

**WRITTEN TESTIMONY OF  
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BEFORE THE  
HOUSE APPROPRIATIONS COMMITTEE  
SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL  
GOVERNMENT  
ON THE COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND  
AT THE U.S. DEPARTMENT OF THE TREASURY  
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**INTRODUCTION**

Chairman Quigley, Ranking Member Graves, and Members of the Subcommittee, thank you for the opportunity to speak with you today about the Department of the Treasury's Community Development Financial Institutions Fund (CDFI Fund).

My name is Annie Donovan and I am currently a Senior Fellow at the Center for Community Investment. I have spent nearly thirty years in the community investment field and have experienced the work of the CDFI Fund from different vantage points. For twenty years I held leadership roles at Capital Impact Partners, a certified Community Development Financial Institution and a user of CDFI Fund programs. From December 2014 to January 2019, I had the honor of serving as Director of the CDFI Fund.

**COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS**

Community Development Financial Institutions (CDFIs) are private organizations that invest in markets that lack access to the kinds of safe and affordable financial services that communities and families need to pursue the American Dream. CDFIs come in many forms including banks, credit unions, loan funds, microlenders, venture capital funds, and even socially responsible "fintech" companies. Regardless of their business model, CDFIs share a common mission of reaching the people and places underserved by traditional financial institutions.

CDFIs finance entrepreneurs to create small businesses; home ownership for first-time homebuyers; affordable housing for rent-burdened families and individuals; community facilities such as schools, day care centers, and health centers; and commercial enterprises like healthy food retail and small manufacturing companies. They offer bank accounts to the unbanked and under-banked.

In our market economy, capital flows to where it can secure the highest rate of return for the lowest risk. Communities that are deemed too risky, or not profitable enough, are often bypassed by traditional financial institutions, and as a result do not have access to the credit and capital they need to thrive. CDFIs focus on communities that have suffered

the long-term effects of chronic and systemic disinvestment, such as urban areas where redlining was once practiced and still casts a shadow; rural areas that are characterized by persistent poverty; and Native American communities that are often isolated from local and regional economies. They also focus on emerging areas of economic stress, such as towns that have lost manufacturing businesses without adequate plans to create new industries in their place.

As a nation, if we are to create an inclusive economy that offers opportunity for all, we need community development financial institutions. CDFIs use tools, such as those offered by the CDFI Fund, to unlock private sector investments in low-income communities.

## **THE CDFI FUND**

The CDFI Fund was established with bipartisan support by the Riegle Community Development and Regulatory Improvement Act of 1994. Its purpose is to expand access to credit, capital, and financial services in low-income communities through CDFIs. It accomplishes this by offering the following programs:

- **Community Development Financial Institutions (CDFI) Program:** This program provides Financial Assistance and Technical Assistance awards to help certified and emerging CDFIs sustain and expand their services and build their technical capacity. The program also includes:
  - **Healthy Food Financing Initiative:** This program provides Financial Assistance awards to certified CDFIs that invest in businesses that provide healthy food options, such as grocery stores, farmers markets, bodegas, food co-ops, and urban farms.
  - **Disability Funds-Financial Assistance:** This program provides Financial Assistance awards to certified CDFIs that wish to expand their financing activities and services for persons with disabilities.
  - **Persistent Poverty County-Financial Assistance:** This program provides Financial Assistance awards to certified CDFIs that provide Financial Products in Persistent Poverty Counties (PPCs).
- **Native American CDFI Assistance Program:** This program provides Financial Assistance and Technical Assistance awards to build the capacity of CDFIs serving Native American, Alaska Native, and Native Hawaiian communities.
- **Bank Enterprise Award (BEA) Program:** This program provides monetary awards to federally insured banks that demonstrate increased investments in distressed communities and/or CDFIs.
- **New Markets Tax Credit (NMTC) Program:** This program provides tax credit allocation authority to certified Community Development Entities (CDEs), enabling them to attract investment from the private sector and reinvest the funds in low-income communities.

- **Capital Magnet Fund:** This program provides awards to CDFIs and non-profit affordable housing organizations for the development, preservation, rehabilitation, and purchase of affordable housing, and for related economic development in low-income communities.
- **CDFI Bond Guarantee Program:** provides a source of long-term capital for CDFIs by guaranteeing bonds issued to support CDFIs that make investments for eligible community or economic development purposes.

## IMPACT AND PERFORMANCE OF THE CDFI FUND

According to the CDFI Fund, since inception, it has provided over \$3.3 billion in monetary awards through its programs, and \$54 billion in tax credit allocations through the NMTC Program.

