The Quest for Community Controlled Capital:

Community Development Financial Institutions (CDFI) in the U.S.

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Mainstream Banking and Its Alternatives

The exclusion of the poor, the working class, and minorities from access to capital – and even from access to basic banking services – has a long, inglorious history in the United States. Equally lengthy are the efforts of excluded groups to organize alternatives.

In 1865, following the Civil War, the U.S. Congress chartered the Freedmen's Savings and Trust as a safe place for African-Americans to bank. It grew meteorically, to 55,000 depositors, and crashed tragically within 10 years, as a result of speculation, embezzlement, and the financial panic of 1873, shattering African-Americans' faith in the U.S. government and leaving many to plead for years for the return of their deposits. In 1889, the historically black Hampton Institute in Virginia established the People's Building and Loan Association to provide loans to black homeowners. In 1908, the first U.S. credit union was organized in the state of New Hampshire, the St. Mary's Bank, to serve predominantly French Canadian working-class émigrés. It drew upon the experience of the Caisse Populaire of Quebec and, earlier, the Raiffeisen credit unions in Germany.

Banks as vehicles to provide credit, hold savings, and execute transactions were not designed, nor have they served, to promote financial equality in the U.S. By the 1970s, they had done little to abolish outright racial discrimination and "redlining" – the intentional exclusion of minority neighborhoods and communities from access to loans for homeownership and entrepreneurship. As a response, the U.S. Congress passed the Community Reinvestment Act of 1977, obliging banks to make efforts to serve the needs of all sectors of their communities, including low- and moderate-income segments.[i]

As alternatives to banks for "people of modest means," the credit union movement in the U.S. has achieved impressive success since the early 20th century: Today, more than 100 million Americans belong to local credit unions, which hold an aggregate of more than $1 trillion in savings. Credit unions are the largest cooperative sector in the United States. But the credit union movement – like banking in general – has seen systematic consolidation for several decades: around 1980, there were approximately 20,000 credit unions in communities across the United States. Today, there are barely 6,000, although on average they are much larger and more sophisticated. Unfortunately, from the perspective of the solidarity economy, credit unions have fallen short of becoming a national force for progressive social change.

The Birth of Community Development Finance in the U.S.

The Great Recession and the massive bailout of the largest, "systemically important" banks gave birth to Occupy Wall Street in 2011, an outraged cry against the concentration of wealth and the maldistribution of capital in the United States. But decades before Occupy Wall Street, a diverse group of social activists had begun to create another way of banking: the community development financial institutions (CDFI) movement.

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The streams that fed the CDFI movement date to the 1960s and before, but it was only in the 1980s that the movement began to take shape. The National Federation of Community Development Credit Unions (or, the National Federation), which brought together low-income and minority credit unions, was a driving force.[ii] It was joined by an emerging association of non-regulated, not-for-profit community loan funds, and by several community development banks, the most renowned of which was South Shore Bank, whose motto was "Let's Change the World."

Except for Bill Clinton, CDFIs would have remained a small, struggling movement on the margins of public policy in the U.S. But as governor of the poor Southern state of Arkansas in the 1980s, Clinton had learned of and became a great admirer of the Grameen Bank of Mohammed Yunus and South Shore Bank in Chicago. He and his wife, Hillary Clinton, helped the start-up of Southern Development Bank in Arkansas and a microenterprise fund. Bill Clinton's presidential campaign in 1992 promised to create a "network of 100 community development banks and 1,000 microenterprise funds" to replicate the success of South Shore Bank and the Southern Development Bank in Arkansas.

Meanwhile, the loose coalition of credit unions, loan funds, and several banks had formulated a plan for the creation of a federal fund to invest in these institutions. Immediately after Clinton's election as president in November 1992, these two streams merged. The community lenders, which formalized as the Coalition of CDFIs, successfully urged President Clinton to expand his vision beyond creating start-up community development banks to include the spectrum of CDFIs, including credit unions, loan funds, and microenterprise funds. In September 1994, the CDFI Fund was signed into law, operating under the U.S. Department of the Treasury and dedicated to investing in community development financial institutions of all types.

Today, more than 1,000 mission-driven organizations are officially certified by the CDFI Fund as CDFIs. And twice or three times as many institutions do similar work without benefit of the official certification of the federal CDFI Fund. Their collective assets amount to tens of billions of U.S. dollars.

