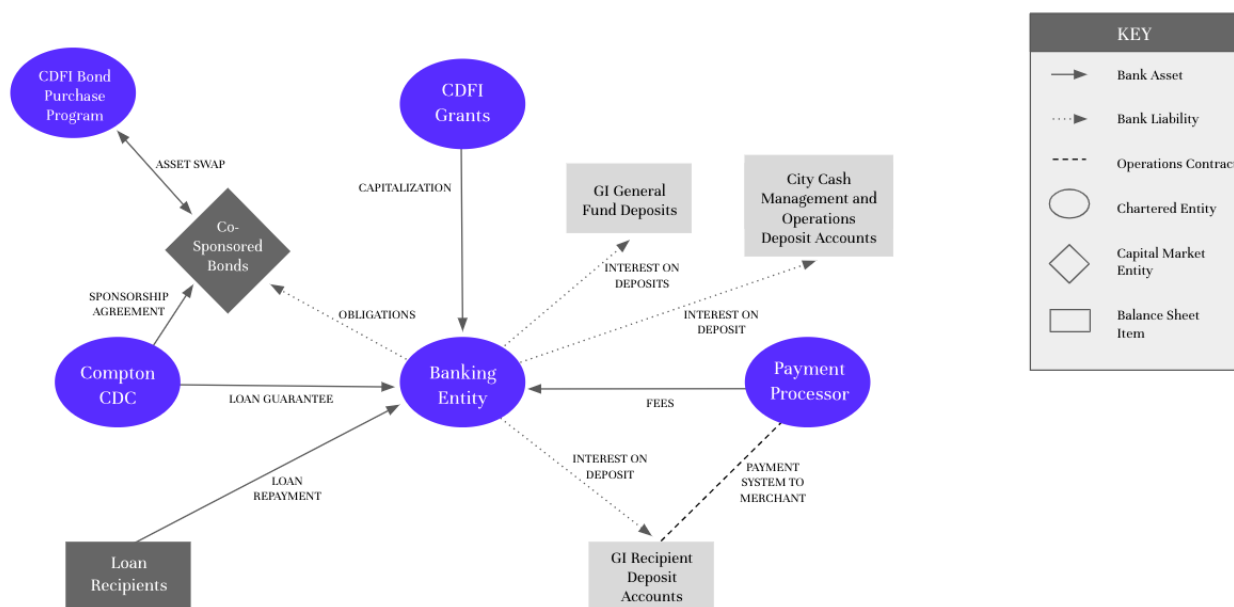
The push to lower the cost of capital and support progressive social policy through a more just and public-serving financial infrastructure could not come at a more critical time. Collectively, cities are facing a projected \$360 billion revenue shortfall over the next three years as a result of the Covid-19 pandemic. Aid to subnational governments continues to be overlooked by most federal fiscal policy. Because of this, in combination with steep cuts, cities are likely to have to turn to the capital markets this year to fund liabilities, putting the City's capacity to secure debt on advantageous terms squarely on the public agenda.

SECTION 3

A NEW BANKING ENTITY FOR COMPTON

At the heart of our proposal stands a private banking entity with meaningful public participation, responsible for the financing and disbursement of guaranteed income, and certified as a CDFI.

While this entity may take several forms (see Section 4 below), in all cases it will support guaranteed income and stand as a key node in a new Compton financial ecosystem. Our entity's place in this ecosystem is depicted in the flow of funds diagram below.



Depicted within this diagram are three key functions of our proposed banking entity. First, it will provide an infrastructure for the disbursement of guaranteed income, in the process offering powerful opportunities for financial inclusion through expanded access to banking services and education. Second, it will serve as a platform for financing a permanent guaranteed income, through CDFI programs and further opportunities to leverage private and philanthropic capital to generate fees and other income for the banking entity. Third, it will deliver numerous ancillary benefits to the City of Compton and its residents, among them support for the CCDC and the leveraging of GI endowment funds to provide low-cost loans. Each of these functions is described in greater detail below.

3.1 An Infrastructure for the Disbursement of a Permanent Guaranteed Income

Until now, the majority of guaranteed income schemes have operated through a debit card or similar payment system. For example, New York's MOIA program uses a system reliant on Paypal's payment network. The Compton Pledge pilot will operate similarly. Under this model, Paypal makes a fee by way of its "float," the internal reserve of cash held by Paypal, on which it earns interest.

While this third-party approach is well suited to the needs and timeline of the Compton Pledge pilot, we propose housing the infrastructure of a permanent guaranteed income program in our bank. This will allow us to capture the same pool of capital on which Paypal or another third party earns its float and instead use it to finance socially beneficial programs, such as community development loans. Moreover, attaching payments to bank accounts solves the problem of access to bank accounts by low income individuals, bringing formerly unbanked individuals into the financial system on highly favorable terms. These individuals can be offered financial education in conjunction with their account, and the bank can also facilitate the investment of the capital into savings accounts or higher yielding products such as CDs. This, in turn, further increases the bank's deposit base and its balance sheet for lending -- a true win-win for Compton and its residents.

3.2 Financing Guaranteed Income

No matter the size and shape of a permanent guaranteed income program for Compton, funding it will represent a heavy lift. Our proposed banking entity will serve as a platform for financing this program, offering a firm foundation for our capital stack and opening the door to innovative possibilities.

