

Support to Community Development Financial Institutions in the United States of America

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When President Clinton announced his intention to create a national system of 100 community development banks, leaders from alternative financial institutions knew their experience could help shape such a bold initiative. Forming a coalition representing the full range of community development banks, credit unions, and loan funds they coined the phrase **community development financial institutions** (CDFI) to give a name to what is both a movement and emerging industry. More importantly, the *Coalition of Community Development Financial Institutions* articulated the principles that would help guide the Administration's vision to develop a public purpose banking system. That vision has been translated into legislation entitled *The Community Development Banking and Financial Institutions Act of 1994*, which will be signed into law in September.

The CDFI industry comprises five principal types of organisations.

Community Development Banks are federally insured and regulated depository institutions organised to provide capital to low-income communities;

Community Development Credit Unions are regulated financial co-operatives owned and operated by lower-income members;

Community Development Loan Funds are unregulated financial intermediaries that aggregate capital from individual and institutional social investors at below-market rates and re-lend this money primarily to non-profit housing and business developers in low-income communities;

Micro-loan Funds are most often components of micro-enterprise development programs that strive to increase incomes, create jobs and role models, build skills, enhance self-esteem and spark a process of community renewal; and finally,

Community Development Venture Funds make equity investments in community development enterprises.

Though diverse, these institutions all attempt to provide the poor with access to credit and spur social and economic development in disadvantaged communities. Together, 43 loan funds, 100 community development credit unions, 5 development banks and 100 micro-loan funds manage approximately \$1 billion in private capital. Together they have loaned over \$3 billion with better loan loss rates than bank industry standards. Overall, the Coalition represents 300 institutions in 45 States. It has sought, successfully, to expand the Administration's initial focus on community development banks to incorporate the strength, diversity and experience of this network.

As a result, the CDFI Act of 1994 establishes the CDFI Fund to build strong financial institutions through equity investments, deposits, credit union shares, loans, grants and

technical assistance in amounts up to \$5 million for any single applicant. CDFIs must match federal monies dollar for dollar and type for type. Reflecting the diversity of institutions qualifying for assistance, CDFI lending can support low-income housing, community facilities, small businesses and financial services. The bill is funded at \$125 million for fiscal year 1995 starting 1 October 1994.

Some of the issues that needed resolution during negotiations on this legislation highlight what Mark Pinsky, Co-ordinator for the CDFI Coalition, feels is a very strong bill. One major issue involved the appropriate course for creating and multiplying CDFIs. Rather than undertake wholesale efforts to create new development banks, the bill seeks to expand the existing CDFI industry. Because these financial institutions are rooted in and responsible to the communities they serve, they can gauge lending to real credit needs and borrower capacity. Their success has been built over time through uniquely skilled personnel, detailed market knowledge and local institutional capacity. The bill does have the franchising of CDFIs but any institution seeking to do so must target populations outside of any State and metropolitan area currently served.

Secondly, the bill clearly is intended to support private sector institutions serving low-income communities. Public agencies do not qualify for CDFI funding. While some public agencies have similar mandates, the type of development they support is very different from that of CDFIs. In addition, Pinsky notes, public agencies have a history of patronage problems.

Perhaps most critical to the long-term success of the CDFI industry is the relationship between CDFIs and the commercial banks. While the Coalition opposed efforts by the banks to qualify directly under this legislation, Pinsky emphatically affirms that “*banks are our friends.*”

Banks do not have direct access to CDFI funding but CDFI-bank partnerships – where both institutions provide capital and the CDFI offers the connection with the community, prepares borrowers and takes on the greatest risk – hold great potential.

To promote bank equity investments in CDFIs, the bill includes a *Depository Incentives Program* (DIP). This program will provide grants on a competitive basis to financial institutions that lend or invest equity in CDFIs. Banks can receive cash awards up to 15 percent of the investment they make in CDFIs; the competitive nature of these grants is intended to stimulate innovative collaborations between the two types of institutions.

The Coalition argues that neither the CDFI network to be strengthened by this legislation nor the *Depository Incentives Program* should substitute for the *Community Reinvestment Act* (CRA). This legislation, in effect since the 1970s, requires banks to invest in their communities. Because CDFIs grow borrowers for banks, it is crucial that the banks be present in low-income communities when borrowers are ready to approach them. The absence of banks in low-income areas will mitigate CDFI impact, forcing them to become according to Pinsky, “*bridges to nowhere.*”

The CDFI Fund will be an independent federal agency, similar to the Environmental Protection Agency, run by an Administrator appointed by the President and confirmed by the Senate.

The Coalition is pleased with the legislation. Their success in influencing the bill’s intent and content was rooted in their ability to translate the diverse experience of members into well-articulated principles of community development lending.

The Coalition itself did not engage in lobbying, but Pinsky believes the integrity and intelligence of its representatives attracted the attention of Clinton’s team. Now, with the

CDFI Act so near passage, the CDFI Coalition will monitor its implementation. But in addition to policy work, it has another agenda to create an industry-wide training initiative. Focusing on community development finance, it will work with institutions at all levels to promote the sustainability of the industry.

Source

Much of the information for this article was excerpted from the CDFI Coalition paper entitled *Principles of Community Development Lending and Proposals for Key Federal Support*.

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