

PUBLISHED BY THE  
COMMUNITY DEVELOPMENT  
STUDIES & EDUCATION  
DEPARTMENT OF THE  
FEDERAL RESERVE BANK  
OF PHILADELPHIA

# CASCADE

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## CDFIs: What's in a Name?\*

By Mark Pinsky, President and CEO, Opportunity Finance Network

The Community Development Financial Institutions (CDFI) Fund in the U.S. Department of the Treasury has certified more than 1,000 organizations as CDFIs in accordance with the Riegle-Neal Interstate Banking and Branching Act of 1994.<sup>1</sup> This year, the CDFI Fund will determine which of these CDFIs it will recertify. Although this work is extremely timely, it is also time-consuming.

CDFIs are increasingly important to credit markets and lenders, fiscal policymakers,

state and municipal officials, and, most important, the low-income and low-wealth people and communities that CDFIs serve. This rise in responsibilities is a product of:

- Strong CDFI performance through the Great Recession when CDFI lending stayed strong and portfolios performed well;<sup>2</sup>
- The increasing challenges that banks face in extending credit in uncertain conditions, leaving significant credit market gaps;

...continued on page 14

\* The views expressed here are those of the author and do not necessarily represent the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.

<sup>1</sup> Public Law 103-325 (12 U.S.C. Chapter 47).

<sup>2</sup> In a quarterly survey of CDFIs conducted between the third quarter of 2008 to the present, the respondents' annual net loan charge-offs remained below 3 percent despite consistently strong reports of increasing loan volume quarter over quarter. More than 100 CDFIs responded to the survey each quarter. Source: Opportunity Finance Network's CDFI Market Conditions Report, Fourth Quarter 2012.



Villard Square Grandfamily Apartments, a 47-unit affordable housing complex for grandparents who are raising their grandchildren in Milwaukee, WI, was developed by Northwest Side Community Development Corporation in Milwaukee with a \$1.3 million construction loan from the Illinois Facilities Fund, a Chicago CDFI that had previously received a Wells Fargo NEXT Award for geographic expansion outside Illinois. The complex includes a public library branch.



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Cascade is published three times a year by the Federal Reserve Bank of Philadelphia's Community Development Studies and Education Department and is available at [www.philadelphiafed.org](http://www.philadelphiafed.org). Material may be reprinted or abstracted provided Cascade is credited. The views expressed in Cascade are not necessarily those of the Federal Reserve Bank of Philadelphia or the Federal Reserve System. Send comments to Keith L. Rolland at 215-574-6569 or [keith.rolland@phil.frb.org](mailto:keith.rolland@phil.frb.org). To subscribe, go to <http://www.philadelphiafed.org/publications/>.

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## Message from the Community Affairs Officer

As community needs and financial markets have become more complex over the decades, the community development financial institution (CDFI) industry has evolved, becoming more sophisticated in its methods, tools, and approaches. Across the nation, many CDFIs are helping to meet the capital needs of low-income communities, partnering with the financial sector in new ways and bringing innovative solutions to old problems. This issue of *Cascade* highlights some of the issues impacting CDFIs, as well as the products and programs they and their funding sources have implemented.

In response to community needs, many CDFIs have moved beyond traditional program areas and financial tools. However, the need to remain focused on the needs of low-income communities is still critical. Mark Pinsky of the Opportunity Finance Network (OFN) provides his perspective on the CDFI recertification underway by the CDFI Fund. Donald Hinkle-Brown discusses The Reinvestment Fund's role as an intermediary of capital and market data in developing healthful foods supermarkets in low-income Baltimore neighborhoods.

Identifying new sources of capital and knowledge is critical in today's financial environment. Goldman Sachs has expanded its small businesses initiative into Pennsylvania by providing loan capital and an educational curriculum for business owners.

Pamela DeGraff Porter of OFN explains how building capacity in lending and business models has enabled CDFIs to innovate and move successfully into new financing areas.



**Theresa Y. Singleton, Ph.D.,**  
Vice President and Community Affairs Officer

We are always excited to share data and information that provide insight into low- and moderate-income communities in the Third Federal Reserve District. In this issue, we introduce a new *Cascade* feature, "Mapping Our Community." Compiled by Keith Wardrip, community development research manager, it shows the location of 35 CDFIs that existed in the Third Federal Reserve District as of April 2013.

Marty Smith reports on a research study that examines the effects of CDFI Fund financial and technical assistance grants on credit union lending.

These articles demonstrate the many ways in which CDFIs can be a dynamic community development resource, providing not only financing but also transformational ideas.

We'll continue to report on the important CDFI industry in future issues.

A handwritten signature in black ink that reads "Theresa Y. Singleton". The signature is written in a cursive, flowing style.

# CDFIs: Intermediaries for Financing to Low-Income Communities\*

By Donald Hinkle-Brown, CEO, The Reinvestment Fund



Michele Speaks-March and Erich March obtained financing from The Reinvestment Fund to convert a vacant building into the Apples and Oranges Fresh Market, which provides fresh food options in a low-income Baltimore neighborhood.

In communities across America, community development financial institutions (CDFIs) successfully connect the “last mile” of the financial credit chain. Just as local cell phone towers across the country connect cellular networks to local users, CDFIs connect larger and remote sources of capital to local communities. CDFIs act as intermediaries of capital to advance their missions, proving that responsible investing can build incomes, assets, and wealth in low-income communities. Increasingly, CDFIs also intermediate market data and other information necessary for successful investments in the unique places they are founded to serve.

