



## **DEPARTMENT OF THE TREASURY OFFICE OF PUBLIC AFFAIRS**

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**Statement of Wayne Abernathy,  
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before the  
U.S. House of Representatives Committee on Appropriations,  
Subcommittee on VA, HUD, and Independent Agencies,  
On the FY 2005 Budget Request for the  
Community Development Financial Institutions Fund**

March 17, 2004

### **INTRODUCTION**

Chairman Walsh, Congressman Mollohan and Members of the Subcommittee, I appreciate the opportunity to testify before you today on behalf of the Community Development Financial Institutions (CDFI) Fund and in support of the President's FY 2005 budget.

Joining me today is the CDFI Fund's Deputy Director for Policy and Programs, Linda Davenport, and Deputy Director for Management/Chief Financial Officer, Owen Jones. Mr. Jones also is serving as the acting Director of the CDFI Fund.

The purpose of the CDFI Fund is to promote economic revitalization and community development through investment in and assistance to community development financial institutions (CDFIs). The CDFI Fund promotes local and regional economic development by expanding the capacity of a wide variety of financial institutions to provide access to credit, capital and financial services to economically distressed communities in the United States. To

achieve these objectives, the Fund makes use of several important tools, including the CDFI Program, the New Markets Tax Credit (NMTC) Program, the Bank Enterprise Award (BEA) Program, the Native American Initiatives, and the CDFI Training Program. Through the CDFI Fund, we make investments that strengthen and sustain a nationwide network of CDFIs and community development entities (CDEs) that serve our nation's most economically distressed areas.

The President and the Treasury Department are committed to the promotion of economic prosperity and stability for all Americans and in all communities. We understand that gaps in access to credit and financial services must be addressed. We support the unique role of the CDFI Fund's community development finance programs in filling those gaps.

My testimony today will focus on three key areas: the President's FY 2005 budget proposal; the CDFI Fund's management and operations in FY 2004; and an update on the CDFI Fund's current programs.

## **PRESIDENT'S FY 2005 BUDGET**

The President's budget for Fiscal Year 2005 requests a \$48.4 million appropriation for the CDFI Fund. The appropriation would provide funding for grant programs, as well as for all of the administrative costs for all the CDFI Fund activities, including the largest CDFI Fund component, the New Markets Tax Credit Program, which leverages tax credits rather than direct appropriations to draw investment into communities.

- The CDFI Fund is committed to the policy that the top priority of the Financial Assistance (FA) Component of the CDFI Program is to target awards to CDFIs that propose to serve communities with the highest level of economic distress (Hot Zones) and to CDFIs that propose to meet other stated programmatic priorities. This policy, first initiated in FY 2003, continues to be the first priority for awards through the current FY 2004 FA Component funding round and will continue to be the top priority for FY 2005 FA Component decisions. In the current FY 2004 funding round, the CDFI Fund has strengthened the flexibility in its policy so that it may make awards to other qualified institutions (in the event that there are funds available after initial awards have been made to those requesting funds) to serve Hot Zones or meet other stated programmatic priorities. The CDFI Fund expects to continue this policy in FY 2005.
- In consultation with the Subcommittee, in the current FY 2004 funding round of the FA Component of the CDFI Program, we re-introduced a Small and Emerging CDFI Assistance (SECA) funding category. We agree that smaller CDFIs serve critical market needs and are important to local economic development and merit encouragement. When reviewing applications from entities that meet SECA criteria, the CDFI Fund will employ flexible underwriting, as discussed by this Subcommittee. The CDFI Fund expects this program modification to continue in FY 2005.
- The CDFI Fund is already beginning to see the positive impact of its efforts to increase the number and capacity of CDFIs that serve Native American communities. The number of certified CDFIs serving Native American communities increased from six in 1999 to 27 by

the end of 2003. The CDFI Fund expects that this number will continue to increase as a result of its technical assistance (TA) and FA awards, as well as due to its training program for Native American communities interested in creating CDFIs.