A. The CDFI Fund

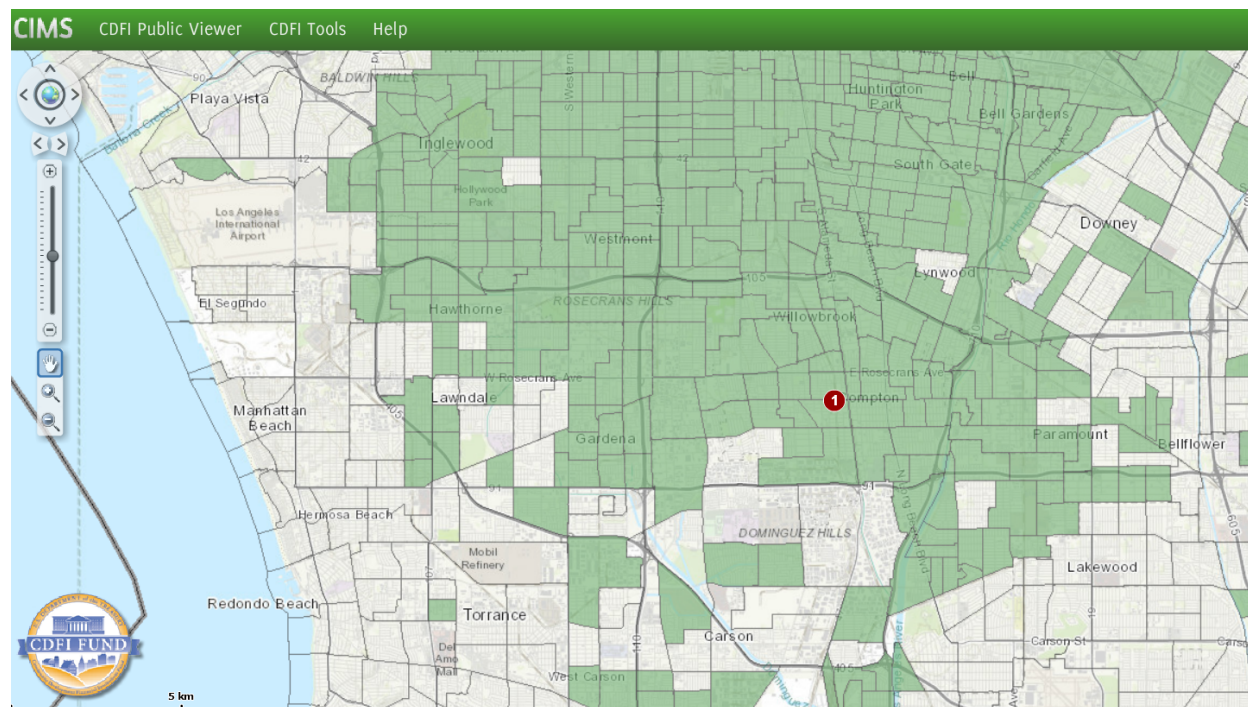
Requirements for Achieving CDFI Status

An applicant for CDFI Status must demonstrate to the CDFI Fund that it satisfies six criteria prior to becoming certified as a CDFI. The entity must: (1) satisfy the primary mission test, (2) be a financing entity, (3) serve a target market, (4) provide development services, (5) meet the accountability requirement, and (6) not be a government entity. These criteria are discussed in detail in the memorandum on CDFI Eligibility Requirements attached as Exhibit 1.. Two of the critical issues to be addressed include (i) the determination of the Target Market and (ii) the structuring of the CDFI and its relationship with the City of Compton.

Target Market Criteria

The CDFI must serve a "Target Market." An entity may meet this requirement by demonstrating that it provides "Financial Products" and/or "Financing Services" in Investment Areas and/or to Targeted Populations. Generally an Investment Area must be an area of "economic distress" that has "significant unmet needs for loans, Equity Investments, Financial Products or Financial Services". A detailed discussion of the criteria for establishing a Target Market is included in Exhibit 1. The CDFI Fund has

designated certain areas as Investment Areas. See a snapshot of the CDFI Fund designated Investment Areas in and around Compton, California below:



We will ensure that the Target Market for the new CDFI meets these requirements.

Non-Government Criteria

Presently, a CDFI entity cannot be an agency or instrumentality of the United States or any State or political subdivision thereof. As a result of this limitation, the new CDFI cannot be an agency or instrumentality of the City of Compton. An entity that is created by, or that receives substantial assistance from, one or more government entities may be a CDFI provided it is not "Controlled" by such entities and maintains independent decision-making power over its activities. Therefore, under current law, the CDFI must be structured in a way that does not cause its relationship with the City of Compton to rise to such a level that the CDFI is considered "controlled" by the City. The control analysis looks at (i) ownership, control and the power to vote on the affairs of the CDFI, (ii) control over the election of a majority of the directors, trustees or general partners of the CDFI, and (iii) power to exercise a controlling influence over the management, credit, investment decisions or policies of the entity. A positive corollary to this requirement is that assuring the formal independence of our new banking entity meaningfully mitigates credit risk to the city. The nongovernmental requirement is discussed in further detail in Exhibit 1. We will structure the new CDFI to comply with this requirement.

CDFI Fund Programs

The benefits of the various programs administered by the CDFI Fund and the income which can be generated as a result of deployment of the proceeds of CDFI Fund programs, together are intended to represent the most secure component of our capital stack for a permanent guaranteed income. Two CDFI Fund programs are of immediate relevance:

- The [CDFI Program](#) invests federal resources, matched by private funding, in CDFIs. These investments can take the form of financial assistance (for example, loans, grants, equity investments, and deposits, all matched dollar for dollar by non-federal funds) or technical assistance.
- The [CDFI Bond Guarantee Program](#) is a credit subsidy program with the potential to meaningfully reduce cost of capital and spur economic development. Under the terms of the program, a qualified Issuer (either a CDFI or its designee) acts as a go-between, selling bonds worth between \$1m and \$1b to the Federal Financing Bank. The qualified issuer in turn extends credit to other CDFIs or secondary borrowers at below market-rate interest for community development purposes. Our CDFI could participate initially as a secondary borrower, and/or could seek over a longer time horizon to attain qualified issuer status, through partnership with neighboring municipalities and other CDFIs and CDEs (see below).

Additional CDFI programs also present opportunities for the future. Three such opportunities are worth signaling now:

- The [Bank Enterprise Award Program](#) facilitates investments by FDIC-insured institutions in CDFIs in “distressed communities,” defined as communities with 1.5x the national unemployment rate and at least 30% of residents living under the poverty line. These investments can include support to CDFIs and service activities (such as discounted accounts for residents) in addition to more traditional forms of financing.
- The [Capital Magnet Fund](#) supports investments in affordable housing and other strategies for community revitalization.
- The [New Markets Tax Credit Program](#) offers attractive investment tax credits for private investment in [Community Development Entities](#) (CDEs), intermediary entities that provide loans and other services to low-income communities.

B. Leveraging Philanthropic Support

We will also create new channels to leverage philanthropic support in innovative ways. One particularly promising avenue centers on the creation of philanthropic credit guarantees, which could serve to backstop major transactions at little or no cost to philanthropists themselves. Developing these new forms of “risk philanthropy” represents one of the principal tasks during the planning phase of our proposed banking entity.

C. New Tax Levies and Fees

As our new banking entity scales up, we anticipate a shift in favor of additional funding sources. Research suggests that a reliable source of revenue for funding guaranteed income will likely include some form of conventional taxation, including the imposition of additional income and/or wealth taxes. Variations on this conventional taxation should be explored in order to create new strategies through which the City of Compton can raise revenue to permanently fund guaranteed income. Below are several such possibilities, presented not as endorsements but as avenues for further exploration.

Community Land Trust

Community land trusts represent a potentially promising strategy to promote affordable housing, combat gentrification, and ensure that the gains from economic development remain in Compton. A community land trust is a nonprofit corporation that holds land on behalf of a community, while serving as the long-term steward for affordable housing, community gardens, civic buildings, commercial spaces and other community assets on behalf of a community. Community land trusts are generally community-based organizations designed to ensure community stewardship of land and may be used for many types of development (including commercial and retail), but are primarily used to ensure long-term housing affordability.

