



# A New Agenda for Community Development Finance

## Seven Big Ideas to Expand Access to Capital, Lessen Racial Disparities, and Tackle Persistent Poverty

*Brett Theodos, Tim Ferguson, Robin Hacke, Lisa Mensah, Brady Meixell*

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Disparate health and economic effects from the COVID-19 pandemic have combined with recent police killings of and violence toward Black Americans to again expose the deep and unsettling racial inequities in the US. Residential segregation and decades-long gaps caused by government policy, private action, and market amplification mean that these inequities also manifest in communities. Some neighborhoods have access to health facilities, grocery stores, parks, quality housing, jobs, transit, and a clean environment; others do not. There are communities in this country of persistent poverty; there are communities of persistent wealth. Although much work remains within criminal justice, health, education, and macroeconomic policy, the field of community development finance also has an important role to play. And increasingly, the field recognizes that racial equity and justice must be centered more explicitly (Andrews 2019).

In this brief, we identify seven big ideas to address these concerns that together constitute our “New Agenda for Community Development Finance.” These are (1) an expansion of the Community Reinvestment Act to cover insurance companies, pension funds, investment firms, and other financial institutions; (2) a new federal corporate standard to promote investment in local communities; (3) time-limited disbursement requirements for donor-advised funds (DAFs); (4) revisions to the Employee Retirement Income Security Act (ERISA) to encompass social as well as financial outcomes; and three new federal expenditure proposals: (5) the creation of a Local Equity Tax Credit, (6) the quadrupling of CDFI Fund grant awards, and (7) substantial revisions to the Opportunity Zone incentive. This brief

builds upon “Building the Double Bottom Line: How a New Corporate Compact Could Birth a Community Development Renaissance” (Theodos et al. 2020) from the Urban Institute’s Opportunity for All project.

Change is indeed possible because the United States is a country of great wealth. As of mid-2019, its residents held an estimated 29 percent of all global wealth (Credit Suisse 2019). But the distribution of that wealth is shaped by jagged disparities. The wealthiest 1 percent of families account for roughly 40 percent of national wealth (Leiserson, McGrew, and Kopparam 2019). In 2016, the median Black family held a net worth of \$17,600, the median Hispanic or Latinx family a net worth of \$20,700, and the median white family a net worth of \$171,000.<sup>1</sup> Black Americans own only 2 percent of US businesses and Hispanic Americans own only 6 percent, and the revenue shares are even worse, with Black-owned businesses constituting less than 1 percent of total US revenues and Hispanic-owned businesses constituting 1 percent (Theodos and Gonzalez 2019). Income inequality has steadily grown since the 1970s, matching levels unseen in nearly a century (Stone et al. 2020). Moreover, these inequalities persist intergenerationally: the likelihood that children born in the bottom quintile of the income distribution will rise to the top quintile in their lifetime is 7.5 percent (Chetty et al. 2018).

National inequalities by race and income (which are themselves often entangled) also manifest at the city and neighborhood levels. Between 2010 and 2016, the 53 largest metropolitan areas in the US were responsible for two-thirds of the country’s economic growth and 74 percent of new jobs.<sup>2</sup> Many smaller and rural areas are falling behind economically. Disparities exist at the neighborhood level as well. Of the neighborhoods in the lowest quintile of median income in 2000, over 75 percent remained in that position by 2010 (Sampson 2016); the same was true for those in the highest quintile. Recent years have only exacerbated these trends. Between 1990 and 2010, income inequality across neighborhoods increased in over 75 percent of regions (Pendall and Hedman 2015). City-level studies reveal glaring disparities in neighborhood access to capital by racial composition. In Chicago, the typical majority-white neighborhood received over 4.5 times the level of private investment per household as the typical majority-Black neighborhood (Theodos et al. 2019). In Baltimore, neighborhoods less than 50 percent Black received nearly four times the per household investment as neighborhoods more than 85 percent Black.<sup>3</sup>

Community development finance looks to mitigate these local and regional voids, directing investment into disinvested communities and financing community priorities. Community development finance has seen watershed moments in recent decades at the federal level. Noteworthy examples include the following:

- In 1977, the Community Reinvestment Act (CRA) was enacted, explicitly requiring private banks to expand access to credit, particularly in low- and moderate-income neighborhoods.
- The Tax Reform Act of 1986 created low-income housing tax credits, which now finance roughly 110,000 new housing units a year (Sally et al. 2018).
- In 1994, the Riegle Community Development and Regulatory Improvement Act began the Department of the Treasury’s Community Development Financial Institutions (CDFI) Fund,

which has since awarded over \$3.3 billion to CDFIs and other community development organizations.<sup>4</sup>

- In 2000, the Community Renewal Tax Relief Act created the New Markets Tax Credit, which has received an estimated \$27 billion in estimated tax expenditure commitments through 2019 and \$100 billion in total project investments through 2016 (Theodos and Edmonds, forthcoming).

Many other programs and regulations over the years, beyond those listed here, have also supported community development.

Community development finance aims to fill the void left by mainstream lenders, providing affordable nonpredatory capital and financial services to underserved people, businesses, and neighborhoods. Through a combination of market-rate and subsidized funding, community development finance provides funds to new and growing small businesses, affordable housing, community facilities, and other essential goods and services necessary for equal opportunity and better quality of life. In the past 60 years, community development finance has grown by leaps and bounds. Important community development finance actors include community development corporations, CDFIs, development finance authorities, and local banks. These actors have grown to significant sophistication and size. For example, in 2019, CDFIs financed \$25 billion in small business and microlending, \$56 billion toward housing, \$59 billion in consumer loans, \$24 billion toward commercial real estate, and \$4 billion toward community facilities.<sup>5</sup> Community development corporations produced an average of 96,000 units of affordable housing and 75,000 jobs a year (NACEDA 2010; NCCED 2006).

Although existing efforts clearly have some impact, much more work remains to create a truly equitable system of neighborhood capital and essential goods and services. Relative to mainstream finance, community development finance remains small.<sup>6</sup> The community development sector has developed an alphabet soup of approaches, yet the broth is too weak. Many varied resources have been dedicated to these efforts, but they do not approach the magnitude of the problem. Moreover, federal policy often prioritizes investor needs over community priorities. And too rarely has community development finance actually sought to grow community power or prioritize resident participation. In the worst instances, such an approach merely shifts the geography of poverty rather than tackling the wealth gaps, especially racial wealth gaps. Current events have laid bare the need for systemic change in our community development system.

This brief sets a new federal agenda for supporting community development finance. We organize our recommendations into two parts. The first, changing the rules for corporations and finance, is about establishing a new corporate contract with communities. The second, renewing federal responsibility, is about updating and expanding the role of the federal government in supporting all communities.

# Changing the Rules for Corporations and Finance

Prosperity could be shared more equitably by all residents and neighborhoods across the United States if corporations acknowledge, given the benefits they receive, their broader obligations to society. Policymakers can incentivize or require this. Considering the scale of community development needs, government spending is not enough. Much as the CRA required that commercial banks deploy capital into low-income and formerly redlined communities where they take deposits, new federal requirements can ensure other private institutions fulfill a broader community obligation. By undertaking four meaningful federal changes to the rules governing corporations and financial institutions, the federal government could lay the groundwork for a resurgence of community wealth building and growth.

In August 2019, 181 of the nation's foremost business executives met as the Business Roundtable and laid out a radical new vision for how corporations should operate. The statement they released declared a corporation's responsibility should no longer be toward its shareholders alone. Instead, they called for a broader set of commitments to shareholders, customers, employees, suppliers, and the communities in which those businesses operate.<sup>7</sup> In line with these principles, it is time for a new set of rules around corporate local responsibility. Such rules would harken back to an era when employers understood that their fate is intertwined with that of their community and their employees.

We suggest four significant components. They are an expansion of the CRA, the "Community Pillar Responsibility," new rules for DAFs, and modifications to ERISA.