There are many ways to judge the performance of the CDFI Fund. The following are key indicators that should be considered:

**Growth of the sector.** Since the creation of the CDFI Fund, CDFIs have grown impressively. At the end of 1997, there were 196 certified CDFIs with total assets of \$4 billion. Today, there are over 1,100 certified CDFIs in all 50 states, the District of Columbia, Puerto Rico, and Guam, with total assets of over \$150 billion.

**Demand for programs.** The demand for CDFI Fund programs remains strong. In fiscal year 2018, across programs, with the exception of the Bond Guarantee Program, demand ranged from two to eight times the supply of funding available.

**Leverage of federal dollars.** The leveraging effect of CDFI Fund awards is a powerful force multiplier. For every \$1 dollar of federal investment, CDFIs leverage \$12 of other investments in the CDFI Program, \$20 in the Capital Magnet Fund, and even higher levels in the Bank Enterprise Award program.

**Community benefits.** The CDFI Fund's Annual Financial Report details program-by-program results. For the CDFI Program alone, in Fiscal Year (FY) 2018, award recipients reported originating loans or investment totaling over \$11 billion. This included:

- \$2 billion for 19,000 home improvement and purchase loans;
- \$2 billion for 17,963 business and microenterprise loans;
- \$3.4 billion for over 207,000 consumer loans; and
- \$1.3 billion for 2,800 residential real estate transactions.

In addition, recipients financed over 33,600 affordable housing units and served more than 343,000 individuals with financial literacy and other training.

**Reaching hard to serve places.** In the CDFI Program, over 80 percent of CDFI investments were made in low-income communities. CDFIs receiving awards outperform the baseline certification guidelines, which require that 60 percent or more of assets be invested in low-income communities. In the NMTC program, allocatees exceed the baseline requirement of serving low-income census tracts by driving 75 percent of transactions to *highly* distressed communities. In the BEA program, all transactions are in communities with poverty rates of 30 percent or higher and unemployment rates 1.5 times higher than the national average.

CDFIs are reaching particularly challenging places, for example:

- **Former manufacturing communities:** There are more than 400 counties affected by manufacturing job losses, and these counties have simultaneously experienced economic decline and population loss. CDFIs have lent and invested \$2.7 billion through more than 49,000 individual transactions. In addition, over \$5 billion in NMTCs have been invested in these counties.
- **Coal-impacted communities:** CDFIs are working in areas experiencing economic challenges due to contractions in the coal industry. They are supporting economic diversification and community revitalization initiatives. Sixty CDFIs across 14 different states have lent or invested more than \$100 million, and 24 CDEs have deployed nearly \$230 million in NMTC investments in nine different states.
- **Areas of persistent poverty:** While over 6 percent of the U.S. population lives in areas of persistent poverty, nearly one-fifth of CDFI investments and transactions, and 18 percent of CDFI headquarters, are located in these counties. CDFIs have invested more than \$640 million in Persistent Poverty Counties.
- **Small towns, rural communities, Native communities:** CDFIs have provided \$6.1 billion in loans and investments in small towns and rural communities and over \$757 million in investments in Native areas.
- **Small business finance:** Financing entrepreneurs and small business owners remains a challenge in America, but CDFIs are making inroads. Last year alone, CDFI Program awardees provided financing to nearly 16,000 businesses nationwide.

## **THE CDFI FUND IS NOT REDUNDANT WITH OTHER FEDERAL PROGRAMS**

The CDFI Fund was a federal policy innovation when it was created in 1994, and it remains so today. Most federal programs that target low-income communities either distribute funds to state and local governments according to population-based formulas,

like Community Development Block Grants, or they fund on a project-by-project basis, usually with stringent rules that make the funds hard to use at the local level.

By contrast, the CDFI Fund's programs are competitive and make funding available to build the capacity of *organizations* at the enterprise level rather than the project level. This means that the CDFI Fund does not pick the projects that CDFIs finance. Investment decisions are left to CDFIs to make at the local level. Financial assistance and other awards enhance the financial strength of the CDFI's balance sheet, which in turn allows CDFIs to create innovative and flexible products that make hard-to-finance transactions feasible. It's the key to their ability to leverage capital from other investors. The unique way in which the CDFI Fund supports CDFIs is essential to their success.

Conventional financial institutions build their balance sheets by raising equity capital that yields lucrative rates of return for investors. This profit motive is what steers them away from low-income people and places, which may appear more risky and be less efficient to serve. As a result, some communities across the nation are left underserved, or bypassed altogether.

