
THE COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

United States Department of the Treasury



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**Testimony of CDFI Fund Director
Kimberly A. Reed
before the House Subcommittee on Financial Services
on Financial Services for Distressed Communities
and the President's Fiscal Year 2008 Budget**

INTRODUCTION

Chairman Serrano, Ranking Member Regula, and distinguished Members of the Subcommittee, I appreciate the opportunity to testify before you today on behalf of the Community Development Financial Institutions Fund (CDFI Fund), which is within the U.S. Department of the Treasury, on the CDFI Fund's important work to expand the capacity of financial institutions to provide financial services to low-income and disadvantaged communities, as well as on the President's fiscal year 2008 budget proposal.

I am Kimberly Reed, the new Director of the CDFI Fund. Treasury Secretary Paulson announced my appointment on January 18, 2007, and I began as Director on February 1, exactly one month ago today. Joining me today are the CDFI Fund's Deputy Director for Policy and Programs, Linda Davenport, and Deputy Director for Management and Chief Information Officer, Terry Keyfauber.

Secretary Paulson's top priority is keeping America's economy strong for our workers, our families, and our businesses. The CDFI Fund helps fulfill this priority by encouraging more jobs and opportunity in America's neediest communities. The mission of the CDFI Fund is to expand the capacity of financial institutions to provide credit, capital, and financial services to underserved populations and communities in the United States. Through its various programs, the CDFI Fund makes investments that strengthen and sustain a network of financial institutions that we call Community Development Financial Institutions and Community Development Entities.

Growing up in rural West Virginia, I appreciate the importance of and impact that programs such as those of the CDFI Fund can make to improve the lives in and economic conditions of America's neediest communities.

THE COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

United States Department of the Treasury



CDFI FUND'S MISSION OF EXPANDING THE CAPACITY OF FINANCIAL INSTITUTIONS TO PROVIDE FINANCIAL SERVICES TO DISADVANTAGED COMMUNITIES

I am pleased to tell you that the CDFI Fund is devoted to supporting financial institutions working in low-income and disadvantaged communities. Given the focus of today's hearing on the need for unique financial services for those residing in disadvantaged communities, I want to highlight the activities of some of our Community Development Financial Institutions (CDFIs). Many CDFIs offer an alternative to what are considered "predatory lending practices".

What is a CDFI?

Generally, CDFIs are community-based specialized financial institutions that serve low-income people or work in economically distressed communities, often working in market niches that may be underserved by traditional financial institutions.

CDFIs include regulated institutions such as community development banks and credit unions. These institutions, in particular, provide consumer financial services that are designed to bring underserved persons into the financial mainstream, building wealth on affordable terms. CDFIs also include loan funds, many of which offer home mortgage products to consumers not reached by conventional mortgage lenders or at terms not generally available to low-income communities.

CDFIs respond to gaps in local markets that traditional financial institutions are not able to adequately serve. They provide a wide range of financial products and services. While the types of products offered by CDFIs may be similar to those provided by larger mainstream financial institutions (such as checking and savings accounts, mortgage financing for low-income and first-time homebuyers, small business lending, and lending for community facilities), CDFIs generally lend to and make equity investments in markets not served by these traditional financial institutions. The size of transactions and the risk profiles of transactions or customers make it difficult for traditional financial institutions to focus on these customers. CDFIs often offer rates and terms that are more flexible than those provided by traditional financial institutions. CDFIs that are certified by the CDFI Fund also are required to provide services that will help ensure that credit is used effectively, such as technical assistance to small businesses and credit counseling to consumers.

THE COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

United States Department of the Treasury



CDFIs are a segment of the financial services industry that is just beginning to grow. Data reported by more than 500 CDFIs to the CDFI Data Project¹ indicate that their total assets doubled in just four years, from \$9 billion in 2001 to more than \$18 billion in 2004. While commendable, this growth results in institutions that are still a fraction of the size of most regional or national banks. The average CDFI bank has \$152 million in assets as compared to \$1.3 billion in assets for the average commercial banks. The average CDFI credit union has \$17 million in assets as compared to the \$78 million of the average federally-insured credit union. In 2006, national commercial banks and savings institutions held nearly \$10 trillion in assets and federally insured credit unions held \$679 billion. The CDFI Fund plays an important role in supporting the growth and increasing the capacity of CDFIs to reach markets those other financial institutions may not.

