CDFIs are starting to flex their post-pandemic clout

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WASHINGTON — The federal government's response to the COVID-19 pandemic catapulted a niche sector of specialized community development lenders to a new level of prominence in American finance.

Now, as the industry matures into a burgeoning political force in the nation's capital, some of the sector's leaders are eying ambitious policy changes in coming years that could transform the sector's long-term trajectory, including a push for a historic increase in government funding, new tax incentive programs and even a national charter for nonbank community lenders.

Senator Mark Warner, D-Va., left, speaks to Sen. Mike Crapo, R-Idaho, prior to a hearing in the Senate Finance Committee. Warner and Crapo recently announced the creation of a bipartisan Community Development Financial Institution Caucus in Congress, signaling the growing influence of the once-marginal industry sector.

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Community development financial institutions — better known as CDFIs — are a set of Treasury Department-certified lenders designed to do a certain amount of business in underserved communities across the U.S., often in the form of small business and affordable housing loans. They include banks, credit unions, loan funds and venture capital firms.

As a designation created during the Clinton administration, well over a thousand CDFIs now play an integral role in the federal government's effort to direct greater amounts of private capital to poor communities, often in coordination with larger banks under the Community Reinvestment Act.

But a surge of pandemic-era emergency funding marked a watershed moment for the industry. Among CDFI banks alone, the sector's assets grew by more than 60% between the first quarters of 2019 and 2022, from $61.1 billion to $100.2 billion, according to data compiled by the Community Development Bankers Association.

Now, CDFIs and their advocates aim to leave a more enduring mark on the financial system, as well as supporters in Congress who could secure policy reforms to make it happen.

"The CDFI industry was a kind of a below-the-radar group of lenders before the Paycheck Protection Program, but that brought a lot of attention to our specialized brand of lending and brought a lot of benefits," said Jennifer A. Vasiloff, chief external affairs officer at the CDFI network and advocacy organization Opportunity Finance Network.

"While we have certainly been happy to see an increased interest in sort of a CDFI solution to poverty and historic discrimination and economic inequality — all the fantastic work that we do — it's still kind of a drop in the bucket," Vasiloff added. "We are by no means done."

Earlier this month, Democratic Sen. Mark Warner of Virginia announced the launch of a new bipartisan caucus for CDFIs, which will be co-chaired by Warner and Republican Sen. Mike Crapo of Idaho. The group's existence is a testament to how far the CDFI sector has come since the Clinton administration and will be a focal point of advocates' efforts in the years to come.

Vasiloff and other sources in the CDFI industry said that the role CDFIs played in a series of emergency programs introduced by the federal government after the onset of the COVID-19 pandemic — especially under the Paycheck Protection Program — was a catalyst driving the sector's increased visibility in Washington.

"I don't think that this caucus could have come together even as recently as two or three years ago," Vasiloff said.

CDFIs' community-driven missions have long garnered support from Democrats in Congress, but Vasiloff said the institutions also have robust backing from Republicans because they utilize private institutions to support entrepreneurship and wealth generation in underserved areas.

"CDFI Fund appropriations and other legislative initiatives around CDFIs have always enjoyed strong Republican support, because I think it's a perfect kind of private-public sector strategy, and that is easier for Republicans to get behind," Vasiloff said. "But the kind of visibility and credibility we earned as an industry with the Paycheck Protection Program has encouraged Republican senators in particular to be willing to put their names on something like this caucus."

Jeannine Jacokes, CEO of the Community Development Bankers Association, who has worked in and around the CDFI sector since its inception during the Clinton years, said that the transformation was remarkable given where the industry started just three decades ago.

"At the very beginning, I will say the industry really had virtually no experience in terms of public policy advocacy," said Jacokes. "Fast forward 30 years, and we have a caucus — that is a mind-blowing thing, because way back when, CDFIs were very much grassroots organizations. Many didn't get a lot of government funding from any source whatsoever."

Sustaining and expanding that government funding remains top of mind for the sector's policy advocates in the years ahead. The industry's foremost source of funding has long been the Treasury's CDFI Fund, which currently distributes a limited amount of capital to applicants every year.

"The CDFI Fund's annual appropriation is the number one pot that everyone gets their money out of," Jacokes said. "Even though the industry has grown many fold, the amount of appropriations is woefully lacking."

