CDFIs & Impact Investing
published October 2020

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Community development financial institutions (CDFIs) are private financial institutions with the mission to deliver economic inclusion and mainstream finance to lower-income, lower-wealth, and other disadvantaged communities. CDFIs have been around for over 30 years and can be for-profits, nonprofits, credit unions, banks, loan funds, or venture capital funds, all of which are certified by the U.S. Treasury Department's CDFI Fund. CDFI Certification is a designation given by the Treasury Department's CDFI Fund to specialized organizations that meet the following requirements: a legal financing entity, has a primary mission of promoting community development, primarily services one or more target markets, maintains accountability to its defined target market, provides development services in conjunction with its financing activities, and is a non-government entity nor under the control of any government entity.[i] These community-focused organizations provide helpful resources to minorities, women, and low-income families and communities that otherwise are unable to access capital through traditional financial institutions.

The main four sectors of CDFIs are:

1. Community development banks (CDBs)
2. Community development credit unions (CDCUs)
3. Community development loan funds (CDLFs)
4. Community development venture capital funds (CDVCs).

CDBs can be for-profit or nonprofit and are organized like traditional banks, but are required to have at least 60% of their financing activities targeted to moderate- and low-income communities.

CDCUs function similarly to commercial banks in providing non-predatory financial services. These CDFI-certified credit unions are federally insured organizations designed to provide financial services to individual members of the credit union. They are not profit-maximizing and are cooperatively owned and governed. CDLFs are non-regulated loan services that lend to build affordable housing, to local businesses, and to community centers or facilities.

CDLFs' borrowers are typically nonprofits, small local businesses, charter schools, and organizations involved in community development projects.

Lastly, **CDVCs** are typically for-profit institutions most commonly found in inner city communities or rural areas where traditional venture capital and angel investors are infrequent. These organizations use investor money to make equity investments that accomplish local community development goals while also yielding a return.[ii, iii]

It is important to note that CDBs and CDCUs are depository institutions regulated by federal agencies whereas CDLFs and CDVCs are not federally insured and not subject to federal banking regulations.

CDFIs are especially relevant in the current economic climate as small businesses are struggling to stay financially afloat during the COVID-19 pandemic. A small business is defined as a privately-owned corporation, partnership or sole proprietorship that has fewer employees and less annual revenue than a corporation or median-sized business in the respective industry.[iv] The Coronavirus Aid, Relief, and Economic Security Act (CARES Act), passed in March of 2020 provided emergency assistance to individuals, households, and businesses. The CARES Act provided temporary financial aid to communities during the pandemic, whereas CDFIs are providing ongoing economic assistance and direction.

The median small business has a cash buffer of 27 days, which in turn is impacting all businesses and individuals in that supply chain. The median small business has average daily cash inflows of $381, average daily cash outflows of $374 and holds an average daily cash balance of $12,100.[v] In many cases, CDFIs that work directly with individuals and businesses are serving as their sole sourceof advice, liquidity, guidance, and information.[vi]

As of February 2020, there were 1,122 CDFIs certified to work in low-wealth communities across the United States.[vii] CDFIs generally follow missions that work towards local improvement and aid in disadvantageous communities, but with a network of over 1,000 in the U.S. alone, CDFIs are able to conquer much larger issues.

For example, CDFIs have been working to create access to affordable healthy foods in low-income urban and rural neighborhoods and address the issue of food insecurity. In many underserved communities, finding stores that are within 2 miles from home and also offer quality, fresh, affordable foods can be very difficult. Across the U.S., CDFIs are making connections with local food entrepreneurs to finance access to fresh foods in inner-city communities.[viii]

Conclusion

CDFIs help empower underserved individuals and communities to take control of their financial futures and have demonstrated strong financial track records. In addition, CDFIs have had a positive impact on the economic growth of the U.S. since their inception. In fiscal year 2016, CDFI Program awardees reported a $3.6 billion contribution in financing to homeowners, businesses, and commercial and residential real estate developments.[ix] Clearbrook actively seeks out and incorporates CDFI exposure into portfolios for clients who are aligning their investments with their mission. CDFIs can be a complementary addition to client portfolios as they can be a good low risk cash proxy, a bond alternative, and can increase portfolio stability.

References:

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