CDFI Fund's CDFI Program

The CDFI Fund, through its CDFI Program, uses federal resources to invest in and build the capacity of certified CDFIs to serve low-income people and communities lacking adequate access to affordable financial products and services. Specifically, the CDFI Program provides Financial Assistance awards to CDFIs and Technical Assistance grants to CDFIs and entities proposing to become CDFIs. The CDFI Fund selects Financial Assistance and Technical Assistance awardees annually through a competitive selection process.

CDFI Certification

Only financial institutions certified by the CDFI Fund can receive Financial Assistance awards through the CDFI Program. Certification requires a determination that the institution has a mission of serving low-income communities, is a financing entity, and commits 60 percent or more of its lending or investing resources to low-income communities together with the provision of technical assistance or counseling services to its customers, among other requirements.

¹ The CDFI Data Project is an industry collaborative that produces data about CDFIs. Supported by the Fannie Mae and the Ford and MacArthur Foundations, the collaborative is made up of eight industry trade associations, coalitions and policy organizations (Aspen Institute, Association of Enterprise Opportunity, CDFI Coalition, Community Development Venture Capital Alliance, Corporation for Enterprise Development, National Community Investment Fund, National Federation of Community Development Credit Unions, and Opportunity Finance Network). The CDFI Fund was a founding member of the CDFI Data Project, but separated in 2003 to develop the industry and the federal government's only transaction level data collection system called the Community Investment Impact System.

THE COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

United States Department of the Treasury



CDFIs are located in both rural and urban communities, as well as on Tribal lands, as follows:

- 82% are located in urban areas, and
- 18% are located in rural areas.

The above statistics include 39 Native CDFIs, 6 of which are located in urban areas and 32 in rural areas.

As of January 31, 2007, the CDFI Fund has certified 778 CDFIs:

- 517 (67%) are Loan Funds
- 152 (19%) are Credit Unions
- 62 (8%) are Banks and Thrifts
- 27 (3%) are Venture Capital Funds
- 20 (3%) are Depository Institution Holding Companies

In the coming year, the CDFI Fund will begin a multi-year re-engineering of the CDFI certification processes using data obtained from an evaluation of the CDFI Program and the certification criteria, resulting in the creation of a web-based tool. This effort will ease the burden on our customers, making the application process more efficient, as well as speeding the CDFI Fund's review and approval process.

CDFI Program Financial Assistance Awards

The CDFI Fund provides Financial Assistance awards in the form of equity investments, loans, deposits, or grants, depending on applicant needs, and must be matched dollar-for-dollar by the applicant with funds of the same type from non-federal sources. There are two applicant categories for Financial Assistance awards: (1) Core, for larger CDFIs, and (2) SECA (Small and/or Emerging CDFI Assistance), which is available for applicants that are smaller and/or have a shorter operating history.

These awards enable CDFIs to leverage private capital to respond to demand for affordable financial products and services in economically distressed markets and by low-income families. CDFIs respond to this demand through the provision of loans, investments, training, technical assistance, and basic financial services, such as checking or savings accounts. Based on data supplied by CDFIs required to report to the CDFI Fund, it is estimated that, for the past two years, CDFIs leverage their Financial Assistance awards with nonfederal dollars by up to an average of 27:1.

THE COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

United States Department of the Treasury



During FY 2006, the CDFI Fund received 127 applications requesting \$146.7 million in Financial Assistance awards, including 41 SECA applicants requesting \$18.2 million. The CDFI Fund awarded a total of \$24.47 million to 52 organizations, including 39 Core awards in 24 states and 13 SECA awards in 12 states.

CDFI Program Technical Assistance Awards

The CDFI Fund provides Technical Assistance grants to build the capacity of start-up and existing CDFIs by acquiring prescribed types of products or services including technology (usually efficiency enhancing technology, such as computers and loan management software), staff training, consulting services to acquire needed skills or services (such as a market analysis or lending policies and procedures), or staff support to conduct discrete, capacity-building activities (such as website development).