For the 2022 fiscal year, Congress appropriated $295 million for the CDFI Fund; a $25 million increase from FY 2021, but far short of what the CDFI industry has asked for in recent years. In April, several financial trade groups — including the Opportunity Finance Network, CDBA, American Bankers Association and the Independent Community Bankers of America — urged Congress to appropriate as much as $1 billion to the CDFI Fund, calling the sum "modest relative to the size and scope of the CDFI industry."

Members of the CDFI industry say the sector's need for capital goes beyond meeting the demand they see for loans and other services; several representatives interviewed by American Banker emphasized that CDFIs also need some dedicated funding to improve their technological capacity and ultimately scale the amount of work the sector can accomplish.

"While great resources have been provided already, we are going to continue to need much more long term capital — that is, patient capital — to give us the ability to invest in our systems and our operating capacity, so that we can become more efficient and more effective as an organization so that we can deliver capital at scale," said Luz Urrutia, CEO of Accion Opportunity Fund.

Others said that equity grant programs like the $9 billion Emergency Capital Investment Program, established by Congress in 2021, had been crucial for helping regulated CDFIs grow, but they also said more could be done within specific federal programs to set aside funds for CDFIs to increase their broader capacity, whether through hiring or technology investments.

"A lot of times, disparate programs are rolled out, but they're very specific and programmatic in nature, and they don't often leave room in the government grants or programs to actually support the capacity building of the institutions themselves," said Beth Bafford, vice president of syndications and strategy at Calvert Impact Capital.

"All these programs are really relying on this delivery system to support communities across the country," Bafford said, "but everything is so earmarked to a certain objective, that CDFIs will run the programs. But there's essentially no margin that actually allows CDFIs to make long-term investments in technology and people and infrastructure and operations that would make them stronger."

Advocates are also hoping the bipartisan Senate caucus will help the sector access a wider spectrum of federal funding programs, such as the Greenhouse Gas Reduction Fund, which is pegged to receive about $27 billion in funding under the Inflation Reduction Act. The landmark climate deal currently awaits President Biden's signature after being passed by both chambers of Congress earlier this month.

"There are other federal lending programs or loan guarantee programs that were designed for depositories or other entities and are perfectly applicable to the CDFI model," Vasiloff said. "But we're just not eligible."

Some CDFI advocates, including the Opportunity Finance Network, CDBA and the National Association of Affordable Housing Lenders, are pushing for the passage of a bill titled the CDFI Tax Credit Investment Act. Introduced in June by Democratic Sens. Warner and Chris Van Hollen of Maryland along with Republican Sens. Roger Wicker and Cindy Hyde-Smith of Mississippi, the bill would provide a tax credit for "private sector investors that make equity, equity-equivalent investments, or long-term patient capital available to CDFIs," according to a press release.

Advocates say the impact of such a bill could be transformative for the CDFI industry. "I think [the bill] has the potential to start to build more infrastructure around the industry," Jacokes said. "Right now, we're mostly dependent upon the CDFI Fund. And if you build these other kinds of support, in the long run, it makes the industry stronger."

Other advocates, such as the Accion Opportunity Fund's Urrutia, say the industry has to develop more national ambitions to become a bigger part of the U.S. financial system. A big part of that drive, Urrutia said, could be the introduction of a national charter for nondepository CDFIs, which would likely require some kind of congressional authorization. Under current law, nonbank CDFIs have to apply for licenses on a state-by-state basis to expand their operations.

Urrutia said that a national CDFIs wouldn't necessarily replace smaller, local outfits but could help them scale their business and improve overall capacity through partnerships.

"If we could get the government to provide a national CDFI charter for nondepository CDFIs that are scalable, that want to grow, that are providing capital across the country, we could help the smaller CDFIs in those markets," Urrutia said. "The intention is not to come in and take over. The intention is to come in to enable and help those CDFIs that may not have the technology, that may not have the know-how, to let them manage the customers they manage locally, which is what they do best."

For now, the sector's advocates dispute that the CDFI industry is in danger of growing too large or too quickly. Most point to the industry's relatively small size versus the degree of unmet lending needs in the U.S. and beyond, whether in small-business lending or housing development.

"The industry is still a little too lean," Jacokes said. "We've been so starved for capital, and to say we shouldn't grow that much — I think there's a ton of room for growth. But what that means is you have to scale up your operations, you have to hire more people."