Equity, First and Foremost

What was unique about the CDFI Fund and crucial to the growth of CDFIs in the U.S. was an initial policy decision: the Fund would *not* provide ongoing annual operational support. Rather, it would provide ***equity capital*** – irrevocable grants and investments to help CDFIs build the net worth line on their balance sheets. Financial leverage was, and is, fundamental***:*** CDFIs could raise debt as a multiple of their net worth – as much as ten times -- and translate this into increased lending capacity and impact. Having more net worth meant that CDFIs could and did safely take risks – risks shunned by conventional markets.

Investing federal funds as equity in community-owned institutions like CDFIs was an innovation in U.S. federal policy, one which has not been duplicated nationally since. Equally important about the CDFI Fund: recipients of CDFI Fund investments could not be government or government-controlled entities (although a limited exception was made for Native American tribes). In the past, municipalities and states had been the recipients of anti-poverty and community development funding. In too many cases, these agencies were politicized, ineffective, and/or corrupt. Had the CDFI Fund invested in these players, it would likely have turned into just another anti-poverty program.

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Another exclusion was also important. The CDFI Fund could not invest equity in conventional banks, unless they provided a substantial majority of their lending and investments to low-income communities and target populations.

Early Assaults on the CDFI Fund

The CDFI movement had the huge ***advantage*** of being one of the initiatives closest to the heart of President Bill Clinton. The CDFI movement had the major ***disadvantage*** of being close to Clinton's heart.

Created in 1994, the CDFI Fund became fully operational in 1995, and made its first awards in 1996. But by early 1995, the right-wing Republican Party came to control both houses of the U.S. Congress. Later that year, in a budget battle with the Clinton Administration, the federal government was shut down for weeks.

In this polarized atmosphere, Clinton's CDFI Fund was vulnerable. A fledgling agency, it had limited resources and skill navigating the ways of Washington. In 1997, its funding decisions came under scrutiny by a Congressional oversight committee. Republicans charged that the funds were awarded went to political cronies of President Clinton, like those associated with South Shore Bank of Chicago. The investigation helped bring down the initial leadership of the CDFI Fund. But the unfounded attack on the Fund did not succeed in eliminating it. The CDFI Fund continued to make annual awards of tens of millions of dollars annually throughout the 1990s.

CDFIs in the Twenty-first Century

The CDFI Fund would come attack once again in the early 2000s, under the administration of President George W. Bush, which sought to "consolidate" – really, to eliminate -- a whole host of federal programs that supported community development. The CDFI movement, with substantial support in Congress, managed to beat back this effort.

During the Obama years, annual appropriations for CDFIs expanded to more than $200 million a year, far more than even under President Clinton. The CDFI Fund became the home of innovative investments, like the "Healthy Foods Financing Initiative," a particular favorite of First Lady Michelle Obama. Despite widespread prosperity, there were large areas of poverty-plagued urban and rural America where residents did not have access to fresh, reasonably priced food. CDFIs began to receive funding to support the development of food cooperatives, community-supported agriculture, wholesale distribution, and more.

The CDFI Fund also became the vehicle for other innovative initiatives to deliver capital on a larger scale to communities. The New Markets Tax Credit Program was created at the end of 2000, and the CDFI Bond program in 2010, after years of advocacy by the CDFI movement. The former was utilized by the largest CDFIs to dramatically expand their financing as well as their net worth and budgets. The CDFI Bond program, today still in its earliest stages, has provided support for bond financing in $100 million blocks by CDFIs.

CDFIs and the Great Recession

By 2007, the CDFI movement had grown in numbers, capital, and credibility. It had successful fought back the efforts of President George W. Bush to eliminate it. But it was still in a relatively early, fragile

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stage of development, and it would be sorely tested in the catastrophic near-collapse of the U.S. economy.

In the U.S., the economic disaster was triggered by ill-advised and fraudulent mortgage lending, securitization practices, and derivatives trading.[iii] A number of the largest banks and investment houses failed or tottered on the brink. In the fall of 2008, under the Bush Administration, the federal government and the Federal Reserve provided support of nearly $800 billion to preserve the financial system as they knew it.

CDFIs were not immune to the crisis. Some of them, especially the non-regulated CDFI loan funds, were regular borrowers from mainstream banks, which received regulatory credit for these loans under the federal Community Reinvestment Act (CRA). But when the crisis hit, CRA considerations were shoved into the background for some banks, as they sought to save themselves. Some reduced or did not renew their investments in CDFIs, which caused some CDFIs to face potential liquidity crises.

The Crisis of Cooperative Finance in the U.S.

Credit unions were not dependent on investments from banks; rather, their financial base was made up of the deposits of their ordinary members. However, the credit union movement was hit by its own catastrophe.