First, **the CRA should be significantly expanded to apply to insurance companies, pension funds, investment firms, and other depository and financial institutions** beyond the current set of banks to which it applies. As currently structured, the CRA requires banks to "serve the convenience and needs of the communities in which they are chartered to do business."<sup>8</sup> Recent decades have seen a significant shift of lending activity and investment to nonbank financial institutions. As a result, extending the CRA to cover these institutions would further the original intent of the legislation to mitigate disparities in access to credit and financial services. Networks such as the California Organized Investment Network create precedent for nonbank institutions participating in community reinvestment. Moreover, with disparities in neighborhood environmental conditions and access to climate change preparedness, an expanded version of CRA should make climate adaptation or mitigation within a low- or moderate-income community a qualifying activity.

Second, we propose that **all large businesses be held to a new federal standard known as the "Community Pillar Responsibility."** This would require that large businesses (i.e., excluding small businesses as defined by the Small Business Administration) would have a standing annual obligation to deploy at least 1 percent of company profits toward bettering their local employment footprint. The local footprint would be defined as the 10 census tracts where the largest share of the business's lowest-paid workers or contractors live (those with full-time equivalent earnings in the bottom 10 percent of the company's payroll). The local footprint could be expanded on a step-up basis for companies with larger levels of employment to encompass greater geographic reach (e.g., for a

company with 5,000 employees, the number of census tracts could be 50; for a company with 50,000 employees, the number of census tracts could be 500). Rural areas could be eligible for somewhat larger catchment areas than urban ones, reflecting spatial differences in employment patterns. The deployment standard could be met through grants or qualifying investments in affordable housing, food access, health facilities, small businesses owned by community residents, scholarships for students from low- or moderate-income families, environmental improvements, public parks, or other community amenities. Investments could be made directly or through mission-driven organizations such as CDFIs, community development corporations, nonprofit affordable housing developers, or other such entities. Investments could also take the form of philanthropic support of nonprofit community-serving organizations or the use or donation of land to serve the community.

Third, DAFs should be subject to annual disbursement requirements unless they are 100 percent invested in mission-oriented investments including social benefit funds, or social enterprises or projects. DAFs are giving vehicles that allow donors to contribute assets to an account; the donor is eligible for immediate tax deductions while funds can be disbursed to charity at a later point. DAFs have grown tremendously in recent years: their share of the charitable giving market increased from 4.4 percent in 2010 to 12.7 percent in 2018. In 2018, DAFs held \$121 billion in assets (National Philanthropic Trust 2019). Taxpayers can claim tax benefits from charitable deductions immediately after giving to a DAF, but these funds can sit in the DAF in perpetuity. Given the scale of the problems we currently face, we believe charitable giving has a significant role to play. And although impact investing has grown in recent years, its market in the US remains small. For these reasons and to better align tax benefits with charitable benefits, 10 percent of DAF assets should be required to be disbursed on an annual basis unless 100 percent of assets are placed in mission-oriented investments. Further, DAFs are not the only part of the charitable sector that should be held to a higher standard. Payout requirements for private foundations should be strengthened by raising the minimum payout requirement from 5 to 6 percent and narrowing what expenses count toward that threshold.

Finally, we propose that the federal government alter **ERISA** such that (1) broader environmental, community health, and social outcomes rather than just financial outcomes must be considered when making investment choices and (2) the recent investment advice rule is reversed. ERISA requires fiduciaries of private retirement and health accounts to act in the best interests of their client. This definition of fiduciary responsibility should be expanded to include broader community benefit. Under this revision, fiduciaries would have the responsibility of considering net societal benefit in their actions so long as the client's financial interests were still met to a reasonable degree. Such an approach would be in line with a broader understanding of a stakeholder's best interests and it would reflect a growing acceptance and embrace of impact investing (Enclude 2019). The disparate impact of the COVID-19 pandemic on communities of color makes clear that matters of broader societal benefit, such as public health, are also matters of self-interest. The same is true of efforts to combat climate change, the effects of which will be borne disproportionately by low-income communities (Fahey, Wuebbles, and Hayhoe 2018). Such an approach does not have to harm profits. In fact, business strategies that include social and environmental benefit have been found to generate higher operational performance (Viehs and Clark 2014). Alexis de Tocqueville (1838) offers a useful standard: the federal government can work to encourage investors toward "enlightened self-interest," properly understood.