More established CDFIs also use Technical Assistance grants to build their capacity to provide new products, serve current markets in new ways, or enhance the efficiency of their operations; examples include upgrading computer hardware and software.

In FY 2006, the CDFI Fund received 53 applications requesting \$3.4 million in Technical Assistance grants. The CDFI Fund awarded \$1.91 million to 21 organizations, of which 27 percent were funded to increase the efficiency and capacity of their organizations through the addition or expansion of technology.

CDFI Program Impact

CDFI Program awardees are having significant impact in the communities they serve. As a steward of taxpayer dollars, making this impact is of the utmost importance to me. In FY 2005, the most recent year for which data is available, 186 CDFI Program awardees reported leveraging their awards with \$1.4 billion in private and non-CDFI Fund dollars. These CDFIs reported that their financing helped to:

- create or maintain nearly 14,000 full-time equivalent (FTE) jobs, and
- develop or rehabilitate nearly 27,000 affordable housing units.

In addition, these CDFIs reported that they provided:

- home purchase mortgages to 2,000 individuals,
- checking or savings accounts to nearly 14,000 previously unbanked individuals,
- Individual Development Accounts to 2,500 low-income individuals, and
- financial literacy or other training to 148,000 individuals and organizations.

THE COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

United States Department of the Treasury



These new jobs, along with the increase in residential housing and commercial real estate, result in an increase in tax revenue (consisting of federal, state and local income taxes, and social security taxes), reduce the amount of state unemployment benefits paid out, and increase the amount of local property taxes.

CDFIs Provide Financial Services to Disadvantaged Communities

CDFIs provide many services to disadvantaged communities. According to CDFI Fund data from 2005, more than half (59%) of CDFIs receiving CDFI Program awards report that they are providing financial education services and 42 percent are providing homeownership counseling to first-time homebuyers. These education and counseling services increase consumer awareness and help individuals make informed decisions about available financing products. Among bank and credit union CDFIs, half offer alternatives to payday loans and nearly 40 percent provide check cashing services to people who don't have accounts with these institutions. CDFIs also help individuals build wealth, another factor that can help them avoid the need for an emergency payday loan to cover an unexpected illness or other expense. Twenty-nine CDFIs, including 22 unregulated CDFIs in partnership with regulated CDFIs, provide their eligible low-income clients the opportunity to open an Individual Development Accounts.

The following are examples of how the CDFI Fund supports such CDFIs to provide financial services to disadvantaged communities:

1) The National Community Investment Fund, a certified CDFI in **Chicago, Illinois**, that invests equity and debt in banks, thrifts, and credit unions with a primary mission of community development, received a CDFI Program Financial Assistance award of \$1,315,000 in 2003 to support its Retail Financial Services Initiative. This initiative is helping 12 institutions implement financial products that provide affordable retail financial services, and the four CDFIs mentioned below are among the participants.

- **Bethex Federal Credit Union in Bronx, New York**, and scheduled to appear on the next panel at this hearing, has built a partnership with a check cashing outlet to educate and market strategies which help the check cashing customer move into the financial mainstream. This effort to encourage consumers to utilize financial services is conducive to long term wealth creation. Bethex has received six CDFI Program awards totaling \$812,954.
- **North Side Community Federal Credit Union in Chicago, Illinois**, offers a Payday Alternative Loan (PAL) program. Founded in 1974, North Side is a non-profit federally chartered community development credit union and certified CDFI with more than \$7.2 million in assets and is owned and controlled by its more than 3,100

THE COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

United States Department of the Treasury



members. In 2002, North Side began a short-term PAL program to offer low-cost alternatives to payday lenders, as well as banking services to individuals who had been turned down by traditional lenders. This very successful lending program has resulted in over 4,200 loans, as of December 2006, to people facing emergency cash needs. The program has more favorable terms than payday lenders offer and requires borrowers to participate in financial education courses. North Side has received two CDFI Program awards totaling \$239,500.