- The FY 2005 budget request includes the costs of administering each of the CDFI Fund's programs. In FY 2005, we project that 48 percent of the CDFI Fund's total administrative costs will relate to the CDFI Program, 45 percent to the NMTC Program, and seven percent to the BEA Program. In FY 2005, the CDFI Fund expects to incur a significant one-time expense for an independent evaluation of the NMTC Program.
- The CDFI Fund is now leading the community development finance field's most progressive thinking on performance and impact measures and is building a state-of-the-art data collection system - known as the Community Investment Impact System, or CIIS. In FY 2004, a sizable portion of information technology costs for the CDFI Fund was allocated to this initiative. The CDFI Fund expects this initiative to continue in FY 2005.

## 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). These controls have allowed the CDFI Fund to receive an unqualified (clean) audit opinion. This marks the sixth consecutive year that the independent auditors have expressed an unqualified opinion on the Fund's financial statements and in which no material weaknesses or reportable conditions have been identified. This, along with the CDFI Fund's continued compliance with the Federal Managers' Financial Integrity Act (FMFIA) and the Federal Financial Management Improvement Act (FFMIA), are a confirmation that the CDFI Fund has good internal controls and that its accounting and administrative systems are operating effectively.

**Compliance and Portfolio Monitoring.** The CDFI Fund has undertaken a variety of initiatives to monitor and conduct compliance reviews of its growing portfolio of awardees. Specific steps being taken in connection with the NMTC Program are discussed below. The CDFI Fund continues making good progress towards the development of a new CDFI performance rating system which will be used to help manage its investment portfolio by creating a compliance "watch list" of under-performing entities.

**Measuring Investment Impact.** Continuing in FY 2005 and beyond, we will further enhance the CDFI Fund's research capacity, implementing market and portfolio analyses to measure the delivery of financial services to underserved communities<sup>[1]</sup> and to critique the financial and program performance of CDFIs. The CDFI Fund places a high priority on measuring impact and is in the forefront of improving performance reporting within the CDFI industry through its investments in CIIS.

**Interagency Cooperation.** The CDFI Fund has worked closely with the Internal Revenue Service to develop the guidance and regulations necessary to implement the NMTC Program; has conducted numerous meetings with the General Accounting Office to determine appropriate compliance and performance measurement requirements for NMTC Program allocatees; and has

organized several meetings of the newly formed Interagency Collaborative on Community and Economic Development to promote coordination among federal agencies that implement economic development programs.

**E-Gov Enhancements** During the past year, the CDFI Fund launched a new customer service tool called "myCDFIFund" to facilitate on-line electronic access to a wide variety of our services. As part of this new service, we now offer electronic versions of two of our largest program applications, including the NMTC Program. This new service permits users to access information on their awards and update contact information.

## **OVERVIEW OF PROGRAMS ADMINISTERED BY THE CDFI FUND**

The strategic goal of the CDFI Fund is to strengthen economic growth in underserved communities by encouraging an array of community development financing and financial services, particularly through a nationwide network of sustainable regulated and non-regulated CDFIs and CDEs. The CDFI Fund promotes economic revitalization and community development through investments in and assistance to CDFIs and CDEs, including enhancing the liquidity of these institutions in five key ways:

- 1) Through the NMTC Program by providing an allocation of tax credits to CDEs, which enables them to attract investment from the private sector and to invest these dollars in low-income communities;
- 2) Through the CDFI Program by directly investing in and supporting CDFIs;
- 3) Through the BEA Program by providing incentives to banks and thrifts to invest in CDFIs and the most severely economically distressed areas of their communities;
- 4) Through the Native American Initiatives, by encouraging the creation and supporting the growth of CDFIs serving Native American communities; and,
- 5) Through the CDFI Training Program by supporting the operational capacity of CDFIs to serve their markets.