The thousands of credit unions in the United States routinely invested their idle funds in wholesale, or "corporate," credit unions. Ultimately, some of these funds flowed upward to an apex financial cooperative, U.S. Central Credit Union – a "credit union for credit unions" -- which aggregated more than US$30 billion. Rather than reinvesting in local credit unions or projects, U.S. Central Credit Union bought mortgage-backed securities. When this market collapsed, U.S. Central and several other large, regional wholesale credit unions incurred paper losses of billions of dollars, rendering them insolvent. On March 20, 2009, the federal credit union regulatory agency seized U.S. Central, with $34 billion in assets, and the regional $23-billion Western Corporate Federal Credit Union, to "stabilize the corporate credit union system and resolve balance sheet issues." The losses from U.S. Central Credit Union were passed downstream to the thousands of ordinary local credit unions across the country, compounding the economic stress of the Great Recession.

For the most part, U.S. credit unions have recovered from these blows. But the downfall of U.S. Central is a sobering lesson in the challenges of building an enduring national cooperative financial institution at scale. U.S. Central was an institution that was built by cooperative dollars, pure and simple. It aspired to be a full-fledged participant in the capitalist marketplace. Seeking yield over mission, it failed.

Recovery ... for Some

Coming into office in January 2009, the Obama Administration inherited the bail-out of the financial system. It moved to develop a variety of programs and initiatives seeking to restore some of the damage to the "Main Street" economy, the millions of homeowners whose home values had declined precipitously and small businesses that were frozen out of credit from the big banks that had benefited from the bail-out.

CDFIs benefited in two ways. First, in 2009 there was a special supplemental allocation for the CDFI Fund, added to its annual appropriation that had grown substantially under President Obama. This

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meant greater access to critically needed equity for many CDFIs. Some had seen their balance sheets threatened by decreased access to private capital; some had seen their portfolios of low-income mortgages and community projects suffer defaults and delinquencies.

The second way was through a special window created under TARP, the Troubled Asset Relief Program. The biggest financial institutions had received hundreds of billions of dollars of government capital relief under TARP. Smaller institutions, and especially those serving low-income communities, had not. So, beginning in 2009, the CDFI movement lobbied for a comparable program. Reluctantly, in February 2010 the Treasury Department agreed to establish a special window under TARP, the Community Development Capital Initiative (CDCI) for CDFIs. The CDCI program provided low-cost, equity-like, medium-term debt to those CDFIs that were regulated depositories – that is, CDFI banks and credit unions. They had to prove, however, that they would be "viable" or could become viable.

The increase in capital access from the federal government was comparatively modest. Authorized to provide up to $1 billion, over the course of 2010, the Treasury Department committed $570 million dollars to 84 CDFI banks and CDFI credit unions that met its standards. This investment, though paltry compared to the TARP program for the big banks, nonetheless was a lifesaver for some CDFIs.

ShoreBank's Final Chapter

In bitter contrast to the bailout of mega-banks, the U.S. Treasury Department did not use the CDCI program under TARP to save ShoreBank, the first community development bank, much beloved by President Clinton and an inspiration for much of the CDFI movement.

ShoreBank, which had reached approximately $2 billion in assets with operations in Chicago, Cleveland, Detroit, and northern Michigan, ran into severe trouble in 2009.[iv] Following its mission of investing in some of the lowest-income, most troubled geographies in the country, ShoreBank's mortgage portfolio suffered calamitous losses. By July 2009, badly needing to raise capital, it was under a "cease and desist" action from its regulators.

In 2010, when the CDCI program was instituted, ShoreBank hoped to gain federal support to remain in business. It raised at least $150 million in pledges of private capital (mostly from large banks as well as philanthropies) in order to match a possible federal investment of $75 million. But its application was denied by a federal committee of regulators. On August 20, 2010, ShoreBank was seized by regulators, ending its 40-year history. While some U.S. banks were "too big to fail," ShoreBank was, in the words of two authors, "too good to save…"[v] In her book, *Bull by the Horns,"* Sheila Bair, the former chief regulator of the Federal Deposit Insurance Corporation, described the closure of ShoreBank as "heart-rending… a particular tragedy" (p. 284).

Occupy!

Meanwhile, popular resentment of the TARP bailout, the continued bad practices of banks, and the growing anger at economic inequality acquired a public face, if not a coherent shape. In September 2011, Occupy Wall Street drew thousands of activists to scores of sites across the United States (and in other countries) to voice their protest. "Ground zero" of the protest was a small, quasi-public park near the foot of Wall Street, a few blocks from the destroyed World Trade Center.