The trust could acquire land and maintain ownership of it permanently. It would enter into a long-term, renewable lease (generally 99 years) instead of a traditional sale and thereafter, when the homeowner sells, the seller earns a portion of the increased property value and the remainder is kept by the trust. This remainder could be utilized to fund guaranteed income.

Value Added Tax (VAT)

A VAT is a consumption tax—like a retail sales tax, but collected in small bits at each stage of production. A VAT tax could be imposed on goods and/or services sold in Compton.

Environmental Degradation Tax

The City could investigate the potential for the imposition of an environmental degradation tax. The tax would be imposed to address the failure of businesses to take environmental impacts into account as they conduct their operations. The environmental degradation tax could help to raise revenue while achieving environmental effectiveness and transparency.

In structuring the tax, the environmental tax base could be targeted to the pollutant or polluting behavior, and should have few if any exceptions. The tax rate could be commensurate with the environmental damage caused by the pollutant. Additionally, the tax could be set at a rate that is predictable in order to motivate environmental improvements.

Disposition Tax

The City of Compton could impose a levy on the disposition of multi-family and/or commercial projects. The disposition tax could be a levy on the sale of real estate, including development projects, imposed on the gross or net proceeds from such transactions without exemption.

Development Impact Fees

Development Impact Fees could be imposed on development projects that require Compton to pay for roads, water, and other infrastructure in order for these developments to be completed. This could be a one-time fee paid to the City of Compton for the expansion of city services in connection with the development. Such fees are common in fast-growing areas and can generally be passed/imposed by the city council.

Increased Revenue Pool if New Tax Levies are Expanded to LA County

The City could also explore imposition of these taxes/levies on a regional basis. The expansion of the tax base to include all of LA County or other jurisdictions could significantly raise annual tax/fee revenue that could be utilized to fund guaranteed income or other social programs on a broader scale.

Further Possibilities

Additional possibilities remain to be explored. These include federal and state development programs, particularly Qualified Opportunity Zones and Enhanced Infrastructure Financing Districts, the latter of which may be adapted by the State of California in the near future to provide a project pipeline relevant to our work.

The City of Compton may also wish to consider whether there are other assets at its disposal that can be utilized to generate social dividends to support guaranteed income.

Finally, future partnerships with neighboring jurisdictions including the cities of Los Angeles and Long Beach (home to the first and second busiest ports in the country, respectively), as well as Los Angeles County, could open possibilities for new revenue streams and/or grant access to the Federal Reserve's Municipal Liquidity Facility. The interest in guaranteed income already expressed by the government of Long Beach makes this city an especially attractive prospective partner, and we intend to initiate conversations with city representatives as soon as practicable.

3.3 Additional Benefits for Compton, its Residents, and its Neighbors

Beyond its core function of supporting guaranteed income, our proposed banking entity will be poised to deliver numerous additional benefits for the City of Compton, its residents, and neighboring jurisdictions. Seven of the most exciting are outlined below. Undergirding all of these benefits is a sense of possibility, and the certainty that these lines of approach will change and develop as our banking entity takes shape.

Refinancing Existing Debt

Given favorable current market conditions, refinancing existing City bonds, either through our new banking entity or in a parallel workstream, could create new opportunities for both the city and other public and public-serving entities to explore new avenues in city finance. Refinancing under a new entity could be leveraged to seek out better terms and to take advantage of historically low interest rates, a strategy presently being pursued by numerous cities. Furthermore, this collaboration could serve as a test case in forging new partnerships between philanthropists and cities, and in demonstrating new thinking about muni bonds. New avenues of "risk philanthropy," including the assumption of risk via philanthropic credit guarantees, could be particularly powerful.

Issuing Tax-Exempt Bonds

Federal and state laws permit certain types of tax-exempt debt financing for capital improvements. Tax-exempt bonds have typically been issued in order to finance traditional government functions including school construction, public infrastructure, and municipal utilities. However, certain private organizations (including 501(c)(3) nonprofit corporations) are permitted to utilize the proceeds of tax-exempt bond financing for capital improvements. Generally, in a financing involving a nonprofit entity, the tax-exempt bonds are issued by a state or local government issuer which then on-lends the bond proceeds to the 501(c)(3) organization. Many local issuers (such as a city, town or county) can only finance activities of a 501(c)(3) entity within its geographic boundaries. However, statewide issuers enable such organizations to pool their financing needs with other 501(c)(3) organizations throughout the state.

Typically, tax-exempt bond proceeds are used to fund the cost of (i) acquiring or constructing capital assets, (ii) paying interest during construction, (iii) establishing a debt service reserve fund, (iv) certain

costs of credit enhancement, and (v) other costs of issuance. Costs of issuance funded from bond proceeds are limited to 2% of the proceeds of the bonds. Federal law also permits 501(c)(3) organizations to finance working capital. However, the arbitrage rules applicable to such financing are somewhat restrictive and may make working capital financing unattractive. Generally, the weighted average maturity of the tax exempt bonds may not exceed 120% of the weighted average useful life of the capital assets being financed, excluding land. Thus, a 501(c)(3) organization may want to avoid selecting equipment, information systems, and other short term assets for a significant portion of the assets being financed if a long term tax exempt financing is anticipated.

Section 145 of the Internal Revenue Code (the primary tax statute dealing with tax-exempt bonds for 501(c)(3) organizations) requires all property financed by tax-exempt bonds to be owned by a 501(c)(3) organization or a governmental unit. Section 145 also requires that 95% of the proceeds of the tax-exempt bonds be used in the exempt activities of the 501(c)(3) organization ("qualified use"). Therefore, use of bond-financed facilities by private businesses, the federal government or by a 501(c)(3) organization in an unrelated trade or business ("private use") is not permitted.

Finally, it should be noted that the differential between taxable and tax-exempt interest rates provide opportunities to 501(c)(3) organizations to recognize profits by borrowing at a low tax-exempt rate and investing the proceeds at a higher taxable rate. However, the government has directed a lot of regulatory effort toward controlling the amount of profit or "arbitrage" which can be realized by a borrower in a tax-exempt financing. Generally, any interest earnings on investments of tax-exempt bond proceeds in excess of the interest rate on the tax-exempt bonds must be paid back, or "rebated," to the Federal government and cannot be kept by the 501(c)(3) organization. Numerous exceptions to this rule exist to provide relief from this requirement for borrowers who fit within certain permitted exceptions. Any tax-exempt bond financing would need to be planned to take advantage of these exceptions in order to enhance the overall benefits of this type of financing. Nevertheless, the proceeds of tax exempt bond financing can be utilized to further support the capital needs of the City of Compton.