# Renewing Federal Responsibility

Although the changes proposed in the previous section can harness significant private-sector resources to open up access to capital, the US also needs renewed and expanded federal investments to address persistent poverty and racial inequity in accessing opportunity and capital. The federal government needs to work proactively and robustly to overcome structural racism and help communities build the infrastructure, wealth, and opportunity needed to thrive. The multi-trillion-dollar federal response to the COVID-19 pandemic demonstrates that we are capable of making enormous investments in the wake of an acute crisis. But the federal government needs to make sustained, sizable investments in the wake of chronic, generations-long crises as well. This can be achieved through new and revised federal approaches through which federal dollars can substantially leverage the private market to create structural change in community development and ownership.

The first step in fostering community development and neighborhood revitalization should be promoting new models of community ownership. Residents typically have little financial stake in their neighborhood's apartments, businesses, and commercial developments. New and emerging platforms are being built to support the kinds of small-dollar investments that residents can make and thus build financial equity in their communities (Theodos and Edmonds, forthcoming). These investments may take the form of neighborhood real estate investment trusts, cooperative businesses, community equity investment tools, or other shared-ownership approaches. To this end, we propose the creation of the **local equity tax credit**. This refundable tax credit would subsidize residents who make equity investments of up to \$1,000 in commercial real estate, multifamily buildings, and businesses located in their census tract or an adjacent one.

An efficient and underappreciated existing tool for expanding capital access to disinvested communities is the CDFI Fund. The CDFI Fund administers a series of grant programs that provide equity capital to CDFIs at the enterprise level rather than directing financing to a specific project. This flexibility allows CDFIs to be nimble in addressing the financing needs facing their communities. Today, the CDFI industry has grown to \$222 billion in total assets under management, but its potential is much greater. Therefore, we recommend that the budget for **CDFI Fund grant programs** be expanded at least four-fold, to \$1 billion annually. CDFI Fund grants enable the recipients to leverage debt from private-sector sources to direct financing toward areas of deepest need and persistent poverty, but its programs have always been underresourced. With a more serious federal investment and the private funds that investment will leverage, CDFI financing will launch new businesses, build affordable homes, and help community residents build wealth.

Our final recommendation is an overhaul of **Opportunity Zones**, the federal government's most recent attempt to encourage private investment in disinvested communities. This incentive has proven inadequate in supporting community benefit (Theodos 2019; Theodos et al. 2018, 2020). Under their current structure, Opportunity Zones deliver tax benefits to projects based on their size and profitability rather than their community impact, do not promote ownership from within communities, and are largely a tool for real estate development. To generate effective mission-oriented investment

at scale, policymakers must (1) redesign the incentive to better support investments in small businesses; (2) size the incentive based on the size of the impact; (3) broaden who can invest; (4) support mission-driven funds that are accountable to the community in particular via CDFIs; (5) remove high-income, high-home-value, and highly invested zones; and (6) include transaction-level publicly reported data (Theodos et al. 2020).

## A New Paradigm

Some may criticize the ideas advanced here, but we would point out that the current set of community development policies have failed to truly change our system of access to capital and have left far too many of our communities and their residents devoid of opportunity.

Corporate compacts have yielded results in previous eras. And the federal government has made transformative investments. Rural America was electrified. The Pure Food and Drug Act of 1906 was put into place with the ethos that private companies had a responsibility to consumers to provide full information on the products they were purchasing and putting into their bodies.<sup>9</sup> The Federal Labor Standards Act of 1938 was made law under the belief that private employers had a responsibility to employees to uphold a “minimum standard of living necessary for health, efficiency, and general well-being.”<sup>10</sup> And as mentioned, the CRA was enacted to reverse the harms of redlining. Under each, we emerged a safer, stronger, more connected, and fairer society.