- **Alternatives Federal Credit Union in Ithaca, New York**, offers financial services and financial education and economic development programs to its members, residents of Tompkins County (Central New York), since it was chartered in 1979. A full-service credit union with over 7,113 members, Alternatives FCU plays a key role in assisting its low-income members to build wealth and accumulate assets. Alternatives has received five CDFI Fund awards totaling \$4,331,715 to help support its capacity and expansion of programs and financial services.

Since 2002, Alternatives FCU has been managing a free tax-preparation service by running an IRS Volunteer Income Tax Assistance (VITA) program as a “new-accounts strategy” to encourage individuals to come into the financial services mainstream. As an incentive to have individuals open accounts, Alternatives waives the \$10 membership fee and suspends the \$5 minimum balance until the tax refund is deposited.

- **Legacy Bank in Milwaukee, Wisconsin**, is a state-chartered commercial bank founded by three African American women. Legacy opened in 1999 and already is a \$160 million asset financial institution. The bank focuses on financial education and affordable lending products that encourage the use of a bank rather than payday lenders. More than a third of its low-income customers have had some type of negative experience with payday lenders and rapid tax refund loans. Its primary product to combat this issue was the Financial Liberty First Accounts product that has now evolved into the Liberty Checking/Savings Account products.

To support the Liberty Checking/Savings Account products, financial education classes are taught offsite through partnerships with more than 30 organizations that serve low-income populations. The bank also holds monthly classes on site. Successful completion of the classes results in the participant being able to open an account even if they have had prior credit or checking account issues. The bank focuses on turning these account customers into loan customers who buy homes and start-up businesses. Many of them have learned how to save for their own or their children’s education, emergency expenses (to avoid payday lenders), and other financial goals. Several thousand people have taken advantage of these programs and

THE COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

United States Department of the Treasury



products – bringing them into the mainstream of banking rather than the downward cycle of payday lending. Legacy has received five CDFI Fund awards, totaling nearly \$4.5 million.

2) **ASI Federal Credit Union in New Orleans, Louisiana**, is a low-income designated credit union that serves approximately 77,000 members in New Orleans and southeast Louisiana. ASI's mission is to serve the underserved, promote economic empowerment, and provide affordable financial products and services to those with little or no credit. Over 60 percent of ASI's members fall below the poverty level, and it is estimated that ten percent of its members were unbanked prior to joining the credit union. ASI's mission became more critical following the devastation of Hurricane Katrina. Most members served by ASI experienced substantial personal losses, including homes, automobiles, and employment opportunities.

In its history of serving the underserved, ASI has pioneered a number of products and services catered specifically to those of modest means. The five main products offered are the Stretch Plan, the Credit Enhancement Plan, the Asset Builder Loan, the Yours-to-Own Loan, and the Payday Lender ReBuilder Loan. All of these products provide a much-needed outlet for the credit union's low-income members who frequently fall victim to the debt trap. ASI received a CDFI Financial Assistance award in the amount of \$585,000 in 2006.

Additional CDFI Fund Efforts to Assist with Financial Services in Distressed Communities

As the new Director of the CDFI Fund, I plan to work with our CDFI Advisory Board on the important issues that we are discussing here today. The Community Development Advisory Board was established in the Community Development Banking and Financial Institutions Act of 1994 to advise the Director of the Fund on policies regarding the activities of the CDFI Fund. The Board is composed of public representatives from the Departments of Agriculture, Commerce, Housing and Urban Development, Interior, Treasury, and the Small Business Administration, as well as nine private citizens with a variety of backgrounds relevant to the CDFI Fund's mission. The current Chair is Bill Bynum, President and CEO of the Enterprise Corporation of the Delta. I hope to invite a number of CDFIs to attend a Community Development Advisory Board meeting for a discussion of ways in which the CDFI Fund can improve and expand its support of CDFIs doing this important work.

Additionally, the CDFI Fund will continue to cultivate its close working relationship with the Treasury Department's Office of Financial Education, the Internal Revenue Service, and other Treasury and federal agencies in important financial education work. For example, CDFI Fund staff will join other Treasury officials in its partnership with the American Bankers Association Education Foundation for the 11th annual "Teach Children to Save Day" initiative on April 24, 2007. This is Treasury's fourth year participating in this program, where thousands of bankers and Department officials connect with students in classrooms and after-

THE COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

United States Department of the Treasury



school programs to share "real life" lessons about money. The CDFI Fund recognizes that such outreach is important to help the youth in disadvantaged communities better understand the advantages of or possible pitfalls associated with various financial services.