CDFIs can fill market gaps left by traditional investors because they can assemble capital, like Financial Assistance Awards, that has the flexibility of equity, but does not demand such high rates of financial return. This is referred to as "equity-like" capital, and it is rare. The CDFI Fund's programs are an essential source of this type of funding. CDFIs blend equity-like capital with conventional financing in ways that fill market gaps and restore market functionality in distressed places.

Finally, because all of the CDFI Fund's programs are competitive, CDFIs must remain results-oriented, focusing on impact and performance from year to year. CDFIs compete for awards based on their track record of community impact, the strength of their business plan, the capacity of their management team, their ability to partner with other community actors, both public and private, and their ability to leverage resources. This discipline keeps CDFIs results-oriented.

## **THE CDFI FUND IS STILL NEEDED**

CDFIs have become an important part of the financial services sector, in no small measure due to the effectiveness of the CDFI Fund, whose investments have helped CDFIs grow to a scale that has relevance in the marketplace.

The current Administration has proposed to eliminate the CDFI Program, the Native American CDFI Assistance Program, Healthy Food Financing Initiative, the Bank Enterprise Award Program, and the Capital Magnet Fund. Their argument, according to the President's Budget Proposals for 2017, 2018 and 2019, is that *the CDFI Fund was created more than 20 years ago to support a now mature industry where private institutions have ready access to the capital needed to extend credit and provide financial services to underserved communities.*

This argument does not hold up well under the facts, nor does it hold up under simple observation of the communities served by CDFIs.

Though CDFIs have grown impressively, and continue to punch above their weight, their total assets under management round up to a mere one percent of total assets under management by regulated banks and credit unions. But, size is not the only or the most important way to measure the demand for CDFIs. For that, we should look to whether or not access to capital exists at the scale of the need in economically distressed places.

The data required to answer such a question are scarce. However, the Urban Institute (Urban) has conducted some studies that are illuminating.

An Urban study released in 2017 examined capital flows in Detroit when the city was recovering from the financial crisis and fighting its way out of bankruptcy. The study found that while mainstream financing activity largely diminished in Detroit in the depths of the recession, CDFIs and other “mission capital” providers stepped forward in a counter-cyclical manner. Urban defines the term mission capital to mean capital that seeks a double bottom line of financial and social return.

From 2013 through 2015, 42 percent of investment in commercial, industrial, multifamily, and other real estate in Detroit was sourced from mission capital, the public sector, or leveraged private investment. From 2008 through 2015, CDFIs accounted for 60 percent of direct mission lending and 14 percent of all lending in Detroit.

More recently, Urban examined capital flows in the city of Baltimore and found that investments were fragmented by race, income, and geography. Neighborhoods that are less than 50 percent African American received nearly four times the investment of neighborhoods that are over 85 percent African American. Low-poverty neighborhoods receive one and a half times more investment than high-poverty neighborhoods. Census tracts where less than 50 percent of residents are African American saw both small business lending and investments per household that were five times higher than census tracts where more than 85 percent of residents are African American. For owner-occupied housing units, average loan volumes were two times higher in low-poverty census tracts than in high-poverty ones.

Across the nation, from 2011-2015, Urban found that communities with poverty rates of 20 percent or higher received less than half the investment of communities with poverty rates lower than 20 percent (based on lending for commercial real estate, multifamily and single family housing, Community Reinvestment Act investments, and the Small Business Administration’s small business lending programs). Urban estimates the annual community investment gap—the difference between capital flows in communities above and below 20 percent poverty—to be \$156 billion. In FY 2018, the highest year on record, total investments by CDFIs was \$11 billion, filling approximately 7 percent of the gap.

Regardless of where they live, all Americans want the same thing: they want access to good jobs, good schools, affordable places to live, safe places for their children to play, access to healthy food, and health care. To thrive, all communities need access to capital, the lifeblood of any economy. As it stands, low-income and minority communities experience wide disparities in access to capital. CDFIs are addressing the gap, though the resources available to them are far fewer than the scale of the problem.

## **CONSIDERATIONS FOR THE FUTURE**

Regarding the future of the CDFI Fund, Congress should consider the following:

**Scaling the sector.** Nearly 40 million Americans, 12.3 percent, live below the poverty line, according to the U.S. Census Bureau. Six percent of Americans live in communities characterized by persistent poverty—where at least 20 percent of the population has lived in poverty for 30 years or more. While median household income has made gains over the past three years, the net worth of the median household is still about 20 percent lower than it was in 2007.