Analyzing market data and providing capital are approaches that have been successful. According to

a 2012 Carsey Institute report, CDFIs have been effective in lending to and investing in communities not served by the conventional financial sector. They accomplish this, the study suggests, while maintaining loan performance standards generally equivalent to those of conventional financial institutions.<sup>1</sup> At The Reinvestment Fund (TRF), like so many of the organization’s peers, this track record of success is reliant on a deep understanding of the block-by-block circumstances in underinvested neighborhoods. This contextual knowledge of local markets is a tool that CDFIs use to lower risk and target scarce investment dollars. Sources of capital that lack this market knowledge are more susceptible to using broad strokes to survey markets, which can ham-

per development in overlooked neighborhoods, or connect them with projects that lack authentic local support.

A case in point is TRF’s efforts in Baltimore, where the organization recently helped finance a supermarket in the Howard Park neighborhood. The community had been without a supermarket for over a decade, and local leaders, elected officials, and the Baltimore Development Corporation had been working to restore access. TRF’s data analysis revealed that the neighborhood is located in a USDA-designated food desert<sup>2</sup> and a TRF limited supermarket access (LSA) area.<sup>3</sup> According to the 2011 LSA analysis, there is \$64.8 million in grocery demand in the Howard Park neighborhood.

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<sup>1</sup> *CDFI Industry Analysis Summary Report*, Carsey Institute, Spring 2012, available at <http://carseyinstitute.unh.edu/publications/Report-Swack-CDFI-Industry-Analysis.pdf>.

<sup>2</sup> The U.S. Department of Agriculture conducted a study to assess the extent of areas with limited access to affordable and nutritious food. These areas are sometimes called “food deserts.” See *Access to Affordable and Nutritious Food: Measuring and Understanding Food Deserts and Their Consequences*, available at [www.ers.usda.gov/media/242675/ap036\\_1\\_.pdf](http://www.ers.usda.gov/media/242675/ap036_1_.pdf).

Working with the community organizing network Baltimoreans United in Leadership Development, TRF successfully applied for Healthy Food Financing Initiative funds for the supermarket project from the U.S. Department of Health and Human Services. The funds supported predevelopment costs and helped kick-start the development, which finally broke ground this past spring. TRF is also providing new markets tax credit financing to support the store's construction. The new Shop-Rite supermarket is expected to provide much needed fresh foods and create 250 full-time and part-time jobs, many of which will be filled by neighborhood residents. In addition to TRF's own community partnerships, local support and the store's commitment to hiring from the surrounding neighborhoods served as critical elements to solidifying the project as a viable opportunity. The combination of information, capital, and community partnerships is a critical component in helping TRF mitigate risk.

Another element that has contributed to the growth and success of the CDFI industry is consolidation within the traditional banking sector. In 1980, the 10 largest banking organizations held only 13.5 percent of the banking assets.<sup>4</sup> In 2000, that number had risen to 36 percent, only to rise again to roughly 50 percent of banking assets in 2010. During that span, the retail banking experience has become more automated and less based on familiar relationships between the bank officer and the borrower, as well as between

the bank and the neighborhood. As a result, bank staff who are tasked with investing in low-income communities have less first-hand experience in these markets, as they are required to cover wider geographies and sometimes multiple metropolitan regions.

TRF's financing of Apples and Oranges Fresh Market (A&O Market) in East Baltimore through the Baltimore Integration Partnership (BIP) is a recent example of a transaction that traditional banks passed over. TRF is the financial intermediary for BIP, which is supported by Living Cities, a philanthropic collaborative of 22 foundations and financial institutions that works to improve conditions in urban areas and increase opportunities for low-income individuals. As part of its role in BIP, TRF provides financing to transform community investment in three underinvested target Baltimore neighborhoods.

A&O Market was being developed by a local minority entrepreneur couple, Erich March and his wife, Michele Speaks-March. The couple had several successful businesses. In addition, they have been part of the local community for generations. They wanted to repurpose space in a building that had stood vacant for many years to create a 4,800-square-foot supermarket that would bring healthful fresh food options to the local low-income community. The couple had originally approached three banks and failed to obtain financing from any of them, especially after cost assessments proved higher than earlier projections.

TRF has a strong knowledge of the neighborhood because it is an area in which TRF helped develop affordable housing and community businesses. TRF's data also showed that the project site was at the nexus of three TRF LSA areas. TRF was able to step in and figure out an affordable financing option for the project. The CDFI provided \$750,000 in financing for this \$1.16 million project, including federal Healthy Food Financing Initiative funds. TRF's financing supported the necessary fit-out of the leased space and the purchase of equipment for the grocery store and deli. Apples and Oranges Fresh Market opened in March of this year to much media fanfare because it was the first grocery store in its neighborhood. The grocery store created 15 jobs.

In Baltimore, as in the rest of the mid-Atlantic region, TRF has successfully scaled its ability to efficiently manage capital, work with data, and build on local relationships that ensure the delivery of capital and opportunity to low-income communities. While these are examples specific to geography and sector, every CDFI has the capacity to replicate this model and harness the power of its local experience and relationships — the very ingredients that have made CDFIs a success as the critical last mile in the credit chain.

