

# CRS Report for Congress

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## Community Development Financial Institutions (CDFI) Fund

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### Summary

The Community Development Financial Institutions Fund was established in August 1994 by P.L. 103-325. The purpose of the Fund is to provide credit and investment capital to distressed urban and rural areas by investing in and supporting community based organizations. The Fund's programs also encourage banks and thrifts to expand their activities in distressed communities. The programs provide technical and training assistance. In addition, the Fund will administer the New Markets Tax Credit program created by P.L. 106-554. The Fund is managed by the Secretary of the Treasury. From FY1996 through FY2001, Congress appropriated \$483 million to the CDFI Fund.<sup>1</sup> The Bush Administration proposed a significant cut in funding for FY2002. The Administration's request was for \$68 million, a decrease of 42% from the \$118 million appropriated in FY2001. Supporters of the Fund stated the proposed large cut in funding would adversely affect the operations of the Fund's programs. P.L. 107-73 provides \$80 million for FY2002, a decrease of \$38 million from FY2001. This report will be updated as warranted.

### Background

In 1993, President Clinton proposed using development banking institutions to facilitate community economic development as part of a broad effort to bring greater capital and investment into America's economically distressed areas. Legislation was introduced in the 103<sup>rd</sup> Congress to establish a fund to facilitate the operations of financial entities, with the primary goal of revitalization of low income communities. These entities came to be collectively referred to as community development financial institutions (CDFIs). CDFIs include community development banks, credit unions, housing/facilities

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<sup>1</sup> Funding is provided through the annual VA-HUD-Independent Agencies appropriations. A description of the process and progress of that bill is provided by CRS Report RL31004, *Appropriations for FY2002: VA, HUD, and Independent Agencies*, by Dennis W. Snook and E. Richard Bourdon.

loan funds, microenterprise loan funds, and venture capital funds. As of May, 2001 the CDFI Fund had certified 421 organizations as CDFIs.<sup>2</sup>

There was general agreement between Congress and the Clinton Administration on the need for rebuilding poverty-stricken and transitional neighborhoods. An additional goal was to bring economic opportunity to individuals living in markets considered to be underserved by the financial services industry. Providing access to credit and investment capital is a primary step towards creating and retaining jobs, revitalizing neighborhoods, developing affordable housing, and supporting small businesses.

Two laws, P.L. 103-325 and P.L. 104-19, established the CDFI Fund and provided for its management. P.L. 103-325, enacted in August, 1994, created the CDFI Fund as a wholly owned government corporation. The intent of the legislation was to facilitate the flow of lending and investment capital into distressed communities and to individuals who had been unable to take full advantage of financial services offerings. Funding for the Fund's programs has been provided through the annual VA-HUD-Independent Agencies appropriation.

P.L. 104-19, enacted in July, 1995, placed the Fund within the Department of the Treasury and the Secretary of the Treasury was given the authority to manage the Fund. In addition, P.L. 104-19 allocated one-third of the appropriation for the CDFI Fund to the Bank Enterprise Act (BEA) program. This program was authorized in 1991 but was never funded. The law redesigned the original BEA program to function as a companion to the CDFI Fund programs. The name was changed to the Bank Enterprise Award program. The purpose of this program is to encourage and expand lending, investment, and service activities by traditional banks and thrifts in distressed communities. A major goal is to form partnerships between banks and thrifts and CDFIs.

The Community Renewal Tax Relief Act of 2000 (part of P.L.106-554, enacted in December, 2000) created the New Markets Tax Credit (NMTC) program which will be administered by the Fund. The intent of this program is to encourage investments in businesses located in low-income communities. Incentives to investors will be provided in the form of a tax credit over seven years. The Fund is developing guidelines and application materials. The first credits are expected to be allocated in 2002.

## **Fund Programs and Their Impact**

The Fund's stated mission is "to promote access to capital and local economic growth by directly investing in and supporting community development financial institutions (CDFIs) and expanding financial service organizations' lending, investment and services within underserved markets."<sup>3</sup> The CDFI Fund has established five major programs through which it provides monetary and nonmonetary assistance to distressed communities. They are the CDFI program, the BEA program, the Training program, the Native American program, and the NMTC program. As a means of measuring the

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<sup>2</sup> *CDFI Fund Quarterly*. Department of the Treasury. Spring 2001, p.5.