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Occupy Wall Street never developed a unified, broadly accepted "platform." But it did stoke and crystallize popular disgust with the prevailing financial system. The "Move Your Money" campaign sprang up in 2011, calling upon people to move their accounts from the big banks to local institutions, including credit unions and community banks. It was estimated that as many as one-million people moved their deposits from banks to credit unions. The New York contingent of Occupy Wall Street moved the funds they received through contributions to a CDFI, the Lower East Side Peoples Federal Credit Union, and to Amalgamated Bank, the labor-union-owned bank two blocks from the small park that Occupy Wall Street had commandeered.

There were, quietly, other positive legacies of the Occupy movement. Solidarity economy activists and concepts were embedded in Occupy Wall Street, and a number of cooperatives of various sectors – screenprinters, media, and others -- emerged from the movement. When Hurricane Sandy wrought unprecedented devastation to New York and New Jersey in the fall of 2012, veterans of the Occupy movement sprang into action, organizing relief and rebuilding efforts, and in the process, gaining new respect.

Resilience: The CDFI Movement in Perspective

Back in 1990, as the CDFI movement began to take shape, there were a few "flagship" institutions like South Shore Bank and North Carolina's Center for Community Self-Help. There were scores of small nonprofit loan funds, most with less than $1 million in assets, and a couple of hundred community development credit unions (CDCUs), a few of which had assets in the tens of millions of dollars.

Twenty-five years later, by 2015, there were nearly one-thousand federally certified CDFIs, which over the course of 20 years had received nearly $2 billion in direct federal investments, and utilized billions more through the New Markets Tax Credit program. There were unregulated loan funds that had grown from almost nothing to hundreds of millions of dollars of assets. Self-Help, which as of 1989 had $15 million in deposits in its credit union in North Carolina, controlled nearly $2 billion under an umbrella structure that included a loan/venture fund, credit unions both in North Carolina and California, and a formerly minority bank in Chicago. The combined assets of CDFIs were approaching $50 billion.

ShoreBank was gone. But despite the apprehensions of many CDFI leaders and notwithstanding the iconic role of the bank, ShoreBank's failure in August 2010 did not discredit or destroy the CDFI movement. The CDFI movement had become too large for one institution to trigger a collapse. For the most part, the hundreds of CDFIs had demonstrated their resilience.

Burning Questions

Over the decades, leaders of the CDFI movement had questioned whether it was, in fact, a "***movement***," or perhaps an **"industry."** Some answered that it was both. Others argued that it didn't matter: the key question was simply whether these institutions, the earliest of which were founded by social and civil rights activists, were or were not dedicated above all to ***mission.*** Would they continue to take risk on behalf of disenfranchised and marginalized people, communities, and enterprises – or would the pressures of generating year-over-year surpluses (otherwise known as "profits") and satisfying public and private investors move them in a conventional bank-like direction? Would the next generation of CDFI leaders, many of whom were vastly more sophisticated and skilled financially than the CDFI founders, continue to emphasize CDFI mission? As CDFIs gained increased recognition and regulatory

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privileges, would the CDFI "brand" be diluted as newcomers sought CDFI certification solely because of the capital and benefits they could obtain?

Interwoven among these questions was another: **achieving scale**. Collectively, CDFIs amount to a few grains of sand on the financial beach. Some CDFI leaders argue that to achieve meaningful social and economic change, CDFIs must grow much larger, develop standardized procedures and products, and outsource or share back-office operations. Others see meaningful scale as unlikely or impossible for the CDFI movement – but see the importance of CDFIs as demonstrating that "another world is possible" in the financial arena.

A thousand flowers have bloomed in the CDFI world. Many will survive, and become perennials. Some may perish, but even in so doing, may scatter their seeds and begin to populate the financial landscape.

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[i] Banks are rated from "Outstanding" to "Substantial Noncompliance" by regulators according to their level of lending, investment, and services in low- and moderate-income areas. Banks that do not receive a satisfactory rating may be prevented from mergers, acquisitions, or branch openings. CRA is generally credited with producing billions of dollars of bank investments in low-income communities that would not have happened otherwise. Investments in and loans to CDFIs as intermediaries became a popular way for banks to earn CRA credit.

[ii] I joined the National Federation of CDCUs in 1980 and served as its CEO from 1982 to 2012.

[iii] There were attempts to blame the collapse on bank lending to low-income and minority borrowers as a result of the Community Reinvestment Act (CRA). These have been refuted by the evidence, but attacks nonetheless continue.

[iv] ShoreBank was the name of the holding company for South Shore Bank.

[v] Post, James E., and Fiona S. Wilson, "Too Good to Fail," Stanford Social Innovation Review, Fall 2011:66-71

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