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<sup>3</sup> A limited supermarket access (LSA) area is an area in which the residents must travel significantly farther to reach a supermarket than the "comparatively acceptable" distance traveled by residents in well-served areas. TRF defines "comparatively acceptable" as the distance that residents of well-served areas (block group with incomes greater than 120 percent of the area's median income) travel to the nearest supermarket. See *Searching for Markets: The Geography of Inequitable Access to Healthy & Affordable Food in the United States*, The Reinvestment Fund, 2012, available at [ow.ly/oR0TP](http://ow.ly/oR0TP).

<sup>4</sup> Robert M. Adams, "Consolidation and Merger Activity in the United States Banking Industry from 2000 Through 2010." Federal Reserve Board of Governors, Washington, D.C., 2012-51, 8 August 2012.

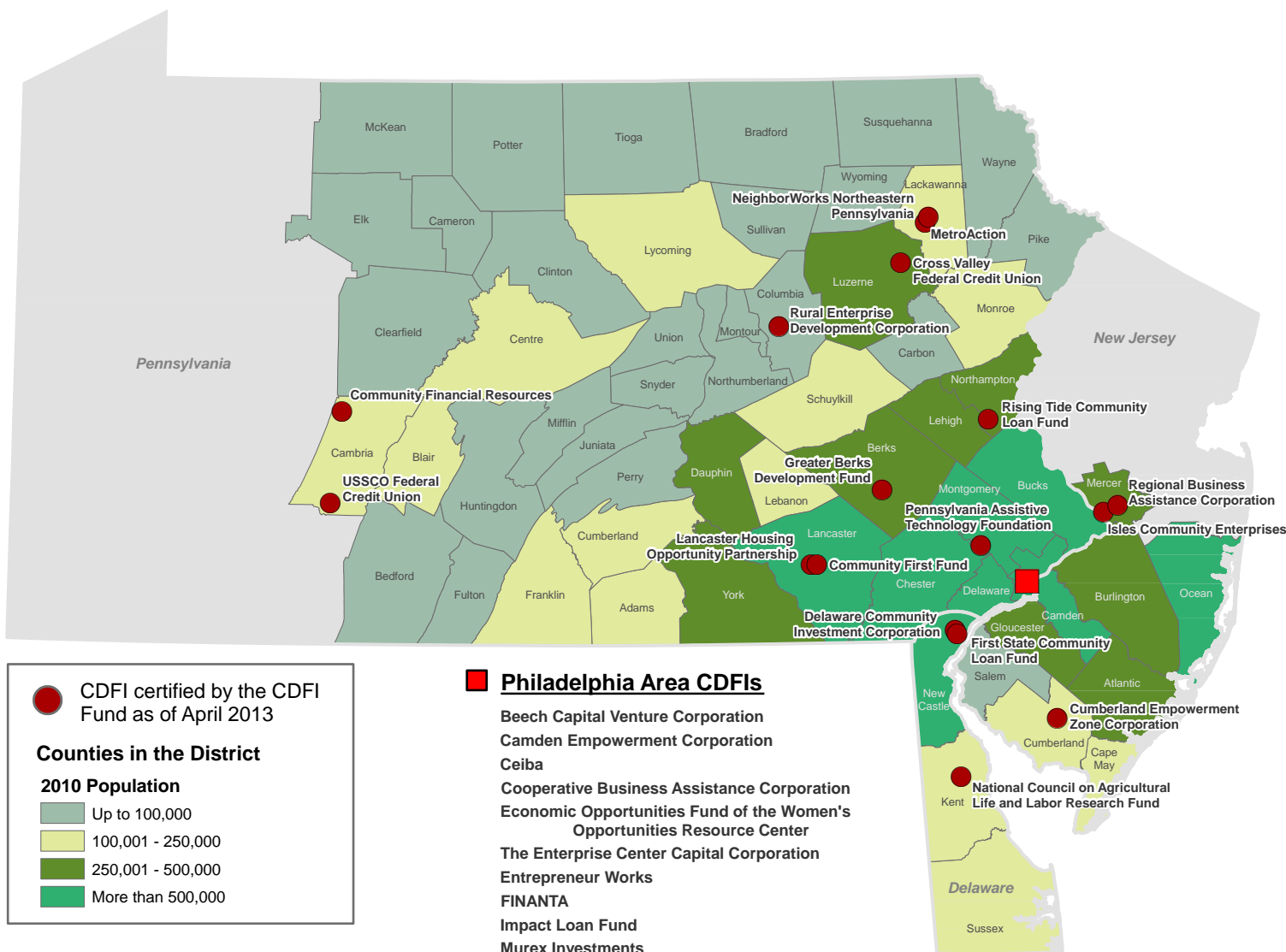
# MAPPING OUR COMMUNITY

THIRD FEDERAL RESERVE DISTRICT

KEITH WARDRIP, COMMUNITY DEVELOPMENT RESEARCH MANAGER

## CDFI Locations

As of April 2013, there were 35 community development financial institutions (CDFIs) headquartered in the Third Federal Reserve District and certified by the U.S. Department of the Treasury's CDFI Fund.\* As indicated on the map below, most (27) are in Pennsylvania and, like the District's population, are concentrated in Philadelphia and its neighboring counties. These 35 CDFIs, as well as many others located in the surrounding area\*\* and some that operate nationally, help finance small and large businesses, housing and commercial development, and other community assets throughout the Third District.