Supporting the CCDC

Our new banking entity will support the Compton Community Development Corporation's full suite of initiatives, seeking to finance critical development projects on advantageous terms. We will aim to do so by facilitating credit guarantees, co-sponsored bonds, and interest-rate swaps, harnessing the power of CDFI Fund programs and private philanthropy on behalf of the CCDC.

A Better Way for the City of Compton to Bank

It is our hope that our proposed banking entity will ultimately handle a meaningful share of the City of Compton's banking business, including housing liquid cash reserves. Not only will this represent an opportunity to avoid the fees charged by commercial banks, but also to augment our bank's cash flows, in turn generating further opportunities and resources to serve the public interest. We also hope that any philanthropic partners make use of the new entity to handle accounts for programs related to the Compton Guaranteed Income Pilot. This also points the way to future possibilities for active management of the City's public assets, in the vein of [recent proposals](#) by public finance specialists Dag Detter and Stefan Fölster.

Opportunities for New Partnerships

We intend to actively seek out a working relationship with prominent public pension funds, including CalPERS and LACERA. CalPERS in particular is both well positioned to be a partner and regarded as an industry leader in setting the direction many other pension funds follow. Similar to their decision to shift

out of hedge funds, a signal from CalPERS that they are interested in this project would open the door to many other pension funds. We will also reach out to smaller pensions funds while placing a high priority on California-based pension funds, as a California partner of some kind will likely be a precondition for bringing out-of-state funds on board.

Infrastructure for Future Solidarity Economy Programs

As our banking entity matures, it will open space for additional programs to support Compton's economic development. In the near term, one promising option is the creation of a microcredit facility, funded by a share of bank interchange fees, which would offer small loans to local enterprises on highly favorable terms. Looking further afield, such programs could be coupled with bolder efforts to promote local economic growth and keep resources in the community for longer, such as a complementary currency spendable only in Compton and/or partner jurisdictions. Such a currency could have a meaningful multiplier effect on local and federal dollars spent on benefit programs, and depending on its structure, could even create additional fiscal space for City initiatives. While the implementation of an effective complementary currency would be a substantial effort likely requiring regulatory changes at the federal level, the [success](#) of the local [mumbuca](#) currency developed by Maricá, Brazil -- a city just outside of Rio de Janeiro and a close partner of the Jain Family Institute -- demonstrates the potential upsides that such a policy could hold for Compton.

Engagement with a Growing Public Banking Ecosystem

Public banking has seen an unprecedented burst of interest and advocacy in the United States in recent years. Publicly owned banks are important parts of both the retail and investment banking systems in the United States and in many industrialized economies. In the United States, the best known publicly owned bank is the North Dakota Public Bank (BND), founded in 1919 to provide loans to farmers, the BND is now a lender to businesses and offers limited, checking, savings, and foreign exchange (Canadian Dollar) services with a mandate to maintain public access rather than profit. A newer example is the Territorial Bank of American Samoa, which is a government owned, full service commercial bank with access to the Federal Reserve backstop and Federal Deposit Insurance Corporation guarantees. The best known and developed public banking system is the German system, where municipally owned banks are a major part of the savings system holding around 40% of household deposits. These small municipal institutions are federated into the state run "landesbanken" which act both as clearing houses and commercial banks that amplify the lending power of the municipal banks.

Finally, the Texas General Land Office represents an interesting example of how a state agency can evolve and expand far beyond its original parameters. The agency governs land and mineral rights and has a broad mandate to fund education at all levels in Texas. It does this through the Texas Permanent School Fund, a sovereign wealth fund with an endowment larger than Harvard's that underwrites many of the educational bonds in Texas, at AAA rating. The financial flexibility the office has created and the ability to secure excellent bond ratings for many different entities make it an attractive office to engage.

These examples underlie several features of a public banking system. First, public banks need to build connections with communities by being deposit holders. Second, this empowers a community to build long-term savings over time. As well, the most salient feature is the federation of banking across regions and nations. The Federal Reserve is just such a federation that exists already, which allows banks, public and private, to leverage their balance sheet to expand credit. However, it would also be important to work with other municipalities and with state authorities to create larger federations of public banks. There are already productive discussions to convert the California Infrastructure and Economic Development Bank into a full service lending and saving institution that, like the German landesbank,

will coordinate and clear between networks of municipal banks. This would have amalgamation and network effects across the state, and could create meaningful efficiencies for member institutions.

Finally, there are pushes to expand and make permanent the Federal Reserve Municipal Liquidity Facility to accept the debt of municipal and state entities at a below market rate. Moreover, a potential Biden Administration and Democratic Senate would likely pass some form of public green or infrastructure investment bank. Every legislative proposal for such an entity has a requirement for this federally backstopped entity to work with local “green banks” to fund projects (some restrict it to only such actions). Moreover, each of these proposals are being modified to increase environmental justice components of their proposals to boost investment in underserved communities. There is a distinct potential of a more extensive public banking ecosystem emerging in the coming years which Compton might be able to quickly mobilize with an effective infrastructure in place.

SECTION 4

KEY STRUCTURAL QUESTIONS TO RESOLVE

As we move toward the creation of our new entity, we will need to resolve key questions concerning its nature, fund structure, target market, relationship to the city and CCDC.

4.1 The Nature of Our Entity

There are three basic forms our entity could take in order to achieve the aims outlined in this brief: a *de novo* bank, a bank partnership, or a non-bank financial institution with banking functions assumed by a bank partner. While each option entails particular advantages, it is our belief that the bank partnership model holds the greatest promise for Compton. Below, we briefly describe the three forms and explain our preference for the bank partnership model.

Form Alternative 1: A De Novo Bank

Creating a new bank with its own charter would maximize our independence while also bringing the greatest degree of technical complexity and regulatory hurdles. A *de novo* bank would be chartered by the State of California and approved by the Federal Deposit Insurance Company to receive FDIC-insured deposits, extend loans, and make equity investments. As described in the document attached as Exhibit 2, standing up such a bank would involve the completion of more than 30 discrete tasks requiring, in a best-case scenario, at least twelve months and likely many more. It would also require raising substantial funds to capitalize the bank, and would entail greater overhead expenses than either of the two alternatives below. Upon creation, we could seek certification as a CDFI.