It is time for the federal government to establish into law and fund the steps and programs needed build opportunity in all communities. To meet the totality of the often racially driven problem of neighborhood disinvestment requires comprehensive solutions that leverage the power of multiple sources and sectors: the federal government; the corporate including insurance companies, pension funds, investment firms, depository and other financial institutions; and high-net-worth individuals with resources in DAFs and philanthropy. It is under this new paradigm and compact that the private sector, our federal government, and our local communities can be joined together in common cause.

## Conclusion

The challenges faced by our country are significant, so necessarily the remedies will not be small or easy; they will require robust action. As we look to both restart our economy and grapple with the systemic racism that permeates the US, we will be faced with defining choices. We could build our recovery out of old and underresourced approaches, or we could forge a new commitment to community and economic development and recapitalize communities for all.

## Notes

<sup>1</sup> Lisa J. Dettling, Joanne W. Hsu, Lindsay Jacobs, Kevin B. Moore, and Jeffrey P. Thompson, with Elizabeth Llanes, “Recent Trends in Wealth-Holding by Race and Ethnicity: Evidence from the Survey of Consumer Finances,”

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- <sup>2</sup> Mark Muro and Jacob Whiton, “Geographic Gaps Are Widening while U.S. Economic Growth Increases” *The Avenue* (Brookings Institution blog), January 23, 2018, <https://www.brookings.edu/blog/the-avenue/2018/01/22/uneven-growth/>.
- <sup>3</sup> Brett Theodos, Eric Hangen, Brady Meixell, and Lionel Foster, “‘The Black Butterfly’: Racial Segregation and Investment Patterns in Baltimore,” Urban Institute, February 5, 2019, <https://apps.urban.org/features/baltimore-investment-flows/>.
- <sup>4</sup> “CDFI Fund Awards \$25 Million to Banks That Increased Investments in Severely Distressed Communities,” news release, CDFI Fund, September 17, 2019, <https://www.cdfifund.gov/news-events/Pages/news-detail.aspx?NewsID=355>.
- <sup>5</sup> CDFI Fund Annual Certification Reporting Database.
- <sup>6</sup> For city-specific examples of the magnitude difference between community development finance and mainstream finance, see Brett Theodos, Eric Hangen, Brady Meixell, and Lionel Foster, “‘The Black Butterfly’: Racial Segregation and Investment Patterns in Baltimore,” Urban Institute, February 5, 2019, <https://apps.urban.org/features/baltimore-investment-flows/>. See also Theodos et al. (2017) and Theodos et al. (2019).
- <sup>7</sup> “Statement on the Purpose of a Corporation,” Business Roundtable, accessed September 23, 2020, <https://opportunity.businessroundtable.org/ourcommitment/>.
- <sup>8</sup> “Community Reinvestment,” 12 USC § 2901 (1977).
- <sup>9</sup> “Part I: The 1906 Food and Drugs Act and Its Enforcement,” US Food and Drug Administration, last updated April 24, 2019, <https://www.fda.gov/about-fda/fdas-evolving-regulatory-powers/part-i-1906-food-and-drugs-act-and-its-enforcement>.
- <sup>10</sup> The Fair Labor Standards Act of 1938, Pub. L. No. 1318, 29 U.S.C. 201, et seq. (2011), <https://www.dol.gov/sites/dolgov/files/WHD/legacy/files/FairLaborStandAct.pdf>.

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## About the Authors

**Brett Theodos** is a senior fellow in the Metropolitan Housing and Communities Policy Center at the Urban Institute, where he directs the Community Economic Development Hub.

**Tim Ferguson** is the founder and chairman of Next Street.

**Robin Hacke** is executive director and cofounder of the Center for Community Investment.

**Brady Meixell** is a research analyst in the Metropolitan Housing and Communities Policy Center. His work focuses on community and economic development, racial and economic disparities, and place based interventions to address poverty and related issues.

**Lisa Mensah** is the president and CEO of Opportunity Finance Network.

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Washington, DC 20024

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