\* The CDFI Fund is undergoing a national recertification process that could change the certification status of the CDFIs in the District and elsewhere.

\*\* New Jersey Community Capital is an example of a CDFI that has its headquarters outside the Third District but is active within the District.

Source: CDFI Fund, U.S. Department of the Treasury; U.S. Census Bureau; ESRI, derived from Tele Atlas

Note: The views expressed here do not necessarily represent the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.

# Goldman Sachs Expands Small Business Initiative\*

By Keith L. Rolland, Community Development Advisor

In an expansion of its 10,000 Small Businesses initiative in 2013, Goldman Sachs is providing small business loan capital to the Philadelphia Industrial Development Corporation (PIDC) and Community First Fund (Community First) and is funding a 100-hour educational curriculum for small business owners at the Community College of Philadelphia (CCP).

## Background

Goldman Sachs targets small businesses that have annual revenues of \$150,000 to \$4 million, at least four full-time employees, two years of operating history, and a business model that could result in job creation. It also targets businesses that operate in economically disadvantaged areas.

John F.W. Rogers, executive vice president of Goldman Sachs and chairman of the Goldman Sachs Foundation, said, "We want to move them (the business owners) to the next level of development. They already have succeeded, and they know what they want to achieve."<sup>1</sup>

The Goldman Sachs program has a focus on access to capital and education supplemented by business support services. The capital is provided by community development financial institutions (CDFIs) or other nonprofit business lenders, while the educational curriculum is provided at community colleges. The curriculum, which is free to accepted owners and was developed by Babson College in Massachusetts, assists

owners in implementing growth plans and understanding customer relationships, target markets, and their competitors as well as human resources, finances, and other key topics. Applicants for the educational program must complete a detailed application and submit balance sheets, profit and loss statements, and federal tax returns.

Loans provided by the initiative's capital partners typically range from \$50,000 to \$750,000, average about \$190,000, and generally have terms of three to 10 years and interest rates of 6 percent to 10 percent. Eligible loan purposes are working capital, machinery and equipment, building improvements, leasehold improvements, and real estate acquisition and construction.

Goldman Sachs has committed \$500 million to its 10,000 Small Businesses program, which started in 2009 and also operates in Chicago; Cleveland; Houston; Long Beach, CA; Los Angeles; New Orleans; New York; and Salt Lake City. Goldman Sachs is providing only the access to capital component in Kentucky, Montana, Oregon, Tennessee, Virginia, and Washington State.<sup>2</sup> Goldman Sachs makes a commitment to maintain the program at each site for at least five years. Cristina Shapiro, vice president at Goldman Sachs, said that Goldman Sachs has made a \$500 million investment in the 10,000 Small Businesses program. Of this amount, Goldman Sachs Bank provides \$250

million for loans to CDFIs or other community-based lenders, and the Goldman Sachs Foundation provides \$50 million in grants to the CDFIs or other lenders for capacity building, operating support, and loan-loss reserves. The \$500 million investment includes \$200 million from the Goldman Sachs Foundation for the educational program and business support services.

Shapiro also said that the initiative's goal is to provide underserved small businesses with access to business education, capital, or both. Most borrowers under the initiative have been located in low- and moderate-income areas and/or have been women- or minority-owned companies, she said.

## Philadelphia and Eastern and Central Pennsylvania

According to Shapiro, the \$500 million investment includes \$10 million for PIDC loans, \$5 million for Community First loans, and \$5 million for the educational program and business support services at CCP.

PIDC and Community First are making loans through the 10,000 Small Businesses program to new or existing borrowers for expansion or working capital. The loans are typically secured and require an equity contribution from business owners. The CDFIs identify potential borrowers through the educational program and referrals from banks and other business assistance providers, such as small business development centers and SCORE.

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<sup>1</sup> See [ow.ly/oQWe9](http://ow.ly/oQWe9).

<sup>2</sup> Locations are selected by such factors as the needs of the small business community, the strength of local partners, and the ability to develop the entrepreneurial ecosystem within a community, according to Goldman Sachs.

PIDC, which has financed and managed large economic development projects since 1958 and has also provided financing to small and mid-size businesses,<sup>3</sup> formed a CDFI subsidiary in 2012. Community First, based in Lancaster, PA, became a CDFI in 1992 and has focused substantially on small business lending.

Under the Goldman Sachs initiative, the two CDFIs lend in their traditional service areas. PIDC lends in Philadelphia and Community First lends in a 13-county region in eastern and central Pennsylvania.<sup>4</sup>

Margaret Berger Bradley, executive director of Goldman Sachs 10,000 Small Businesses – Greater Philadelphia and a former chief operating officer of The Reinvestment Fund, said that participants in the first set of classes, which started this past spring, consisted of 23 owners, including a kitchen countertop manufacturer with 30 employees, an aerospace parts manufacturer, and owners of a specialty food business, a textile design studio, and a coffeehouse. A second set of owners will begin classes in September.<sup>5</sup> The owners spend 10 to 15 hours between classes on assignments related to their businesses, including working with a business advisor and attending clinics and networking events with business organizations and professional service firms, she added.

The Greater Philadelphia Chamber of Commerce, the Greater Philadelphia Hispanic Chamber of Commerce, and the Urban League of

Philadelphia helped inform small business owners about the educational program.