Form Alternative 2: A Bank Partnership

The bank partnership model has gained increasing popularity in recent years, as it combines nearly the full functionality of a *de novo* bank with a lesser regulatory burden and lower overhead costs. Under this scenario, we would constitute a financial institution that presents itself as a bank, one capable of taking FDIC-insured deposits, offering various credit products, and making equity investments. Rather than chartering our entity as a *de novo* bank, however, we would instead form a partnership with an existing bank, ideally one either mission-driven and/or with a presence in or near Compton. Our entity would assume responsibility for marketing and compliance, while our bank partner would use its charter to backend our operations. The bank partner would likely charge an origination fee for loans and on the deposit side would reserve a portion of the interchange fee charged to merchants, transferring the remaining portion to our entity. We could structure our partnership to provide a built-in runway for our entity to ultimately obtain its own charter and stand on its own, including a provision for porting depository accounts from our bank partner to our new bank in the future. To unlock the advantages of

the CDFI program, we could either seek certification of our new entity as a non-bank CDFI or partner with a bank which already holds CDFI certification.

This approach holds several advantages relative to the *de novo* bank described in Form Alternative 1. These include:

- A shorter timeline to launch: once structural questions are resolved and our desired partner identified, the timeline for incorporation and regulatory approval is approximately six months
- Lower overhead costs
- Reduced regulatory complexity
- Lower capitalization requirements

We believe that these advantages substantially outweigh the downsides of this approach, the most important of which are the origination fees and loss of a portion of depository-account interchange fees. As such the bank partnership model is our preferred approach.

Form Alternative 3: A Non-Bank Financial Institution

A third option is to form a non-bank financial institution capable of making loans and equity investments, but incapable of receiving deposits. We could, however, partner with a bank to offer depository accounts to guaranteed-income beneficiaries on favorable terms. As in the case of Alternative 2 above, we could unlock CDFI benefits through partnership with an existing CDFI or certification of our entity as a non-bank CDFI.

This approach would present the fewest regulatory hurdles and thus would offer us the fastest path to incorporation and the commencement of lending operations. It would, however, sever deposit-taking from lending, thus depriving us of a secure source of revenue as described in Section 3A above. While for this reason we do not favor Form Alternative 3, we would nonetheless be happy to consider it further should it be of interest to the City.

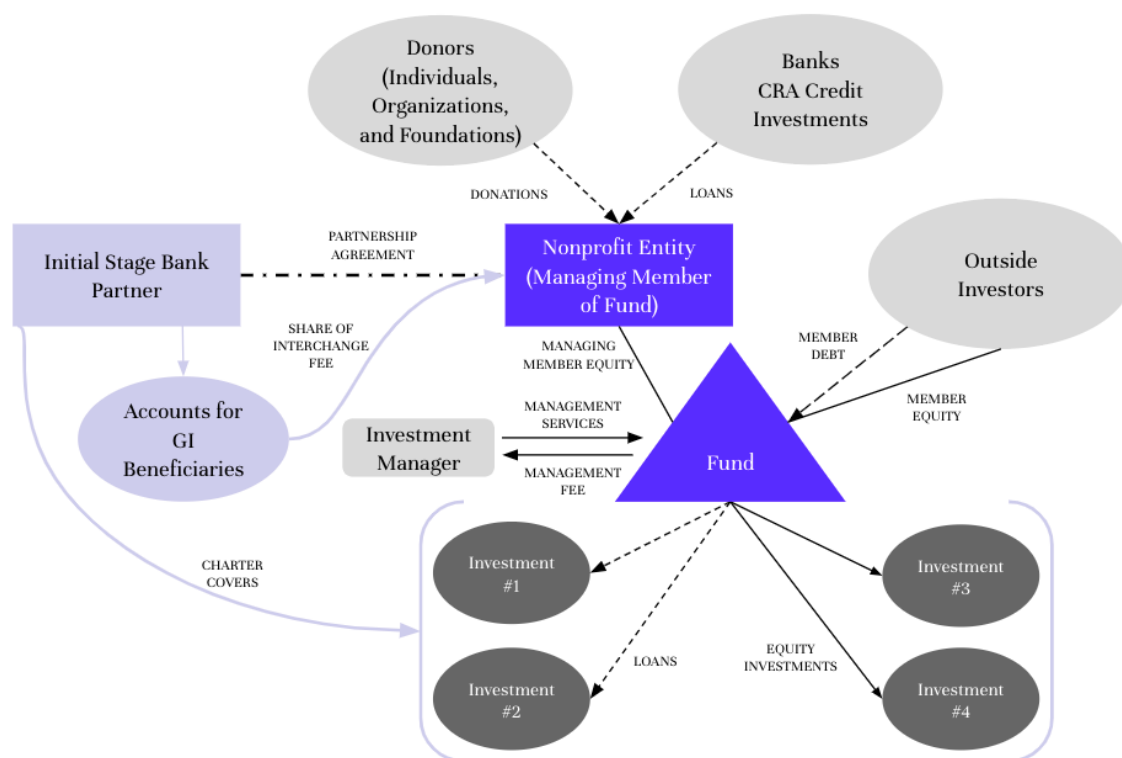
4.2 Fund Structure

Central to our mission is the ability to leverage private capital through the participation of outside investors. Two alternative fund structures could facilitate this, as depicted below.

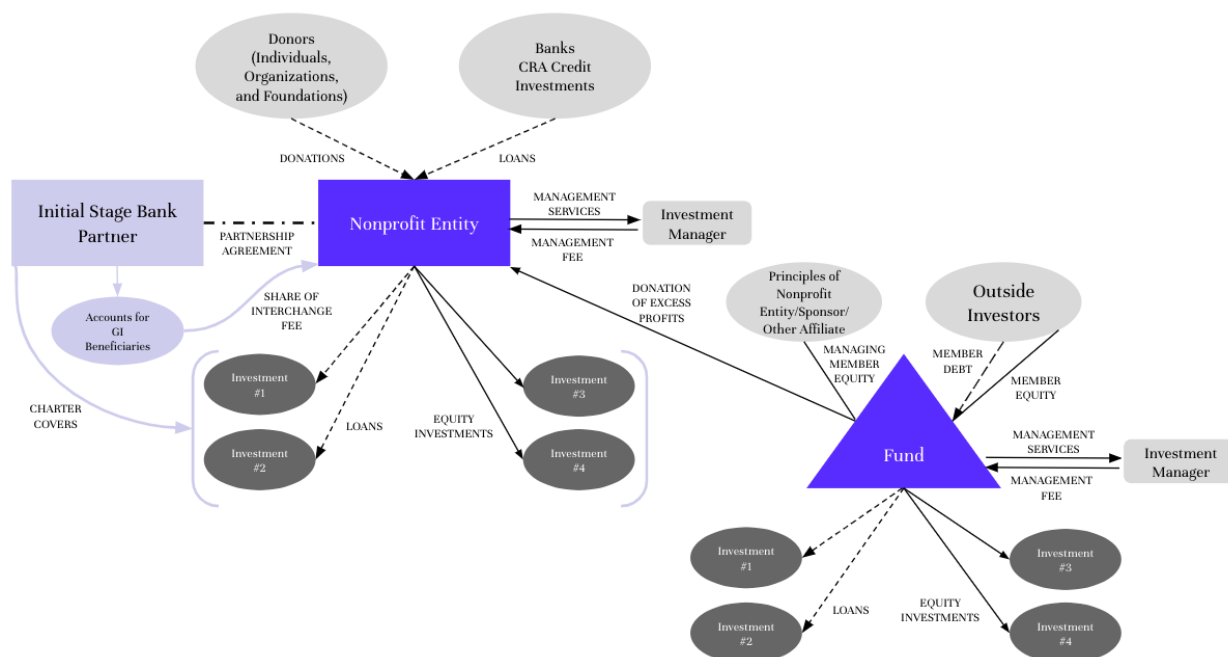
In both Fund Alternatives, the Fund is constituted as a for-profit limited liability company capable of raising capital from all categories of outside investors. In Fund Alternative 1, our new entity would serve as the Fund's managing member, and would transfer to the Fund any donations or loans received. The New Entity and the Fund would have separate governance structures, though the Managing Member and the Fund could share a board of directors. An independent Investment Manager would provide management services to the Fund. Fund Alternative 2 largely duplicates this structure; however, it offers a greater degree of separation between programmatic investments and investments from outside investors.