<sup>3</sup> [<http://www.treas.gov/cdfi>]

performance of its programs, the Fund has conducted surveys of some of the past award recipients in the Core Component of the CDFI program and in the BEA program. The Fund has completed a preliminary evaluation of the impact and influence of these recipients.

## Programs

Under the **CDFI program** the Fund provides financial and technical assistance to selected applicants who are chosen through a competitive process. The CDFI program has three components; the Core Component, the Intermediary Component, and the Small and Emerging CDFI Assistance (SECA) Component. To be eligible, an entity must first qualify as a CDFI. In general, a CDFI must have a primary mission of promoting community development, be in the business of providing loans and investments, and serve a defined investment area or targeted population. An applicant must be a non-government entity; it can be either for-profit or non-profit. An organization is judged by its business plan, financial viability, history of operations, experience of the management team, and potential impact on the community. The Fund administers a CDFI certification program.

The Core Component is directed at building the financial capacity of CDFIs by enhancing the capital base of individual organizations. The Intermediary Component involves assistance to CDFIs that provide support to other CDFIs and to emerging CDFIs. Applicants for funding under both Components request awards in the form of grants, loans, equity investments, shares, or deposits. The applicant must obtain matching funds equal to the amount of financial assistance. Matching funds must be from sources other than the federal government. The Fund is generally prohibited from obligating more than \$5 million to any one organization in any three-year period. By May, 2001, the Fund had made approximately 275 Core awards totaling over \$267 million and seven Intermediary awards totaling over \$18 million.<sup>4</sup>

The Small and Emerging CDFI Assistance (SECA) Component was established in November, 2000, it replaced the Technical Assistance (TA) Component introduced in 1998. The TA Component was created to build up the institutional capacity of new and smaller CDFIs. TA grants were given for identified technical needs such as staff training, consulting services, computer system upgrades, and software acquisition. The SECA Component expands the operations to allow limited financial assistance to be combined with the technical assistance for “small and emerging” CDFIs. In general, these CDFIs are defined as institutions with total assets of less than \$5 million and that have never received a Core Component award. SECA awards are limited to \$150,000. Unlike the technical assistance, the SECA financial assistance must be matched with other non-federal funds. The first SECA awards will be delivered in FY2001. A total of 225 TA Component awards were made from 1998 to 2000. The awards totaled over \$10 million.<sup>5</sup>

The **BEA program** provides monetary incentives to banks and thrifts to expand their activities in distressed communities. BEA program awards are also distributed through a

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<sup>4</sup> U.S. House. Subcommittee on VA, HUD, and Independent Agencies. Hearing on FY2002 Appropriations. Statement of Jeffery Berg, Acting Director of the CDFI Fund. May 8, 2001.

<sup>5</sup> Ibid.

competitive applications process. The awards are based on increases in “qualified activities” engaged in by a bank or thrift during an assessment period. Program participants receive funds after the successful completion of specified activities. Qualified activities include investing in or otherwise supporting CDFIs and increasing loans, services, or technical assistance to distressed communities. Federal regulations established procedures for calculating award amounts based on the activities engaged in by the bank or thrift. By May, 2001, the BEA program had made 433 awards totaling over \$135 million.<sup>6</sup>

The **Training program** was initiated in 1999. This program directs funds to activities involved with the development and delivery of training products to CDFIs and other community-focused financial service organizations. Training can be provided through classroom instruction and electronic formats. Currently, the Fund has contracts with four training providers to develop and teach courses.

The Fund recognized the need to stimulate private investment on Native American reservations and other lands held in trust by the United States. In the FY2001 appropriation Congress set aside \$5 million for the **Native American Training and Technical Assistance Program**. CDFIs, tribal organizations, and non-profit organizations serving these communities are eligible for direct grants under this program.

