Bond Case Briefs

Municipal Finance Law Since 1971

The Past, Present and Future of Community Development Financial Institutions.

It takes money to get money — this rule of thumb shapes so much of our financial system. If you have a couple thousand dollars saved up in a bank, it's easy to use that as collateral to get a secured personal loan up to the same amount. It works that way for businesses, too; the more money a business can set aside and leave in the bank as cash reserves, the more banks or other investors are willing to open up their coffers and invest in that business.

That same basic principle lies at the heart of the Community Development Financial Institutions Fund, or CDFI Fund, an arm of the U.S. Treasury created to support financial institutions that serve low- and moderate-income areas, rural areas, and native lands. The fund was created under the Clinton Administration, but its roots are much deeper than that.

No one knows those roots better than Clifford Rosenthal, who recently completed "Democratizing Finance: Origins of the Community Development Financial Institutions Movement," a 556-page history of mission-driven lending and investing in the United States.

"What is totally unique about the CDFI Fund in policy history is that it provides capital — not loans, but discretionary capital — to build your balance sheet," says Rosenthal.

In other words, the CDFI Fund is the only federal program that distributes money to organizations who don't have to go out and spend it. They can choose to leave it on their balance sheets, then they can use those dollars to go out and attract more capital from others.

It's never been very big — since its inception in 1994, the CDFI Fund has awarded only $3 billion to CDFIs in this way.

But still, if that sounds like a program rife with opportunities for corruption and waste, you'd be right — which is partly why the application process is remarkably onerous, to a fault, many would say. It involves user accounts created at three separate federal websites, and at least 17 application components, including some with multiple documents and steps under each component. There are four different deadlines across two months, some with multiple components due that day. This year's application process is currently underway, to conclude in June.

And that's just the application process. There's also a separate process to become certified as a CDFI and therefore eligible to apply at all. Then there's the annual data reporting back to the CDFI Fund for a typical period of three years after being awarded dollars from the fund's main financial assistance program. Current regulations require CDFIs to show at least 60 percent of their lending going to low- and moderate-income census tracts.

While the need to protect the program from corruption and waste is important, in some ways the onerous process has kept out the institutions Rosenthal hoped would benefit most from the CDFI Fund — the tiny credit unions and community banks like the one he helped found on Manhattan's Lower East Side in the mid-1980s. Nonprofits simply turned out to be a better fit for the program, with their professional grant writers and experience seeking funding from government agencies.

"The charts I developed show 80 cents out of every dollar the CDFI Fund put out in capital over its first 20 years went to nonprofit loan funds, while less than 20 percent went to banks and credit unions," Rosenthal says.

The loan funds — although some of them have gone on to do striking things like [raising capital from Wall Street investors to bring back to Main Street] — don't quite fulfill the vision Rosenthal sees for CDFIs.

"It's done a lot in terms of building the CDFI field, but it has not transformed banking, and for my particular bias, what it has not done is empowered the people in those communities in the same way," Rosenthal says. In other words, the loan funds are doing for communities, but not always with them, with leadership and at least some dollars from those communities.

In recent years, the CDFI Fund has [made efforts to reduce barriers for credit unions], including Puerto Rico's 100-year old network of state-insured credit unions known as the '[cooperativas].'

Still, Rosenthal sees it as a success that there are now more than a thousand organizations certified as a CDFI. There are CDFIs in every state as well as Puerto Rico and Guam. Collectively, these organizations account for more than $136 billion in assets — though that's still just a rounding error compared to the $17 trillion in assets held by commercial banks or the $22 trillion in assets managed by U.S.-registered investment companies.

But the growth in numbers and asset size, especially over the past decade, has not been matched by similarly rapid growth in size for the CDFI Fund. Its $250 million budget proposed by Congress for FY2019 is the highest it's ever been, but the Trump administration has repeatedly requested to zero out the CDFI Fund budget, and only bipartisan support in Congress for CDFIs has kept it at $250 million a year.

The growth of CDFIs in conjunction with stagnant funding has meant more and more applications being turned away. More and more communities are learning how to form CDFIs and access the fund, but the fund isn't growing in response. Last year, 538 applications came from 485 organizations across the country, requesting a total of $504.5 million. The fund awarded just 265 organizations a total of only $188 million from its main program.

One criticism of CDFIs has been that politicians on both sides of the aisle have used their support for them as a distraction or excuse to do little else to make the economy work better for people at the bottom of the economic ladder — as generations of politicians have used black banking as a distraction from needed structural change to deconstruct the overlapping legacies of slavery, Jim Crow, redlining and mass incarceration.

The transformative potential for CDFI Fund is in how it can complement the organizing work in communities like the Lower East Side, whose residents and organizers Rosenthal worked alongside to found the Lower East Side People's Federal Credit Union in 1986, taking over what had been the last bank branch operating in the neighborhood.

"This was the first wave of banks leaving those neighborhoods," says Rosenthal. "Branches generally were unprofitable, they were leaving these neighborhoods, poor neighborhoods, and I was saying the next wave should be credit unions."

For 30 years, Rosenthal also served as president of the National Federation of Community Development Credit Unions (which recently changed its name to [Inclusiv]), where he wrote the white paper that was eventually used as an early template for the legislation to create the CDFI Fund. He envisioned the fund as helping to overcome a key regulatory challenge for credit unions as well as community banks — the need to meet capital requirements as regulated depository institutions.

For every $100 in loans, regulators typically require banks and credit unions to hold around $8 of capital in reserve. For banks, those funds typically come from shareholders or profits; for credit unions they usually come from members, net income, or philanthropic contributions. Rosenthal wanted the CDFI Fund to help credit unions like those in his federation raise capital to meet their regulatory requirements.

Today, Rosenthal feels a sense of camaraderie with community organizers in the Black Lives Matter movement who are interested in moving deposits into community-owned, community-led financial institutions, especially credit unions.

“The lack of diversity in the CDFI field in terms of the leadership has been striking,” Rosenthal says as we sit in a coffee shop just a few blocks from where the Lower East Side People’s Federal Credit Union’s headquarters still stand today.

He brings up the folks behind Village Financial Cooperative, a credit union forming in Minneapolis as a direct response to the police killing of Philando Castile, as an example of the racial justice work he hopes to see grow as part of the CDFI Fund’s portfolio. He wants the federal government, so long after breaking its promise to former enslaved persons after the Civil War, to stand behind such communities in the work they are already doing.

“I would love to see the CDFI Fund as a source of start-up capital for that,” he says. “It’s the kind of story that I think that gives me hope of its relevance in a new era, that it could still matter.”

NEXT CITY

by OSCAR PERRY ABELLO

APRIL 18, 2019