#### Lessons Learned

Shapiro said that some early lessons from the initiative included the following:

- Programs should be adapted to meet the specific needs of communities and small business owners. Although a number of small business owners have benefited from the combination of capital, education, and business support services, many others have elected to focus on just the educational component in order to grow their business.
- There is a gap in funding for small businesses looking for \$50,000 to \$250,000 in growth capital that is still not being addressed by traditional financial institutions. The program's provision of capacity-building grants as well as loan-loss reserve grants has been critical to allow the program lenders to reach underserved businesses.
- There is uneven capacity of CDFI loan funds across the country that can manage loan capital of \$5 million or more and relend it to small businesses.<sup>6</sup> There are opportunities to partner with other community-based lenders, such as Small Business Administration 504 providers that already lend to small businesses and are interested in expanding into working capital loan products.

- With more than 1,100 graduates to date, the education program has a 99 percent graduation rate. Among more than 400 respondents to a survey six months after graduation, approximately 63 percent reported increasing their revenues, and approximately 47 percent reported creating new net jobs.

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Saudia Davis, CEO of GreenHouse Eco-Cleaning in Brooklyn, NY, is a graduate of the Goldman Sachs 10,000 Small Businesses program and the recipient of a working capital loan from TruFund Financial Services, Inc., formerly SEEDCO Financial.

<sup>3</sup> In 2009, PIDC absorbed the portfolio of Philadelphia Commercial Development Corporation, which had provided financing and technical assistance since 1974 to businesses, business associations, and community development corporations.

<sup>4</sup> Community First lends in Adams, Berks, Chester, Cumberland, Dauphin, Franklin, Lancaster, Lebanon, Lehigh, Montgomery, Northampton, Perry, and York counties in Pennsylvania.

<sup>5</sup> According to Berger Bradley, the participating business owners come from a broad area, and there is no residency requirement for applicants to the educational program.

<sup>6</sup> Goldman Sachs worked with the Opportunity Finance Network from 2011 to 2013 on a capacity-building initiative to enable 21 CDFIs, including Community First, to strengthen their capacity to lend to small businesses through peer learning opportunities, consulting services, training, webinars, and white papers.



## The Impact of Government Subsidized Lending: Community Development Financial Institutions Fund\*

Access to credit in all segments of the population not only enhances the financial viability of individuals and their communities but also contributes to a robust economy. However, for various reasons, the private sector might not supply an adequate amount of credit or capital to meet the demand in certain areas. In these instances, the government might step in and bridge the gap. One approach taken by the federal government is to provide funds from the Community Development Financial Institutions (CDFI) Fund to financial intermediaries such as community development financial institutions (CDFIs), which in turn supply the credit and capital to the populations in need. While the federal government's effort to correct an imbalance is laudable, questions might be raised as to its effectiveness and possible undue political influence. These concerns are addressed in a study by Kristle Romero Cortés and Josh Lerner.<sup>1</sup> The following is a summary of their paper.

### Background

Cortés and Lerner noted that financial institutions are instrumental

in the growth and development of economies. But to maximize the economy's growth potential, financial institutions should fulfill the credit needs of the population. Yet, some sectors of the population might not have their credit demand satisfied. This might require the intervention of the federal government. According to Cortés and Lerner, "In theory, public efforts which enable (and indeed require) financial institutions to extend credit to underserved portions of the population may ease some of these constraints." However, the efficacy of such efforts on the part of the government is suspect and could fall prey to political manipulation. Cortés and Lerner considered these concerns by examining the effectiveness of the government using the CDFI Fund "to grant awards to financial institutions that target certain borrowers."

The CDFI Fund was established in 1994, and its "mission is to expand the capacity of financial institutions to provide credit, capital, and financial services to underserved populations and communities in the United States." It has lent over a billion

dollars since its establishment. The authors chose to study the CDFI Fund because of its relatively long-term existence (as opposed to many of the government's short-lived programs), and its "core program, awarding Financial Assistance (FA) and Technical Assistance (TA) grants, has followed clear-cut, well-documented procedures from its inception." Cortés and Lerner focused on the grants to credit unions<sup>2</sup> "because they make up a large and relatively homogeneous part of the CDFI industry." FA awards can range up to \$2 million and can be used for "financing capital, loan loss reserves, capital reserves, or operations." TA awards can be made up to \$100,000 and used "to purchase equipment, materials, or supplies; for consulting or contracting services; to pay the salaries and benefits of certain personnel; and/or to train staff or board members."

### Data and Methodology

Cortés and Lerner used data from the CDFI Fund for years 2000 to 2009, which contain information on CDFIs that applied for grants, the amounts requested, and the amounts awarded. The authors' study sample

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<sup>1</sup> Kristle Romero Cortés and Josh Lerner, "Bridging the Gap? Government Subsidized Lending and Access to Capital," *Review of Corporate Finance Studies*, 2 (2013), pp. 98–128.

<sup>2</sup> In addition to credit unions, there are three other types of CDFIs — banks, venture capital firms, and loan funds. According to the authors, credit unions make up the second-largest portion of CDFIs (behind loan funds), are regulated, and "have received twice the amounts of grants over the last decade than banks."



included all credit unions that applied for grants during the study period; the credit unions that received funding made up the treatment group, and those whose applications were rejected comprised the control group.<sup>3</sup> Cortés and Lerner noted that credit unions applied for funding twice, on average, during the study period, which resulted in 362 applications. They also included data from the National Credit Union Administration (NCUA), “an independent federal agency that charters and supervises federal credit unions.” The NCUA compiles information quarterly on the financials and specific characteristics of credit unions.