While we prefer Fund Alternative 1 for the greater degree of integration it offers between our new entity and the subsidiary Fund(s), we may wish to consider Fund Alternative 2 should we deem it advantageous to facilitate outside investment.

Fund Alternative 1: A New Entity with Investor Fund(s)



Fund Alternative 2: A New Entity with Sister Investor Fund(s)



Note that the diagrams of both Fund Alternatives above take as their point of departure the bank partnership model (Form Alternative 2, above). Should we instead opt to create a *de novo* bank, we would attribute the functions in green directly to the new entity itself. Should we opt to create a non-bank entity, these functions could still be performed by a separate entity, though we would not be able to represent them publicly as our own.

4.3 Defining Our Target Market

As described in Section 3C above, CDFIs must serve a designated target market, defined as an area of “economic distress” that has “significant unmet needs for loans, Equity Investments, Financial Products or Financial Services.” Proposed changes to the CDFI Fund certification process, currently under public review, would create greater flexibility by eliminating the strict geographic boundaries of the current framework. As these changes to the CDFI program are implemented, we will work together with City officials, expert advisors, and other stakeholders, to define our target market in a manner that maximizes our capacity to capture federal benefits for Compton and its residents while ensuring on-ramps for prospective future partners.

4.4 Relationship to the City and the CCDC

Under current law, our CDFI would need to be structured in a way that does not cause its relationship with the City of Compton to rise to such a level that the CDFI is considered to be “controlled” by the City of Compton. These legal restrictions, coupled with the bond market advantages of independent governance, push toward a private entity which nonetheless maximizes public participation via the City government and the public-serving CCDC. Working together with the City and CCDC, we will collaboratively define the precise role for both in the governance structures of our new banking entity as well as its subsidiary Fund(s).

SECTION 5

TIMELINE

The following timeline corresponds to Form Alternative 2, the Bank Partnership model. Opting to create a *de novo* bank (Form Alternative 1) would stretch the timeline by at least six months to a year. In contrast, establishing a non-bank entity (Form Alternative 3) could accelerate the timeline by a similar measure.

Q4 2020 - Q1 2021: Resolve Key Structural Questions

Through dialogue with City officials, relevant stakeholders, and outside experts, we will answer the outstanding structural questions identified in Section 4 above.

Q2 2021 - Q1 2022: Establish New Banking Entity

During this period, we will (i) develop a CDFI bank platform and potential bank model partnership and (ii) work with legal and regulatory advisors to navigate the federal and state regulatory and structuring issues surrounding:

- Product and system design
- Third party vendor relationships and contract negotiation
- Payment partnerships
- Account structures (prepaid, DDA, savings, time deposits, deposit array networks, “stacked” RIA, B/D, and non-fiat currency services)
- Lending partnerships
- Federal and state regulatory approval and compliance (including auditing of controls and consumer compliance)
- Capital stack and long-term investment structure
- Intellectual property
- Other material contracts and agreement

During this time, and through a parallel workstream, we will also seek to take advantage of favorable market conditions by exploring options to refinance existing debt, freeing additional fiscal space for economic development and other city priorities.

Q2 2022 - Q1 2023: Launch New Programs and Services

As the Compton Pledge pilot unfolds, we will launch the programs and services that will ultimately undergird a permanent guaranteed income, which may include optional no-fee savings accounts for Compton Pledge beneficiaries and other city residents. We will also work with the Compton Community Development Corporation to finance CCDC projects on favorable terms. We will initiate the process to certify our new banking entity as a CDFI, and explore possibilities for collaboration with neighboring jurisdictions.

Q2 2023 and Beyond: Support a Permanent Guaranteed Income

The transition from the Compton Pledge pilot to a permanent guaranteed income will mark the maturation of our banking entity, as it will assume responsibility for disbursement and financing of the program.

Exhibit 1

Memo from Sabrina Conyers (Partner, Nelson Mullins) re: CDFI Eligibility Requirements



Memorandum

To: Working Group
From: Sabrina Conyers
Date: September 24, 2020
Re: CDFI Eligibility Requirements

I. CDFI Requirements

The Banking Regulations define a CDFI as “an entity currently meeting the requirements described in § 1805.201.”¹ Under Section 1805.201 of the Regulations, an applicant entity must demonstrate to the CDFI Fund that it satisfies six criteria prior to being certified as a CDFI: (1) the primary mission test, (2) be a financing entity, (3) serve a target market, (4) the provision of development services, (5) accountability requirement, and (6) not be a government entity.² The remaining part of this section of this Memorandum discusses these six criteria.

A. Primary Mission Test

“A CDFI must have a primary mission of promoting community development.” In determining whether the applicant satisfies this requirement, the CDFI Fund will consider whether the “activities of the entity are purposefully directed toward improving the social and/or economic conditions of underserved people (which may include Low-Income persons or persons who lack adequate access to capital and/or Financial Services) and/or residents of economically distressed communities (which may include Investment Areas).”³

B. Financing Entity

An entity must be a financing entity. A financing entity is an “entity whose predominant business activity is the provision, in arms-length transactions, of Financial Products and/or Financial Services.”⁴ An entity can establish this by being (1) a depository institution holding company; (2) an insured depository institution, insured credit union, or state-insured credit union; or (3) an entity that has such a “predominant business activity” based on an analysis of its financing statements, organizing documents, and any other information required to be submitted as part of its application.⁵

Financial Products are defined as:

loans, Equity Investments and similar financing activities (as determined by the CDFI Fund) including the purchase of loans originated by certified CDFIs and the provision of loan guarantees; in the case of CDFI Intermediaries, Financial Products may also include loans to CDFIs and/or emerging CDFIs and deposits in Insured Credit Union CDFIs, emerging Insured Credit Union CDFIs, and/or State-Insured Credit Union CDFIs.⁶

¹ 12 C.F.R. § 1805.104.