The Fund is developing guidelines and application materials to establish and administer the **NMTC program**. This program was developed to encourage investments in businesses located in low-income communities. Incentives to investors will be provided in the form of a tax credit over seven years. Investments will be channeled through qualified community development entities (CDEs). A CDE must be a domestic corporation or partnership that has the primary mission of serving, or providing investment capital for, low-income communities or individuals. The Fund will certify CDEs; all CDFIs will automatically qualify. The tax credits will be allocated to for-profit CDEs annually by the Fund. The CDEs will in turn pass on the credits to investors (both institutional and individual). The first credits are expected to be allocated in 2002.

## Impact

The Fund has conducted award recipient surveys to measure and report on the performance of organizations receiving assistance. The Fund has surveyed participants in two programs, the Core Component of the CDFI program and the BEA program. The preliminary findings of the most recent surveys were released in May, 2001.<sup>7</sup>

The FY1999 survey of Core Component participants included 106 recipients from the 1996 through 1998 funding rounds. Core Component awards for these CDFIs totaled \$122 million. The intent of the survey was to convey what was accomplished in the communities served by these CDFIs with the help of the Fund’s financial assistance.

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<sup>6</sup> Ibid.

<sup>7</sup> *FY 1999 Annual Survey, Preliminary Findings: CDFI Program - Core Component*. US Department of the Treasury. May 8, 2001, 4p. and *FY2000 Annual Survey, Preliminary Findings: BEA Program*. US Department of the Treasury. May 8, 2001, 4p.

During 1999, the 106 recipients reported making \$1.4 billion in community development loans and equity investments. This capital helped to create or expand 3,258 businesses and microenterprises, develop or rehabilitate 24,885 units of housing, and develop or support 411 community facilities. The 411 facilities included childcare centers and health clinics. The 1999 CDFIs that were depository institutions also provided basic financial services to their communities. For example, these institutions held 159,000 checking and savings accounts. The reported, average client base of the 106 organizations was 71% low-income, 62% minority, 66% urban, and 34% rural.

The purpose of the FY2000 survey of BEA program awards was to determine how the program may have influenced the activities of banks and thrifts and how those institutions receiving awards planned to use them. BEA awards are given for activities already performed in distressed communities or for the direct support of CDFIs by an institution. The program does not designate how the award funds are to be spent.

A total of 159 banks and thrifts received BEA program awards totaling \$45 million in FY2000. Most of the individual institutions receiving awards were small, 43% with total assets of less than \$250 million and 59% with total assets of less than \$1 billion. The BEA program awards are given to applicants based on the activities undertaken during an assessment period. In FY2000 the 159 award recipients provided a total of \$244 million in loans and investments to CDFIs and a total of \$1.13 billion in loans, investments and services to distressed communities.

The FY2000 survey preliminary findings were based on 100 of the 159 FY2000 awardee surveys that had been collected and reviewed by the Fund. A vast majority (83) of the 100 respondents had earmarked their BEA program monies. Over 85% of the earmarked funds were reserved for community development initiatives. In addition, 58% of the respondents reported that the existence of the BEA program facilitated their institution's involvement with CDFIs.

## History of Funding

Funding for the programs was provided for the first time in the FY1996 VA-HUD-Independent Agencies appropriation. Calendar year 1996 was the first full year of operations. Congressional oversight of the Fund's early awards procedures raised concerns over certain procedural irregularities and prompted several congressional budget cutting attempts that would have eliminated the Fund. The Treasury Department worked closely with the fund to strengthen its internal systems, controls, and procedures. Independent auditors provided an unqualified opinion on the Fund's financial statements for the fourth consecutive year in 2000. Congress continued to provide annual appropriations.

P.L. 107-73 provides the CDFI Fund with \$80 million for FY2002 a decrease of 32% from the FY2001 appropriation. Congress provided the CDFI Fund with gradual increases during its first 6 years. Congress appropriated \$45 million for FY1996, \$50 million for FY1997, \$80 million for FY1998, \$95 million for FY1999, \$95 million for FY2000, and \$118 million for FY2001. The Administration's budget request for FY2002 was \$68 million. The Senate approved an appropriation of \$100 million. The House approved an appropriation of \$80 million and this was the amount agreed to by the Conference Committee. The Conference Committee agreed with the Senate provision for a set-aside

of \$5 million for Native American, Alaskan Natives, and Native Hawaiian communities. The Committee also agreed with the Senate's request for a report on rural lending practices to be included as part of the FY2003 budget submission.