**Targeting CDFI Fund Resources:** The CDFI Fund's authorizing statute allows it to provide funding for the purpose of facilitating increased lending and provision of financial and other services in economically distressed communities. In FY 2003, the CDFI Fund introduced "Hot Zones" and other programmatic priorities to the FA Component to target the CDFI Fund's resources more effectively. By prioritizing CDFI Fund awards to entities that propose to serve Hot Zones and/or meet other programmatic priorities, our dollars are invested first in areas with the greatest need. Hot Zones are a subset of Investment Areas designated through the CDFI Program as having greater economic distress and community development needs. They are the "most distressed" of the nation's economically distressed markets. Hot Zones have been identified with the help of census data.

To be designated a Hot Zone, an area must exhibit several indicators of distress including a poverty rate of at least 20 percent, income levels at or below 80 percent of the surrounding area

median income, unemployment rates that are at least 1.5 times the national average, and housing costs that exceed 30 percent of the gross monthly income of a low-income household. In FY 2004, in order to improve recognition of economic stress in rural communities, the CDFI Fund lowered the population threshold for Hot Zones, resulting in more non-metro census tracts qualifying. The CDFI Fund expects this program modification to continue in FY 2005.

The chart below shows the number and percentage of census tracts that comprise eligible Investment Areas under both the Hot Zone and other program criteria

### Targeting Resources Geographically

		CDFI Program		BEA Program	NMTC Program
	National Total	Eligible Investment Areas	Hot Zones	Eligible Distressed Communities	Eligible Low-Income Communities
Total Metro Census Tracts	52,241	20,166	13,097	1,843	19,797
Percent of National Metro Tracts	100%	39%	25%	4%	38%
Non-Metro Census Tracts	14,193	5,037	2,774	808	6,629
Percent of Non-Metro	100%	35%	20%	6%	47%
Total Tracts	66,304	25,203	15,871	2,651	26,426
Percent of National	100%	38%	24%	4%	40%
Non-Metro Counties	2,325	714	339	NA	NA
Percent of National	100%	31%	15%	NA	NA

Sources: 2000 Census data. Figures include states, the District of Columbia and Puerto Rico. This chart denotes the number of census tracts that comprise eligible Investment Areas under both the Hot Zone and other program criteria

In consultation with this Committee, in FY 2004, the CDFI Fund reintroduced population loss and out migration as Investment Area qualifiers for non-metropolitan counties. County population loss is characterized by a total population loss of least 10 percent during a ten-year period or at least 5 percent out migration during a five-year period. As a result, 256 additional counties in 37 states were identified as eligible Investment Areas.

The CDFI Fund's new data collection system, CIIS, will enable the CDFI Fund for the first time to map the precise location of each loan and investment that a CDFI or CDE makes. With this data, the CDFI Fund can compare CDFIs/CDEs delivery of financial services in distressed areas to traditional financial institutions using publicly available data.

**Certified CDFIs and CDEs.** Through the CDFI Program, the CDFI Fund certifies entities as CDFIs. CDFIs are specialized financial institutions that focus their activities on serving the financial needs of economically distressed communities and populations, often in partnership with traditional lenders. CDFIs lend in ways that are more flexible than traditional regulated financial institutions. There is at least one CDFI headquartered in each state, the District of Columbia, Puerto Rico and the U.S. Virgin Islands. As of February 1, 2004, the CDFI Fund had certified 651 financial institutions as CDFIs, up from 611 in the prior year.

Through the NMTC Program, the CDFI Fund certifies entities as Community Development Entities (CDEs). CDEs are specialized entities that serve or provide investment capital to low-income communities and people. An entity may apply to be certified as a CDE even if it does not plan to seek an NMTC allocation (such entities presumably plan to sell loans to a CDE that has received an NMTC allocation, or seek an investment or loan from a CDE that has a NMTC allocation). As of February 11, 2003, the CDFI Fund had certified 821 organizations as CDEs. As of March 1, 2004, 1362 organizations have been certified, a 64 percent increase in 12 months.

**New Markets Tax Credit (NMTC) Program Overview.** Through the NMTC Program, taxpayers are provided a credit against Federal income taxes for qualified equity investments made to acquire stock or other equity interests in designated CDEs. In turn, substantially all of the proceeds of qualified equity investments must be used by the CDE to make qualified investments in low-income communities. As investors embrace the program, a significant source of new capital is helping to stimulate new industries and entrepreneurs, diversify the local economy, and generate new jobs in low-income communities.