If CDFIs are to increase the tangible impact they are currently having, the industry must scale to meet the magnitude of the problems it is trying to solve. To do so will require:

- **Equity-like capital.** As discussed above, what makes CDFIs uniquely effective at investing in distressed communities is the flexible capital they are able to raise from investors concerned with the development of low-income communities, especially capital sourced from the CDFI Fund. With these resources in hand, CDFIs are able to bring traditional investors to the table. These investors will continue to invest, as long as CDFIs make it feasible for them to do so. The sector will scale at the pace of investment of equity-like capital. Without such capital, however, CDFIs will not grow in size and impact.
- **Capacity building.** To scale the sector, we need more CDFIs, making more investments, in more places. Not every community in need is currently being served by CDFIs. A 2017 report from the Urban Institute found that one quarter of all distressed communities have little or no CDFI investments. If you examine a heat map of where CDFIs invest, you will indeed see certain places that are being missed.

Achieving greater coverage, either through the creation of new CDFIs, or the expansion of existing CDFIs, requires an investment in capacity building at the local level. Capital, even socially motivated capital, follows community cohesion and community capacity.

CDFIs do not exist or succeed in isolation. Context matters. CDFIs work best when they can align their transactions with priorities set by local stakeholders, and where they can bring to bear the resources of the public, private, and philanthropic sectors, all of whom share an interest in developing low-income places and people. The gaps in CDFI presence and service tend to be places that

lack a strong local enabling environment for investment. At the Center for Community Investment, we call this the “capital absorption capacity of place.” It refers to the ability of communities to be “investment ready.” Where local capacity is weak, however, it can and should be strengthened.

In order to continue to grow the capacity of the sector, it is important for Congress to continue to support the CDFI Fund’s Capacity Building Initiative (CBI). I was pleased to see that \$1.6 million was appropriated in FY 2019 for CBI.

I know that some hold the viewpoint that funding capacity building diverts precious resources away from direct investment in local communities. I agree that Congress should optimize the flow of resources directly to CDFIs. However, channeling a mere 1-2 percent of the budget to the CBI would be sufficient. I would encourage the Committee to seek input directly from CDFIs on this matter, especially those in smaller communities or harder to reach places. They have often told me that the CBI is helpful and necessary.

- **Increasing award sizes in the CDFI Program.** During my tenure as CDFI Fund director, the maximum size for financial assistance awards was reduced from \$2 million to \$1 million in the CDFI Program. This was done to increase the availability of funding to more communities, especially those underserved by the program. Should greater appropriation levels become available in the future, the CDFI Fund should consider restoring the maximum award size to \$2 million so that the highest capacity organizations can grow faster. With more equity-like investment will come more private sector capital and therefore more impact.

**Investing in community resilience.** Congress should consider creating new tools for CDFIs to invest in community resilience strategies. Since Hurricane Katrina hit New Orleans in 2005, our country has continued to experience more frequent and more intense weather related disasters such as Superstorm Sandy; Hurricanes Harvey, Irma, Maria, and Michael; and the Carr and Camp Fires in California. Low-income and distressed communities are typically most vulnerable in the face of disasters, and least equipped to recover from them, as we saw in New Orleans and in many other places since then. The CDFI Fund has not traditionally played a formal role in disaster recovery, though many CDFIs have.

Natural disasters destroy homes and businesses; they wipe out hospitals, schools, and essential community facilities. In some cases, such as the Camp Fires in Paradise, CA, they can even destroy whole communities. As lenders, CDFIs have a long track record of providing flexible financial products that are well suited for the post-disaster environment. CDFIs are uniquely able to meet the lending needs of recovering communities because of their ability to adapt lending guidelines to the needs of borrowers; to accept unconventional collateral for loans; to help consumers and small businesses navigate government red tape; and to provide education, training, and assistance to potential borrowers. CDFIs have the infrastructure and long-term



relationships in place to offer immediate and prolonged help throughout the recovery effort.

The CDFI Coalition has cataloged many stories of CDFI responses to disasters in a report entitled, “CDFIs: On the Front Lines of Disaster Recovery Efforts.” I recommend the Committee examine this report, as well as reports and stories issued by the CDFI Fund on the topic.

I urge Congress to consider the role that CDFIs and the CDFI Fund can play in helping low-income communities build resilience in the face of disasters. This might include special appropriations that are part of post-disaster supplemental funding. CDFIs that are either located in, or have a demonstrated track record of serving, communities that have been declared a federal disaster area could be eligible for resources. Funding could take the form of financial assistance or loans that could be rapidly deployed and carry flexible terms.