² *Id.*

³ *Id.* § 1805.201(b)(1).

⁴ *Id.* § 1805.201(b)(2)(i).

⁵ *Id.* § 1805.201(b)(2).

⁶ *Id.* § 1805.104.

“Equity Investments” are defined to mean:

an investment made by a CDFI that, in the judgment of the CDFI Fund, supports or enhances activities serving the CDFI’s Investment Area(s) or a Targeted Population(s). Such investments must be made through an arms-length transaction with a third party that does not have a relationship with the CDFI as an Affiliate. Equity Investments may comprise a stock purchase, a purchase of a partnership interest, a purchase of a limited liability company membership interest, a loan made on such terms that it has sufficient characteristics of equity (and is considered as such by the CDFI Fund); a purchase of secondary capital, or any other investment deemed by the CDFI Fund to be an Equity Investment.⁷

C. Target Market

The entity must serve a “Target Market.”⁸ “An entity may demonstrate that it meets this requirement by demonstrating that it provides Financial Products and/or Financing Services in an (sic) Investment Areas and/or Targeted Populations.”⁹

1. Investment Areas

A geographic area can be designated as an Investment Area if it satisfies a number of requirements. First, the geographic area must be in the United States or its territories. Second, the geographic area must be an area of “economic distress” that has “significant unmet needs for loans, Equity Investments, Financial Products or Financial Services.” A geographic area is an area of “economic distress” if:

- (1) The percentage of the population living in poverty is at least 20 percent;
- (2) In the case of an Investment Area located:
 - (i) Within a Metropolitan Area, the median family income shall be at or below 80 percent of the Metropolitan Area median family income or the national Metropolitan Area median family income, whichever is greater; or
 - (ii) Outside of a Metropolitan Area, the median family income shall be at or below 80 percent of the statewide non–Metropolitan Area median family income or the national non–Metropolitan Area median family income, whichever is greater;
- (3) The unemployment rate is at least 1.5 times the national average;
- (4) In counties located outside of a Metropolitan Area, the county population loss during the period between the most recent decennial census and the previous decennial census is at least 10 percent; or

⁷ *Id.*

⁸ *Id.* § 1805.201(b)(3)(i)

⁹ *Id.*

(5) In counties located outside of a Metropolitan Area, the county net migration loss during the five-year period preceding the most recent decennial census is at least five percent.¹⁰

The third way an entity can satisfy this test is by selecting an Investment Area that “encompasses . . . or is wholly located within an Empowerment Zone or Enterprise Community.”¹¹

2. Targeted Population

Alternatively, instead of satisfying the Investment Area test, the entity can satisfy the Targeted Population test. An entity can meet this test by showing that it directly or indirectly targets “individuals, or an identifiable group of individuals, who are Low-Income persons or lack adequate access to Financial Products or Financial Services in the entity’s Target Market.”¹² These persons must be located in the United States or its territories.¹³ Low-Income is defined to mean:

income, adjusted for family size, of not more than:¹⁴

(1) For Metropolitan Areas, 80 percent of the area median family income; and

(2) For non–Metropolitan Areas, the greater of:

(i) 80 percent of the area median family income; or

(ii) 80 percent of the statewide non–Metropolitan Area median family income.

D. Development Services

The fourth requirement is the need of Development Services. Under this requirement, “[a] CDFI directly, through an Affiliate, or through a contract with another provider, must have a track record of providing Development Services in conjunction with its Financial Products and/or Financial Services.”¹⁵ Development Services is defined as

activities undertaken by a CDFI, its Affiliate or contractor that promote community development and shall prepare or assist current or potential borrowers or investees to use the CDFI’s Financial Products or Financial Services. For example, such activities include, financial or credit counseling; homeownership counseling; and business planning and management assistance.¹⁶

E. Accountability

¹⁰ *Id.* § 1805.201(b)(3)(ii)(D).

¹¹ *Id.* § 1805.201(b)(3)(ii)(A)(3).

¹² *Id.* § 1805.201(b)(3)(iii)(A).

¹³ *Id.*

¹⁴ *Id.* § 1805.104.

¹⁵ *Id.* § 1805.201(b)(4).

¹⁶ *Id.* § 1805.104.

Accountability to the Target Market is the fifth requirement. “A CDFI must maintain accountability to residents of its Investment Area(s) or Targeted Population(s) through representation on its governing board and/or advisory board(s).”¹⁷

F. Non-Government

The sixth requirement is that the entity cannot be a governmental entity.¹⁸ This requires the following:

A CDFI shall not be an agency or instrumentality of the United States, or any State or political subdivision thereof. An entity applying for CDFI certification must demonstrate that it meets this requirement. An entity that is created by, or that receives substantial assistance from, one or more government entities may be a CDFI provided it is not Controlled by such entities and maintains independent decision-making power over its activities.¹⁹

The nongovernmental requirement contains three prohibitions: (1) the CDFI being a governmental agency or instrumentality, (2) the CDFI being controlled by a government agency or instrumentality that creates it, and (3) the CDFI being controlled by a government agency or instrumentality that provides substantial assistance to it.

The question then becomes whether the amount of oversight an entity rises to the level to be considered “controlled” under the CDFI rules. Controlled is defined as follows:

- (1) Ownership, control, or power to vote 25 percent or more of the outstanding shares of any class of Voting Securities of any company, directly or indirectly or acting through one or more other persons;
- (2) Control in any manner over the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of any company; or
- (3) Power to exercise, directly or indirectly, a controlling influence over the management, credit or investment decisions, or policies of any company.²⁰

The first two tests are objective, while the third test is subjective. Based on our understanding of what the CDFI Fund considers, it will primarily focus on explicit controls in the governing documents and power of an entity has on investment and operational decisions. In attempting to show that a separate entity would not be controlled, the CDFI Fund has indicated that it generally considers an applicant “controlled” if any one of the following is true:

- The Applicant’s organizing documents (articles of incorporation, by-laws, charter, etc.) indicate that the Applicant is a government entity.
- A majority or substantial minority of the Applicant’s board consist of government officials, (elected, appointed, employees, etc.).

¹⁷ *Id.* § 1805.201(b)(5).

¹⁸ *Id.* § 1805.201(b)(6).