The tax credit provided to the investor can be claimed over a seven-year period. In each of the first three years, the investor receives a credit totaling five percent of the total value of the stock or equity interest at the time of purchase. For the final four years, the value of the credit is six percent annually.

Through the NMTC Program, the CDFI Fund is authorized to allocate a total of \$15 billion of equity investments for which tax credits can be claimed, in the years 2001-2007. The first four years' allocations were combined into two allocation rounds, with \$2.5 billion available for FY 2001 and FY 2002 and \$3.5 billion available for FY 2003 and FY 2004 (the second allocation round is currently underway).

<b>Highlights</b>	<b>2001/2002</b>	<b>2003/2004</b>
Allocation Authority	\$2.5 billion	\$3.5 billion
Applicant Requests	\$25.8 billion	\$30.1 billion
Amount Allocated	\$2.5 billion	NA
Total Applications	345	271
Total Allocatees	66	NA

**2001-2002 NMTC Allocation Summary.** The first round of NMTC Program allocatees represent a broad cross section of community development entities. There are both large and small CDEs, affiliates of nonprofits as well as for-profit entities, CDEs that focus locally as well as nationally, and CDEs that focus on both rural and urban locations. The majority of allocatees focus on providing loans or investments directly in support of business or real estate projects in low-income communities, with a lesser number making investments in other CDEs or purchasing loans from CDEs. The allocatees in the first round of the NMTC Program show a broad geographical mix and focus for investment activity. The primary service areas of the 2001-2002 allocatees (and the national market allocatees who were required to list seven states they intend to serve) encompass 40 states and the District of Columbia.

**2003-2004 Application Summary.** The second round of the NMTC Program is currently underway, with \$3.5 billion in NMTCs available. Here are some preliminary data on the pool of applicants for this current allocation round:

- 38 percent of the applications were submitted by non-profit organizations or by entities that are subsidiaries of non-profit organizations.
- 19 percent of the applications were submitted by banks, thrifts or bank holding companies, or subsidiaries of such institutions.
- 15 percent of the applications were submitted by CDFIs or by entities that are subsidiaries of CDFIs.
- Eight percent of the applications were submitted by publicly traded companies or by subsidiaries of publicly traded companies.
- Six percent of the applications were submitted by government-controlled entities, or by subsidiaries of governmentally controlled entities.
- Three applications were submitted by faith-based institutions or subsidiaries of faith-based institutions.

**NMTC Program Compliance and Performance Evaluations.** The General Accounting Office (GAO) recently completed its first audit of the NMTC Program, and noted the significant progress that the CDFI Fund has made in implementation. The GAO audit report included only one recommendation for action, that the Secretary of the Treasury direct the CDFI Fund and the IRS to develop plans, including milestones, for designing and implementing compliance monitoring processes for the NMTC Program.

Response to the recommendation is already underway. The CDFI Fund is committed to developing, with the IRS, an allocation tracking and compliance system for the NMTC Program that will ensure that each entity that receives a NMTC allocation will continue to fulfill its CDE certification requirements and the terms of its allocation agreements with the CDFI Fund, and that the IRS has appropriate information to determine that allocatees are operating within the legislation and regulations promulgated by the IRS.

Portions of this system are already in place, including a web-based tool that allocatees use to report their investor activity to the Fund and to the IRS. Information in this system shows that as of March 8, 2004, 29 allocatees reported that they have issued Qualified Equity Investments (QEIs) for a total of \$473 million from investors. CIIS, which will be operational in June 2004, will be used to collect the vast majority of allocatee compliance information. Other elements of our monitoring and compliance system are still under development, but will be fully operational well in advance of the date by which most allocatees will begin reporting their actual investment data following the conclusion of their 2004 fiscal years.

In FY 2005, the CDFI Fund will engage an independent contractor to conduct an evaluation of the NMTC Program. This multi-year evaluation will rely on CIIS data as well as other data sources.