PRESIDENT'S FY 2008 BUDGET REQUEST

The President's budget for fiscal year 2008 requests a \$28.6 million appropriation for the CDFI Fund. Specifically, the CDFI Fund's budget request includes \$24.4 million for the CDFI Program and \$4.1 million for the administration of the New Markets Tax Credit (NMTC) Program. This request is \$21 million above the President's FY 2007 budget request, as funding was not requested in FY 2007 for the CDFI Fund's grant programs, other than for support of the management of the existing portfolios. Because the NMTC Program provides tax credit allocations instead of grants or loans, all costs are administrative in nature.

As in FY 2006 and 2007, the FY 2008 budget does not request funding for the Bank Enterprise Award (BEA) Program. Through the BEA Program, the CDFI Fund provides monetary awards to FDIC insured depository institutions as incentives to increase their lending and investments in economically distressed communities. The awards are made on the basis of past activity, which is, in our view, a fundamental program flaw and the reason, among others, funding is not requested for FY 2008.

Additionally, because no separate authorization exists for the CDFI Fund's Native Initiatives, no separate set-aside for this program is being requested in FY 2008. However, the CDFI Fund will continue to provide economic and community development to Native American, Alaskan Native, and Native Hawaiian communities through our existing CDFI Program.

Since it began its awards programs in 1996, the CDFI Fund has awarded more than \$820 million through its programs. In addition, the CDFI Fund has allocated \$12.1 billion in tax credit authority to CDEs through the NMTC Program.

By directing our efforts to increase the capacity of CDFIs, and administering the NMTC Program, the President's FY 2008 budget request allows us to focus our programs to promote economic revitalization and community development through investments in and assistance to CDFIs and CDEs through four key ways:

Make Awards Through the CDFI Program

The CDFI Program provides financial assistance awards and technical assistance awards to carry out the Fund's mission of expanding the capacity of financial institutions to provide credit, capital and financial services to underserved populations and communities in the United States.

THE COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

United States Department of the Treasury



Issue Allocations of Tax Credits Through the NMTC Program

The NMTC Program attracts private sector capital into low-income communities through Community Development Entities (CDEs). CDEs raise funds by providing tax credits to private investors in exchange for equity investments, which are then invested in low-income communities. CDEs apply for allocations of NMTCs through annual, competitive allocation rounds.

Manage the Existing Portfolio of Awards

Certain activities pertaining to the existing portfolio of awards are required. These activities consist of finalizing the terms of assistance agreements with recent awardees, making disbursements of awards, and monitoring awardee compliance with the terms of their two and three-year award assistance agreements. This later step includes reviewing annual reports provided by awardees to ensure that their performance meets the goals as outlined in the assistance agreements.

Evaluate Program Design, Effectiveness, and Impact and Provide Training

It is of great importance to me not only to ensure that our awards create lasting impact on our nation's distressed communities, but also that the organizations that utilize our programs find that they are efficient and effective. The Fund's CDFI Program is now over ten years old. To ensure that they are meeting the needs of today's CDFIs, the CDFI Fund has retained an outside research and consulting firm to conduct an evaluation of this program, as well as of the Fund's CDFI certification process and past CDFI training efforts.

In addition, the CDFI Fund is reviewing proposals for independent research to be conducted on the role and impact of CDFIs in increasing the provision of needed financial services and products to low-income communities. The results of these evaluations will set the stage for improvements to existing programs and provide input to the re-engineering of processes that encourage more organizations to seek certification as a CDFI.

Similarly, the CDFI Fund has retained Urban Institute to analyze the effectiveness of the NMTC Program. Lastly, the CDFI Fund is supporting Native CDFIs through three current contracts supporting the creation of Native CDFIs, and financial education in Native communities.