Since CDFIs focus their efforts on underserved populations, they often find themselves conducting business in impoverished areas. The authors pointed out that “CDFIs on average serve the bottom three-fifths of the income distribution.” Thus, to capture the nature of these areas in their analysis, Cortés and Lerner used some macroeconomic controls, such as median income and unemployment and poverty rates. The data are on the local level, with the unemployment rates coming from the U.S. Bureau of Labor Statistics and the median income and poverty rates coming from the U.S. Census Bureau.

First, the authors used regression analysis to determine which factors are influential in the award decision process and which ones enhance a credit union’s prospects of receiving an award. Next, they investigated whether politics influences the award process. Finally, Cortés and Lerner examined what effects a CDFI award had on a credit union’s loan growth.

## Results

Cortés and Lerner investigated the grant decision process and found that the most significant factor contributing to a credit union’s, receiving a grant is whether its “loan portfolio grew in the year previous to the award.” According to the authors, “this suggests that the CDFI Fund is interested in awarding grants to CDFIs that have already demonstrated a strong inclination to loan to low-income borrowers.” The authors also found that median income growth in the region increased the probability that a credit union would receive a grant, while “local poverty and unemployment rates [were] either insignificant, or negative.” Moreover, credit unions whose borrowers had a history of high default rates were less likely to receive grants.

The authors also examined the possible influence of politics in the award decision. Given that the CDFI Fund was established under a Democratic administration, they included a variable in their regression analysis that indicated whether a credit union was located in an area where the congressional representative was a Democrat.<sup>4</sup> In addition, Cortés and Lerner tested whether the award decision would be affected if the Congress member had the same political affiliation as the presiding President. In both cases, the authors found no effect, which led them to “interpret these findings as evidence that politics [did] not seem to play a role in funding.”

Cortés and Lerner finally estimated the impact of the CDFI Fund’s grants on credit union activity. They found that total loan growth



**Marvin M. Smith, Ph.D.,**  
Community Development Economic Advisor

for credit unions that received an award increased by 45 cents in the first year for each dollar awarded. Moreover, “after three years, one dollar of funding translate[d] into \$1.60 of total loan growth.” Thus, the authors observed that “CDFI grant money does in fact increase lending but it takes some time to ramp up.” Cortés and Lerner also discovered that CDFI Fund grants did generate some delinquent loan growth. Namely, “for each dollar awarded, 12 cents become delinquent over three years.” But they hasten to point out that “it is a small portion of the additional generated loans.”

While Cortés and Lerner studied the effects of CDFI Fund grants on credit unions and found that the awards increased their lending, they noted that “much remains to be done in understanding the consequences for borrowers and communities.”

<sup>3</sup> In their analysis, Cortés and Lerner use the control group as benchmarks to gauge the change in the credit union activity of those that receive grants (treatment group).

<sup>4</sup> Since the activities of CDFIs are generally local, the authors reasoned that the “Congressional Representative is the correct way to proxy for political connection because Senators would be too removed from the individual concerns of the diverse communities.”

# Building CDFI Capacity in Lending and Business Models\*

By Pamela DeGraff Porter, Executive Vice President for Strategic Consulting, Opportunity Finance Network

Over the past three decades, community development financial institutions (CDFIs) have been nimble innovators, offering products and services to people, projects, and organizations that mainstream financial institutions could not or would not serve. They opened new lending pathways to address some of the most stubborn challenges

CDFIs opened new lending pathways to address some of the most stubborn challenges facing poor communities across the country.

facing poor communities across the country. The focus of CDFIs was originally on financing affordable housing and then shifted in recent years to financing schools and child-care centers, healthful food markets, small and microbusinesses, and community health centers.

CDFI partners<sup>1</sup> frequently ask CDFIs to scale successful local programs into replicable models to serve other low-income communities across the country or to enter new sectors

of lending in communities where CDFIs are already working, in other words, to build their capacity to serve low-income communities.<sup>2</sup>

For the past two decades, the Opportunity Finance Network (OFN) has worked with CDFIs and their partners on a number of capacity-building initiatives to help CDFIs expand geographically, offer new financial products and services, and increase their positive impact on low-income communities.<sup>3</sup>

Capacity building occurs in two areas — lending sectors and business models. The first area helps CDFIs develop expertise in new sectors of lending, such as:

- **Healthy food financing:** Recently, OFN worked with experts in healthy food financing, including The Reinvestment Fund of Philadelphia, to codify the best practices to share in capacity-building efforts nationally. Over 1,200 individuals across the country participated in some aspect of this program.
- **Microfinance:** Currently, OFN is working with credit unions and loan funds serving low-income communities to increase the availability of microfinance financial products to support

job creation and growth of small businesses.

- **Community health centers (CHCs):** These pillars of the health-care system in low-income communities currently serve 20 million people and are expected to serve over 40 million people due to the expansion of Medicaid in the Affordable Care Act. OFN is bringing together three CDFIs<sup>4</sup> with the greatest expertise in financing CHCs and the National Association of Community Health Centers to train up to 100 CDFIs across the country to effectively lend to CHCs.