**CDFI Program Overview.** Through the CDFI Program, the CDFI Fund promotes access to capital and local economic growth in economically distressed communities by directly investing in CDFIs through FA awards (in the form of grants, loans, equity investments, and deposits) and TA grants. Since its inception, the CDFI Fund has made almost 1,000 CDFI Program awards totaling \$434 million.

We believe that the carryover of \$21.9 million in CDFI Program funds from FY 2003 is a one-time occurrence that was a result of CDFIs needing time to adjust to major program changes and to adapt to the new electronic application system.

Earlier this year, the Fund sponsored a series of targeted teleconferences with respect to its Technical Assistance and Native American funding programs. This month the Fund hosted in-person outreach sessions in three geographic locations across the country to review the Financial Assistance Component FY 2004 funding round in detail and demonstrate the electronic application. This afternoon the Fund is hosting a videoconference on the Financial Assistance Component that will be broadcast to over 70 locations around the country.

**The Financial Assistance (FA) Component.** The FY 2004 funding round of the FA Component of the CDI program currently is underway and implements significant policy and programmatic changes. In FY 2003, we introduced Hot Zones and articulated clear programmatic priorities to define how the Administration would prioritize investments to promote homeownership, economic revitalization and community development. Affordable housing, together with economic and community development activities in Hot Zones, remain the highest priority for funding in FY 2004; however, the CDFI Fund has categorized programmatic priority preferences for an entire series of other activities in underserved markets. These changes are responsive to public comments received in FY 2003.

By the introduction of the FY 2003 and FY 2004 policy and programmatic changes, the CDFI Fund intends to ensure that CDFIs have the requisite financial strength to deploy CDFI awards effectively, including satisfactory management of existing assets and loan portfolios. We also have launched CIMS (Community Investment Mapping System), an upgraded on-line mapping system that enables awardees to determine program eligibility for their proposed community development activities under our various programs and to create maps to accompany their applications.

Further, in consultation with Congress, the Fund has re-introduced a Small and Emerging CDFI Assistance (SECA) program. The Fund will accomplish this in the FY 2004 funding round of the FA Component of the CDFI Program by providing an additional applicant category expressly for SECA applicants.. SECA applications will be evaluated using more flexible review standards than those used when evaluating applicants that are more mature or that have greater assets. The CDFI Fund expects that this approach will result in increased funding of small and emerging CDFIs.

**The Technical Assistance (TA) Component** is currently available through a two-year funding round that will end in May, 2004. The program allows applicants to apply for TA grants on a rolling first-in, first-reviewed basis. The purpose of the TA Component is to allow CDFIs to access needed TA to help them enhance their capacity to serve their target markets through expanded technology, training and non-recurring capacity building expenditures. TA funds are currently available to both new CDFIs looking to establish their operations, and to existing CDFIs having the need to make operational enhancements to serve existing markets better, to provide new products and services, or to serve additional markets.

During FY 2003, the CDFI Fund made ten TA awards totaling \$418,000. The demand for this program in the latter part of FY 2003 was not as great as we expected. However, as of February 28, 2004, the CDFI Fund has received 48 TA applications requesting \$2.5 million.

The CDFI Fund believes that the soft demand for TA funds we experienced in FY 2003 was due in part to the lack of urgency of behalf of CDFIs to apply. The CDFI Fund will be entering into an agreement with the National Academy of Public Administrators during the current fiscal year to conduct an independent programmatic evaluation of the TA Component, including the value that TA awards have had in building the capacity of CDFIs, and the effectiveness of the CDFI Fund's TA delivery strategy. We will use the results of this evaluation to determine the future direction and structure of our TA initiatives for FY 2005 and beyond.

**CDFI Training Program.** The CDFI Training Program carries out the CDFI Fund's statutory authority to strengthen the organizational capacity and expertise of CDFIs and other financial service organizations. The CDFI Training Program, which was started in FY 1999, provides funds that support the development and delivery of training products to CDFIs and other entities engaged in community development finance. Training is addressed via classroom instruction, web-based distance learning, and other electronic formats. The CDFI Fund, through contractors, offers several types of training at present. One, due to expire shortly, is targeted to building the management capacity of staff and board members of CDFIs. The other, discussed below, is targeted to persons interested in forming CDFIs to serve Native American communities.