THE COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

United States Department of the Treasury



CDFI FUND'S MANAGEMENT AND OPERATIONS

Internal Financial and Management Controls

The CDFI Fund has implemented effective financial and management controls, as verified by its independent auditors (KPMG Peat Marwick, LLP). I am pleased to share that FY 2006 marks the ninth consecutive year in which the Fund received an unqualified opinion on its financial statements and in which no material weaknesses were identified. This serves as a confirmation that the CDFI Fund has good internal controls and that our accounting and administrative systems are operating effectively, something that is important to me and this Administration.

Compliance and Portfolio Monitoring

The CDFI Fund has implemented a variety of new initiatives to monitor and conduct compliance reviews of its growing portfolio of awardees and allocatees. The CDFI Fund's NMTC compliance system has been significantly upgraded and now provides us with a fully automatic system that reflects each allocatee's compliance status with the various terms and conditions found in its allocation agreement. The Internal Revenue Service has access to the CDFI Fund's system to assure compliance with the tax code by NMTC investors. Our increased effort in monitoring our awardees has also extended to exploring ways in which all compliance reporting can be fully automated. This would allow the Fund to pull information from various CDFI Fund systems, including the Community Investment Impact System, and would automatically determine an awardee's compliance status with the requirements set forth in each assistance agreement.

In addition to the above systems, our compliance office also conducts post-award site visits to verify the information submitted by awardees and allocatees and plans to substantially increase these visits in the near future. The CDFI Fund also participates in several outreach sessions at various industry conferences each year to better inform awardees and allocatees of the reporting requirements and to answer any individual compliance questions.

Measuring Community Development Investment Impact

The Community Investment Impact System (CIIS) developed by the CDFI Fund is the nation's first system to collect standardized institution and transaction level data from CDFI Program awardees and NMTC Program allocatees. The CIIS database currently contains data from several hundred organizations.

Fully implemented in FY 2004, CIIS collects data such as awardee and allocatee financial position, number of staff, and number of development services clients. It also collects

THE COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

United States Department of the Treasury



transaction level data providing details on each loan or investment made, such as the purpose of the loan or investment, borrower socio-economic characteristics, loan and investment terms, repayment status, and community development impacts. These data allow the CDFI Fund to measure impact at the census tract level and to map CDFI and CDE activity in specific geographic locations. This innovative system has been recognized by both former Federal Reserve Board Chairman Alan Greenspan and current Chairman Ben Bernanke, who stated that these “results can help inform funding decisions, develop programs, establish performance benchmarks, and communicate societal benefits attributable to specific policy.”

CDFI Fund’s Customer Service

The CDFI Fund makes every effort to be citizen-centered and responsive to the communities that we serve. In an effort to reach out to organizations and areas that have not traditionally had access to our programs, the CDFI Fund traveled to 18 states in 2006 to conduct application workshops for the FY 2007 programs. This effort was an attempt to reach out to rural areas and areas that have not traditionally applied to our programs, including such states as Montana, Florida, Iowa, Maryland, South Carolina, and Alabama. The CDFI Fund also hosted three satellite broadcasts of its workshops using HUD’s satellite television network, which were then down linked to every HUD Field Office across the country – over 80. This effort helps ensure that citizens across the country have access to this valuable training.

Plans for the Remainder of FY 2007

The CDFI Fund is in the process of administering its entire cycle of FY 2007 program activities. The CDFI Fund’s goal is to conduct each award program in keeping with its planned schedule for FY 2007, while undertaking planning for those activities that will be required by implementation of the President’s FY 2008 budget.

The CDFI Fund continues to support investment in low-income communities through the CDFI Program and NMTC Program, and supports the Administration in its efforts to focus our programs in building the capacity of CDFIs and CDEs to serve low-income communities.

CLOSING

The CDFI Fund’s vision is an America in which all people have access to affordable credit, capital, and financial services – a vision, I believe, that all interested in the topic of this hearing would support. I thank you for the opportunity to present my testimony on the CDFI Fund’s mission of expanding the capacity of financial institutions to provide financial services to disadvantaged communities through the programs administered by the CDFI Fund, as well as in support of the President’s FY 2008 budget request. I stand ready to answer any questions that you may have.