

CAPITAL POLICY: THE IMPACT OF COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS IN THE INNER CITY¹

SUMMARY

■ The Community Development Financial Institution (CDFI) program is primarily a source of real-estate lending. Of the \$6.5 billion CDFI financial assistance awards provided to distressed areas from 2006 to 2008, \$1.2 billion—less than one-fifth of the total—was used for business transactions.

■ The CDFI program is more successful in reaching inner cities than other targeted areas across the country. Given the concentrated level of poverty in the inner cities, which consist of 8% of the country's population but 19% of U.S.

poverty, it is not surprising that there are nearly three times more CDFI transactions per thousand firms in the inner city than in other areas.

■ CDFI lending, however, is highly concentrated. Just 10 inner cities account for 82% of all CDFI lending to inner cities nationwide.

■ In addition, the CDFI program is not commonly utilized to provide equity capital. Further research is required to determine why equity providers have not embraced the program.

¹ Summary developed from "Lynch, T. and Rho, L. (2011). Capital Availability in Inner Cities: What Role for Federal Policy?"

Background

The CDFI program is explicitly designed to support the economic revitalization of low-income communities. Federal funds are invested in financial institutions certified as CDFIs, which then use that money to invest in businesses or real estate, to make consumer loans or to provide other financial services in communities that lack them. CDFIs are often able to use their government funding as leverage to obtain matching funds from other sources.

The CDFI program provides entrepreneurs with both technical and financial assistance. Financial assistance is supplied through loans and, rarely, equity investments.

Analysis

CDFI funds are an extremely modest source of small business lending. From 2006 to 2008, CDFIs provided a total of \$6.5 billion to businesses and individuals, but business transactions (as opposed to those for real-estate or other

uses) totaled only \$1.2 billion. In those three years, inner city businesses received an average of \$113 million in CDFI loans annually. There were only 31 CDFI equity transactions for business purposes from 2006 to 2008.

In addition, CDFI funds are not a meaningful source of equity financing for businesses in distressed areas. During the 2006 to 2008 period, equity investments accounted for less than 1% of all CDFI transactions. Furthermore, of the 221 equity investments that were made, only 31 were for business purposes. In terms of dollar amount, equity investments accounted for only 2% of the total CDFI transaction amounts, of which only 8% was used for business purposes.

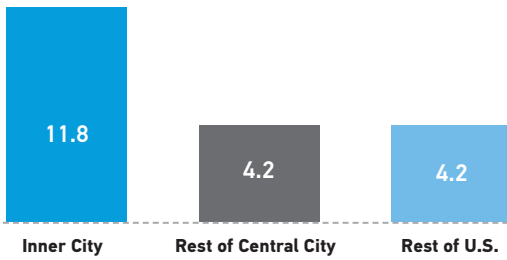
By 2008, the amount of CDFI money channeled to businesses had dropped to about \$200 million, down from \$615 million just two years earlier. In 2008, about 22% of the money used for business transactions was funneled to inner city entrepreneurs, for a total of about \$43 million.

CDFI TRANSACTIONS BY PURPOSE, 2006–2008

(\$ M)	2006	2007	2008	Total
Business	615	397	194	1,206
Home	320	197	90	607
Consumer	255	187	116	558
Real Estate	1,940	973	424	3,337
Other	353	238	208	799
TOTAL	3,484	1,992	1,031	6,507
Business	18%	20%	19%	19%
Home	9%	10%	9%	9%
Consumer	7%	9%	11%	9%
Real Estate	56%	49%	41%	51%
Other	10%	12%	20%	12%
(Number of transactions)	2006	2007	2008	Total
Business	9,091	6,039	2,372	17,502
Home	6,604	4,366	1,720	12,690
Consumer	27,964	24,696	13,331	65,991
Real Estate	2,624	1,439	747	4,810
Other	1,115	695	434	2,244
TOTAL	47,398	37,235	18,604	103,237
Business	19%	16%	13%	17%
Home	14%	12%	9%	12%
Consumer	59%	66%	72%	64%
Real Estate	6%	4%	4%	5%
Other	2%	2%	2%	2%

Source: Community Development Financial Institutions Transaction Level Report data; ICIC analysis

**CDFI AVERAGE TRANSACTIONS-TO-FIRM RATIO
(PER 1,000 FIRMS) BY GEOGRAPHY, 2006–2008**



Source: Small Business Administration 7A and 504 Loan data, 2004–2007, SICE, 2004–2007, ICIC analysis

A significant share of CDFI loans have gone to businesses in inner cities, which received nearly three times more CDFI loans per establishment than other areas.

Business-purpose transactions are similarly concentrated in the inner city, with about 2.6 business-purpose transactions per thousand firms in the inner city, 0.9 in other urban areas and 0.2 in the rest of the country.

CDFI program activity is highly consolidated. Just 10 inner cities—Milwaukee, New Orleans, Richmond, Manhattan-Bronx, Durham, Memphis, Austin, Modesto, Nashville and Spokane—receive 82% of all CDFI business-purpose transactions. Their success suggests that the CDFI program could have a much larger impact if more cities learned to leverage it.

Recommendations

CDFIs are effective at bringing funding to inner cities, but because of the program’s small size—about one-twentieth the size of the Small Business Administration’s (SBA) 7(a) loan program in terms of dollar amounts—CDFIs have only a modest impact on inner city entrepreneurs. The program has the potential to have a much greater impact, on both the debt and equity sides. Furthermore, the disparity in CDFI activity and its effectiveness across locales should be addressed more deliberately.

ICIC’S MISSION IS TO DRIVE ECONOMIC PROSPERITY IN AMERICA’S INNER CITIES THROUGH PRIVATE SECTOR INVESTMENT TO CREATE JOBS, INCOME AND WEALTH FOR LOCAL RESIDENTS.



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