**Native American Initiatives.** The United States has the best banking and financial market system in the world. Yet far too many people live in poverty and hopelessness.

In areas with such severe economic distress, community development finance is needed more than ever to create jobs, build wealth, and provide access to financial services. The nation-wide network of over 1,800 certified CDFIs and CDEs are bound by their common mission to do just that - to fill the financial service and credit gaps in economically distressed communities.

The CDFI Fund's Native American Initiatives, described in an addendum to the CDFI Fund's FY 2003 - FY 2008 Strategic Plan, provides a roadmap to increase access to credit, capital, and financial services. The Native American Initiatives were developed from the findings of the CDFI Fund's Native American Lending Study (the Lending Study), which confirmed the inadequacy of capital investment and identified 17 major barriers to capital access.

Through its Native American Initiatives, the CDFI Fund proposes to:

- Improve economic conditions by encouraging greater availability of capital and financial services, including increased financing to enterprises and individuals desiring to start businesses on Indian reservations;
- Increase homeownership opportunities and expand the supply and quality of housing units on Indian Lands; and
- Expand access to and utilization of financial services.

The CDFI Fund will seek to accomplish these goals by encouraging the creation and growth of CDFIs that primarily serve these communities through targeted programs providing FA and TA awards and will facilitate the provision of training to people and organizations in these communities seeking to establish CDFIs.

Since FY 2003, the Fund has implemented several aspects of the Native American Initiatives. As of mid-FY 2004, the Fund is operating three funding programs, one training program, and is in the process of releasing several contracts to provide training and technical assistance.

**Bank Enterprise Award (BEA) Program Overview.** The Administration supports continuation of the BEA Program. The BEA Program provides the CDFI Fund with an important tool to engage traditional banks and thrifts in improving the economic conditions of

underserved areas through insured depository institutions both as direct lenders and as partners with CDFIs.

The BEA Program provides monetary incentives for banks and thrifts to expand investments in CDFIs and/or to increase lending, investment and service activities in economically distressed communities. BEA Program awards have varied in size from less than \$1,000 to almost \$3 million, depending upon the type and amount of assistance provided by the bank and the activities being funded through the bank's investments. In general, banks that provide equity investments to CDFIs are likely to receive the largest awards relative to the size of their investments.

In FY 2003, the CDFI Fund revised the BEA Program to achieve its strategic objectives more effectively. Specifically, the revisions increase the likelihood of awards for carrying out financing activities in economically distressed communities by substantially modifying the formula and eligibility for awards in the CDFI Related category, and they encourage personal and community wealth building activities in economically distressed areas.

In FY 2003, the CDFI Fund selected 75 FDIC-insured institutions to receive \$13.9 million through the BEA Program. In FY 2003, for the first time since FY 2000, the bulk of awards were provided to financial institutions for increased lending and financial services activities in economically distressed communities. Eighty-two percent of award dollars fell within this category. In FY 2002, only 14 percent of BEA Program award dollars were awarded for increased activities in the Financing and Services categories.

The FY 2004 BEA Program funding round is currently underway. The CDFI Fund will be announcing the BEA Program awards for the FY 2004 round shortly.

I thank you for the opportunity to present my testimony in support of the President's FY 2005 budget request and look forward to answering any questions you may have.

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<sup>[1]</sup> "Underserved communities" include communities that qualify as Target Markets under the CDFI Program (which include a specific geography called an Investment Area, or a specific community of people with demonstrated lack of access to credit, equity or financial services, called a Targeted Population) as well as Hot Zones, the most economically distressed subset of Investment Areas; Low-Income Communities under the NMTC Program; and Distressed Communities under the BEA Program. Many Native American Communities also qualify as underserved communities. "Native American Communities" are defined as any Native American, Alaska Native or Native Hawaiian populations, lands or Census-equivalent entities, with the exception of State or Tribal Designated Statistical Areas.