The second type of capacity building helps CDFIs implement innovative business models, such as:

- **Referral networks:** CDFIs can refer borrowers to other CDFIs that have different lending capabilities. For example, a housing lender might refer small business loan inquiries to a small business CDFI, and a small CDFI might refer a large deal to a CDFI with greater capital available to lend. Strong referral networks are built on shared values, a shared mission, and trusting relationships. OFN has helped facilitate this environment through dedicated efforts

\* The views expressed here are those of the author and do not necessarily represent the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.

<sup>1</sup> Leading CDFI partners in capacity building include the Community Development Financial Institutions Fund of the U.S. Department of the Treasury (CDFI Fund), the Federal Reserve Banks, the Annie E. Casey Foundation, the Goldman Sachs 10,000 Small Businesses Initiative, Citi, Wells Fargo, and Bank of America.

<sup>2</sup> OFN-member CDFIs have demonstrated the ability to lend prudently and productively in high-risk markets. OFN-member CDFIs had a net charge-off rate of 1.7 percent in fiscal year 2011, according to an OFN report, available at [ow.ly/oQYrx](http://ow.ly/oQYrx).

<sup>3</sup> For more information, go to [www.opportunityfinance.net](http://www.opportunityfinance.net) and select Strategic Consulting.

<sup>4</sup> The three CDFIs are Capital Link in Boston ([www.caplink.org/](http://www.caplink.org/)), Primary Care Development Corporation in New York City ([www.pcdcn.org/](http://www.pcdcn.org/)), and NCB Capital Impact in Arlington, VA ([www.ncbcapitalimpact.org/](http://www.ncbcapitalimpact.org/)).

in Baltimore, Atlanta, and other cities as well as through OFN's regional meetings.

- **Technology:** CDFIs increasingly use technology at every stage of the lending process. CDFI loan officers work with borrowers at their place of business using remote scanning devices for loan applications. In some cases, new CDFIs adopt innovative uses of technology more aggressively than more established CDFIs.<sup>5</sup> CDFIs also use shared services technology platforms to support underwriting, loan administration, and participations.
- **Outsourcing:** CDFIs recognize that they can outsource activities that are performed better by others and focus on mission-critical activities. For example, CDFIs offering Small Business Administration (SBA) 7(a) loans through the Community Advantage program use lender service providers (LSPs) that provide compliance services for SBA loan guarantees. A more established practice is to outsource loan administration and servicing to local banks or other CDFIs.

In both types of capacity building, investment in capacity building allows CDFIs to serve low-income communities with a greater set of responsible financial products and services.

In capacity building work, OFN has found that successful capacity-building programs:

- **Use multifaceted approaches to help CDFIs learn and implement strategies.** Successful capacity-building programs include:
  - In-person training,

- Ongoing webinars or teleconferences,
  - Communities of practice for groups with similar interests to share knowledge, and
  - Capital and operating grants to support expansion of new capacity.
- **Provide technical assistance following training:** It is important to provide follow-up technical assistance to help CDFIs implement new capacity. In healthy food financing, 75 percent of CDFIs receiving one-on-one technical assistance following training made healthy food loans within six months of receiving the assistance.
  - **Are creative in designing capacity-building initiatives:** While developing the Scaling Up Microfinance initiative,<sup>6</sup> OFN recognized that credit unions serving low-income communities play a vital role in providing "micro" financial products to small businesses. Integrating credit unions and loan funds in building capacity for microfinance led to rich collaboration nationally and locally.
  - **Incorporate talent development into all capacity-building initiatives:** Topics such as leading organizational change, negotiating effectively, creating an innovative culture, and understanding the employee life cycle ranked among the most highly valued aspects of capacity-building programs by participants.
  - **Identify successful practitioners to replicate or create best practices:** In some cases, such as healthful food retail and CHCs, some CDFIs use proven underwriting models that can be codi-



Mrs. Hui Ping Liu came with her family from China to the U.S. in 2003 and started LH Human Resources, Inc., a 25-person home health-care agency serving Chinese and Vietnamese families with physically or mentally disabled members. Traditional lenders declined her loan application, and in 2010 she qualified for a \$35,000 micro-loan through the Business Center for New Americans, a CDFI and microlender in New York City. Today, the business employs more than 100 individuals.

fied and disseminated through training. However, when proven models do not exist, OFN convenes a meeting of cutting-edge thinkers to develop a new set of best practices. This approach was used to develop the curriculum for financing sustainable agriculture lending.

In conclusion, effective capacity building brings innovation to life at individual CDFIs and those across the nation. Capacity building is the disciplined and creative investment required to keep technical skills and business models of CDFIs aligned with the needs of the communities they serve.

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<sup>5</sup> The Intersect Fund, located in New Brunswick, NJ, is among the most technologically advanced microlenders.

<sup>6</sup> For more information about the Scaling Up Microfinance initiative, see [ow.ly/oQZ0S](http://ow.ly/oQZ0S).

# CDFIs Increase Access to Capital Markets, Federal Loan Programs, and Corporate Support\*

By Keith L. Rolland, Community Development Advisor

Community development financial institutions (CDFIs) are increasing their access to funding from larger capital markets, such as the Federal Home Loan Bank (FHLB) System, federal grant programs, and private corporations. In addition, the new CDFI Bond Guarantee Program authorizes the U.S. Treasury to guarantee up to \$1 billion a year in long-term capital to support CDFI lending and investment activities in underserved communities.