¹⁹ *Id.*

²⁰ 12 C.F.R. § 1805.104.

- One or more government entities control the election or appointment of a majority of the members of the Applicant's board of directors, or even control a substantial minority of such directors.
- One or more government entities have veto power over the selection of the executive director, CEO, or comparable officer of the Applicant, or specific investment decisions of the Applicant.
- Employees of the Applicant are government employees or employees of an organization controlled by one or more government entities.
- The Applicant primarily carries out functions of a government agency.
- The Applicant receives operating and/or capital funds from a government entity, and the government entity has the ability to control the use of those funds.
- The Applicant exhibits other characteristics, (not already covered above), that, in the assessment of the Fund, indicate that the Applicant is controlled by a government entity or entities.

If one of these is true, we would have the burden of demonstrating to the CDFI Fund that the circumstance does not evidence government control of the applicant. For example, although the sharing of employees is listed in the aforementioned list, the CDFI Fund indicates that if we can demonstrate that this fact does not evidence government control over the entity, then this fact may not prohibit the CDFI from qualifying.

Based on that understanding, the next inquiry would be what is meant by "created by" and "substantial assistance." Although there does not appear to be a statutory or regulatory prohibition on a government instrumentality having control over a CDFI, so long as the government instrumentality does not create or provide substantial assistance to the CDFI, the guidance from the CDFI Fund does not discuss this in any depth.

II. CDFI AWARDS

Upon certification of the entity as an CDFI, the entity will want to apply for awards through the CDFI Program. The CDFI Program offers both financial assistance and technical assistance awards to CDFIs, but an applicant can only request one type of award during a year.

The primary type of award that would be beneficial would be the financial assistance awards. A CDFI seeking a financial assistance award must be able to match the award with non-federal funds. Financial assistance awards can be in the form of loans, grants, or equity investments, but the type of award given to a CDFI depends upon the type of matching funds (i.e., if the matching funds are loans, then the CDFI's award will be loans). In the event that the CDFI lends money, its standard loan product in 2018 was a 3.0% fixed-rate, 13-year loan with interest-only payments in years one through ten—apparently regardless of the terms of the matching loan (though CDFI will only match loans with a term greater than 3 years).

An applicant must show that an award would allow it to increase its volume of products or services, allow it to provide new products or services, expand operations geographically, or service new target populations. Overwhelmingly, the recipients of the awards use them to increase volume of financial products.

In 2018, 364 organizations requested \$326.6 million in financial assistance awards. The CDFI Fund granted awards totaling \$160,633,737 to 222 CDFIs.

In addition to financial assistance awards, CDFIs or certifiable CDFIs (CDFIs who are not yet certified but are on the path to certification) may apply for technical assistance awards. These technical assistance awards are grants used for capacity development and are often used to assist CDFIs in purchasing equipment, hiring consulting or contracting services, paying salaries and benefits, or training staff or board members.

In 2018, 68 organizations requested nearly \$8.3 million in technical assistance awards. The CDFI Fund granted awards totaling \$5,107,382 to 43 organizations.

III. BANK ENTERPRISE AWARDS

The CDFI Fund incentivizes bank activity in CDFIs by granting Bank Enterprise Awards (“BEA”) to FDIC-insured financial institutions that demonstrate an increase in investing in CDFIs or in their own lending, investing, or service-related activities in distressed communities (collectively their “Qualified Activities”). BEAs are grants to these financial institutions that allow them to use to further their Qualified Activities.

BEA distressed communities are defined as those where at least 30 percent of residents have incomes that are less than the national poverty level and where the unemployment rate is at least 1.5 times the national unemployment rate.

The BEA Program provides the CDFI with an opportunity to further appeal to banks by providing them with additional capital to deploy in the CDFI. This additional capital received by banks can benefit the CDFI by allowing it to receive additional resources to support its programs.

Exhibit 2

Forming a De Novo Bank: Tasks and Timeline (Prepared by Nelson Mullins)

	Major Tasks	Timeline	Responsibility
1.	Select initial organizers and initial directors	Month 1	Organizers
2.	Select consulting group and attorney (securities counsel)	Months 1-2	Organizers
3.	Determine whether to form a national or state bank and whether to form a holding company	Months 1-2	Organizers
4.	Establish LLC	Months 1-3	Organizers, NMRS
5.	Enter into organizer contribution and joint venture agreement	Months 1-3	Organizers, NMRS
6.	Introduction meeting with state regulators	Months 2-4	Organizers, NMRS, Consultant
7.	Introduction meeting with FDIC	Months 2-4	Organizers, NMRS, Consultant
8.	Raise At-Risk Money: Warrants to be issued for at-risk funds	Months 3-5	Organizers
9.	Locate site	Months 3-5	Organizers
10.	Build business plan and create financial projections	Months 3-5	Organizers, Consultant
11.	Draft FDIC/state application	Months 3-5	Organizers, NMRS, Consultant
12.	Finalize founding group	Months 4-5	Organizers
13.	Obtain financial statements, background data, and fingerprint cards	Months 4-5	Organizers
14.	File application with FDIC/state	Month 5	Organizers, NMRS
15.	Determine whether to use sales agent for stock offering	Month 5	Organizers
15.	Management review of draft offering circular	Months 5-6	Organizers, NMRS
16.	Board review of draft offering circular	Months 5-6	Organizers, NMRS
17.	Board resolution authorizing use of offering circular	Months 5-6	Organizers, NMRS
18.	Commence offering	Months 5-6	Organizers, NMRS, Sales Agent
19.	Preliminary filing meeting with regulators	Months 5-6	Organizers, NMRS
20.	Notify regulators when more than half of capital in escrow	Months 8-12	Organizers, NMRS
21.	Notice of publication for regulatory meeting (30 days prior)	Months 8-12	Organizers, NMRS
22.	Obtain FDIC preliminary approval	Months 9-12	FDIC
23.	Obtain state preliminary approval	Months 9-12	State regulator
24.	File articles of incorporation	Months 9-12	NMRS, Organizers
24.	Break escrow and complete stock offering (Initial closing with at least \$[•] in proceeds to the Bank	Months 9-12	Organizers, NMRS, Escrow Agent
26.	Obtain final regulatory approvals	Months 10-12	FDIC, State regulator
27.	Prepare branch for opening	Months 10-12	Organizers
28.	Hire final staffing	Months 10-12	Organizers
29.	Pre-opening regulatory exam	Months 10-12	FDIC, State regulator
30.	Initial closing with at least \$[•] in proceeds to the Bank	Months 10-12	Organizers, NMRS, Sales Agent
31.	Assignment and assumption agreement between LLC and Bank	Months 10-12	Organizers, NMRS
32.	Open Bank	Months 10-12	Organizers