Grantmakers Advancing Economic Equity

WHAT IS A Community Development Financial Institution (CDFI)?

CDFIs are private financial institutions dedicated to delivering responsible, affordable lending to help low-income, low-wealth, and other disadvantaged people and communities join the economic mainstream. By financing community businesses—including small businesses, microenterprises, nonprofit organizations, commercial real estate, and affordable housing—CDFIs spark job growth and retention in hard-to-serve markets across the nation.

CDFIs blend public, private, and philanthropic capital to offer tailored resources and innovative programs that take a market-based approach to supporting economically disadvantaged communities. More than 70% of CDFIs have less than $1 million in assets. There are numerous ways for foundations to invest in CDFIs, including making direct loans to them, co-lending alongside CDFIs, offering grant-funded credit enhancements for CDFI loans, and even guaranteeing loans made by CDFIs. Grantmakers can also help with technical assistance, education and technological advancement to enhance CDFIs' work. Funders can also provide grant support to CDFIs that provide technical assistance and counseling to their lending clients.[i]

Asset Funders Network will host a series of webinars discussing the role of philanthropy in supporting CDFIs including policy solutions. We also recommend Philanthropy Northwest's Foundation Guide to Investing in Community Development Financial Institutions.

CDFIs share the goal of expanding economic opportunity but are characterized by different business models and business and legal structures including: banks, credit unions, loan funds, and venture capital (VC) funds[ii]:

- **Community development banks** are for-profit entities that provide capital to rebuild economically distressed communities through targeted lending and investing. Community Development Banks have community representation on their board and are regulated by and insured by the FDIC.[iii] They comprise 13 % of CDFIs but 26% of CDFI assets.

- **Community development credit unions** (CDCUs) are member owned nonprofit financial cooperatives that promote ownership of assets and savings through affordable credit and financial services targeted to low-income people and often to minority communities. Community development credit unions are regulated by and incurred by the National Credit Union Administration (NCUA).[iv] They represent 28% of CDFIs but represent 61% of CDFI assets.

· **Community development loan funds** (CDLFs), the primary focus of our series, "provide financing and development services to businesses, organizations, and individuals in low-income communities." Loan funds include: microenterprise, small business, housing, and community service organizations. CDLFs are generally nonprofit entities with community representation that serves on a board of directors.[v] They represent more than half of CDFIs yet they hold only 13% of CDFI assets.

· **Community development venture capital** (CDVC) "funds provide equity and debt-with-equity-features for small and medium-sized businesses in distressed communities. They can be either for-profit or nonprofit and include community representation."[vi]

In short, Community Development Financial Institutions (CDFIs) are often a lender of first, and last, resort- when people don't have the relationships or ability to go elsewhere. As such, CDFI lenders fill a critical niche delivering affordable credit, development services, capital, and financial services to established and aspiring business owners in capital-starved communities that can directly accelerate ownership as a means to build assets.

Learn More: What Is A Community Development Financial Institution (CDFI)? – Forbes Advisor.

Policies that Support and Sustain CDFIs:

American Rescue Plan Act of 2021 was enacted in March 2021 to provide $1.9 trillion in financial relief to Americans struggling with the fallout of the COVID-19 pandemic.

CDFI Fund: In 2021 congress appropriated $272 million along with $1.25 billion emergency appropriation in COVID-19 relief grants. The CDFI fund is a primary funding source for CDFIs that provides financial assistance and technical assistance to CDFIs through competitive awards. Funding is based on demonstration of authentic partnership with communities to address specific economic development needs. The CDFI Fund provides additional federal resources to CDFIs through programs including: the Bank Enterprise Award, Capital Magnet Fund, CDFI Bond Guarantee, Native American CDFI Assistance and New Markets Tax Credit Programs.

Other targeted areas of funding include Community Revitalization Fund, proposed in Build Back Better through the Department of Housing and Urban Development (HUD) seeks to provide $10 billion administered with CDFI partners to make competitive awards to non-profit certified CDFI loan funds to financial community development activities including small business incubators.

Paycheck Protection Program was established by the CARES Act and implemented by SBA and Department of Treasury to provide small businesses with emergency payroll and benefits costs in response to the COVID-19 Pandemic. According to the SBA, as of May 2020 CDFIs had approved more than $7 billion in PPP loans,[vii] but the emergency funding dynamic made it difficult for businesses owned by people of color to successfully access funding[viii].

The State Small Business Credit Initiative (SSBCI) created through the Small Business Jobs Act funded $1.5 billion to strengthen state small business programs. Administered through states, New York State will allocate much of these funds to directly assist CDFIs through capital access, loan loss reserve, credit enhancement, and to mitigate credit risk in order to better serve socially and economically disadvantaged entrepreneurs and to address the racial wealth gap. Program participation included fulfilling a requirement of leveraging $10 of private dollars for every $1 of SSBCI funding.

The Community Navigator Pilot Program provides targeted outreach through SBA to engage state and local governments as well as SBA resource partners to support small businesses in underserved communities. The pilot program offers 51 tiered competitive grants at the local (32 awards, max $1m), state (11 awards, max $2.5m), and national level (8 awards, max $5m) to provide: financial assistance and access to capital, contracting and procurement, marketing, operations, business development, and exporting and industry-specific training.

New York Forward Fund is a new economic recovery loan program aimed at supporting New York State small businesses, nonprofits, and small landlords as they reopen after the COVID-19 outbreak.

New York Secure Choice is a New York State based retirement savings program offered to private-sector New York State employees who are not offered a retirement plan through their workplace. Active state sponsored retirement programs operate in California (CalSavers), Connecticut (MyCTSavings), Illinois (Illinois Secure Choice), Massachusetts (Massachusetts Defined Contribution CORE Plan), Oregon (Oregon Saves), and Washington (Washington Small Business Retirement Marketplace).

To learn more about legislative agendas that support small business and CDFIs, visit:

Opportunity Finance Network's 2022 Public Policy Priorities

Small Business Majority's 2022 Small Business Policy Priorities

Glossary of Terms:

Loan Loss Reserve: Collateral to raise loan capital that you can distribute into communities. Provide loss reserves are **types of insurance and credit enhancements that help banks and lenders mitigate estimated losses on loans in the event of defaults or non-payments**. When borrowers default on loan, banks, credit unions or CDFIs might use loan loss reserve funds to alleviate these losses. A key place where philanthropy can boost the capacity of CDFIs to invest in communities.

Credit Enhancement: Credit enhancement is a strategy for improving the credit risk profile of a business, usually to obtain better terms for repaying debt. In the financial industry, credit enhancement may be used to reduce the risks to investors of certain structured financial products.

Debt Capital: Is borrowed capital that is owed back.

Equity Capital: A portion of the business is sold for capital.

Technical Assistance: Marketing, ecommerce, web design, and market access are all forms of technical assistance that CDFIs can provide business owners to enhance a loan, build trust, and build success. CDFIs often provide at least 8-15 hours of technical assistance for each loan that they provide.

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[i] William Darity et. al, *Unlocking Assets Building Women's Wealth through Business Ownership.* Asset Funders Network 2019

[ii] What is a CDFI? | Opportunity Finance Network (ofn.org)

[iii] ibid

[iv] ibid

[v] ibid

[vi] ibid

[vii][vii] U.S. Small Business Administration $10 Billion for CDFIs to Participate in PPP | The U.S. Small Business Administration | SBA.gov

[viii] Next Street and Common Future, New York City Small Business Ecosystem Assessment: Building A More Inclusive, Resilient New York City