**Improving the measurement of social outcomes.** Congress should continue to appropriate resources for the CDFI Fund to develop and improve its data collection and analytical tools.

Demonstrating that CDFIs and the CDFI Fund are accomplishing results for the public resources invested is a shared priority of this Committee, the CDFI Fund, and CDFIs. Maximizing the return on taxpayer dollars was foremost on my mind as CDFI Fund director.

The CDFI Fund is making great progress in modernizing its reporting systems and creating tools that will allow for better analysis, data-driven decisions, and improved alignment of awardees’ performance and outcome measurements.

The cornerstone of the CDFI Fund’s information technology (IT) modernization strategy has been the creation of a unified technology platform called the Awards Management Information System (AMIS). AMIS has the capacity to automate much of the management of the awards lifecycle of CDFI Fund programs. Collecting better data through AMIS allows for the creation of powerful analytical capabilities to improve decision-making throughout the application awards process, and especially as an input for the suite of Assessment and Risk Management (ARM) tools that are currently under development, including:

- **Annual Certification and Data Collection Report (ACR):** The ACR establishes common definitions and collects annual data on all certified CDFIs, not just awardees. The data permits the computation of the Minimum and Prudent Standards to measure financial performance and risks for the universe of all certified CDFIs and permits an analysis of the geographic and product line coverage for all certified CDFIs, rather than just those who receive a CDFI Program award.

- **CDFI Program Application Assessment Tool (AAT):** The AAT is a tool for evaluating the organizational risk of a CDFI applicant's financial performance and management capabilities. It will help the CDFI Fund evaluate how the applicant's proposed activities meet current needs in distressed communities and underserved populations, especially market gaps in CDFI geographic coverage in specific product lines and service, and compare their proposed activities against the applicant pool to ensure geographic diversity of award recipients.
- **Compliance Assessment Tool: Noncompliance Score Card (NSC):** This tool will rank compliance reporting into high, medium and low categories of risk and allow the CDFI Fund to prioritize compliance interventions, including additional monitoring or penalties, according to the level of risk.
- **Certification Assessment Tool (CAT):** The CAT will provide the functionality to support the application review process for new CDFI certification applicants and to monitor CDFI certification status of all certified CDFIs.
- **CDFI Industry Data Analysis Reporting Tool (DART):** DART will integrate data from a variety of sources to evaluate how a financial assistance applicant's proposed activities meet current needs in distressed communities, persistent poverty counties, and underserved populations, as well as how the activities close market gaps in CDFI geographic coverage.
- **Macroeconomic Risk Tool (MRT):** The MRT will analyze macroeconomic factors at the county level to predict changes in the industry risk profile, including regional factors, product-line or asset classes, and other factors that help explain CDFI performance, trends, and performance risks by asset classes and target markets.
- **Direct Loan Component Portfolio Monitoring Tool (PMT):** The PMT will provide the capability to monitor direct loans and manage risk within the portfolio and awardee loan performance level consistent with OMB circular A-129 on management of federal credit programs. The PMT provides compliance assurance for the CDFI's financial performance based on financial ratios derived from the ACR data points after the three-year assistance agreement and during the remaining period of the term of the loan.

Outcomes measurement is not easy or cheap, but together, AMIS and the ARM tools will go a long way toward ensuring that CDFI Fund resources are well spent.

### **CONCLUSION: WHEN WILL THE CDFI FUND NO LONGER BE NEEDED?**

It is well known that we are living in a time of widening gaps between the have and the have-nots in our country. Hanging on to a middle class lifestyle is increasingly challenging, and mobility from poverty is not getting easier. It is these conditions that create the need for CDFIs to exist. The rules of the capital markets are such that some

communities do not have access to the resources they need to thrive. If we are to be a nation where opportunity is truly available to all, we need institutions like CDFIs to correct for market failures. CDFIs do this in a way that gets markets to work more effectively in distressed communities, by partnering with conventionally motivated investors. But to accomplish this, CDFIs need the tools available through the CDFI Fund.

When income and wealth inequality is eliminated, and when the engines of mobility from poverty such as good schools, safe and affordable housing, access to healthy food, and quality health care are widely available, then we will no longer need CDFIs and the CDFI Fund.

Chairman Quigley, Ranking Member Graves, and Members of the Subcommittee, that concludes my statement. I look forward to taking your questions.