- **FHLB System:** The first CDFIs joined the FHLB System in 2010. As of March 31, 2013, FHLB members included 15 CDFIs, five of which had taken \$38 million in

Community development financial institutions (CDFIs) are increasing their access to funding from larger capital markets, such as the Federal Home Loan Bank (FHLB) System, federal grant programs, and private corporations.

advances.<sup>1</sup> Sixteen CDFIs<sup>2</sup> were FHLB members as of the second quarter of 2013, said Cheryl A. Neas, senior vice president of Opportunity Finance Network (OFN). CDFIs that have been certified by the CDFI Fund are eligible to join the FHLBs.

- **U.S. Small Business Administration (SBA):** The SBA launched Community Advantage, a pilot program that targets community-based, mission-focused financial institutions that had previously been unable to offer SBA 7(a) loans. The maximum Community Advantage loan size is \$250,000, with SBA guarantees of 85 percent on loans up to \$150,000 and 75 percent on those greater than \$150,000.

Forty-eight CDFIs participated in the program and had approved 265 loans totaling \$36.9 million as of June 2013, according to the SBA. CDFI Community Advantage lenders include the Progress Fund and the Washington County Council on Economic Development in Pennsylvania, the Trenton Business Assistance Corporation and Union County Economic Development Corporation in New Jersey, and First State Community Loan Fund in Delaware.<sup>3</sup>

- **USDA Rural Development:** Many CDFIs also participate in USDA Rural Development programs. OFN's annual member survey for the 2011 fiscal year showed CDFI participation in the following programs: Intermediary Relending Program — 46 CDFIs; Rural Business Enterprise Grant — 40 CDFIs; Rural Community Development Initiative — 24 CDFIs; Business & Industry Loan Program — 16 CDFIs; and Rural Business Opportunity Grants — 16 CDFIs.
- **Healthy Foods Financing Initiative:** In 2011–12, eight CDFIs received a total of \$5.8 million from the Healthy Foods Financing Initiative located within the U.S. Department of Health and Human Services.<sup>4</sup> The Philadelphia-area grantees were The Reinvestment Fund in 2011 and the Enterprise Center Community Development Corporation in 2012.
- **Starbucks–OFN Program to Create Jobs:** The Starbucks Corporation developed a program with OFN in 2011 to address the issue of unemployment. The Starbucks Foundation made a grant of \$5 million to seed the Create Jobs for USA Fund,<sup>5</sup> and Starbucks stores provided “In-

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<sup>1</sup> For information, see [ow.ly/oR465](http://ow.ly/oR465); [ow.ly/oR4lf](http://ow.ly/oR4lf); and [ow.ly/oR4xM](http://ow.ly/oR4xM).

<sup>2</sup> None of the 16 CDFIs are located in Pennsylvania, New Jersey, or Delaware.

<sup>3</sup> Community First Fund and The Reinvestment Fund had SBA 7(a) licenses prior to the start of Community Advantage and have participated in the 7(a) guarantee program as well.

<sup>4</sup> For information, see [www.acf.hhs.gov/programs/ocs/resource/healthy-food-financing-initiative-0](http://www.acf.hhs.gov/programs/ocs/resource/healthy-food-financing-initiative-0).

<sup>5</sup> See [createjobsforusa.org](http://createjobsforusa.org).



Greg Forget had worked at Frechette's Sales and Service, a landscaping and garden equipment center in Buckfield, ME, for about two years when the owner retired. Forget put together a business plan and obtained financing and technical assistance from Community Concepts Finance Corporation, a CDFI based in Maine, and Create Jobs for USA, a partnership of the Starbucks Foundation, Starbucks' customers, and the Opportunity Finance Network. Today, the business employs Forget and two other employees.

divisible" wristbands to donors who contributed \$5 or more.

The fund has been supported by donations from 800,000 individuals and more than 20 corporate entities, including Citi Community Development, the Citi Foundation, Google Offers, and Banana Republic, explained Beth Lipson, executive vice president at OFN.

The fund has raised \$15 million, supporting OFN capital grants to 112 CDFIs. The grants have supported CDFI loans of approximately \$105 million to community businesses,<sup>6</sup> creating or retaining 5,000 jobs, Lipson said.

According to Lipson, this program, which was created to tackle unemployment, shows "CDFIs as a solution to a difficult problem" and puts CDFIs in the national spotlight. In addition, the partnership demonstrates that many people, including a company's customers, care about the issues in which CDFIs are involved, she said.

- **Leadership at State and City Levels:** CDFIs are leaders in 20 state and city initiatives on issues such as healthy foods financing, and sometimes they convene meetings with government, nonprofit, and business partners to address issues collaboratively,

Pam Porter, executive vice president at OFN, pointed out.

- **New Markets Tax Credits:** CDFIs are among the entities that have been certified by the CDFI Fund as community development entities (CDEs) to participate in the new markets tax credit program. The program attracts investment capital in low-income communities by permitting investors to receive federal tax credits in exchange for equity investments in CDEs. Since the program's inception in 2000, the CDFI Fund has made awards allocating \$36.5 billion in tax credit authority.
- **CDFI Bond Guarantee Program:** The U.S. Treasury has received authority in the 2013 fiscal year to guarantee up to \$500 million in bonds, which will be issued by Qualified Issuers (certified CDFIs or their designees).<sup>7</sup> The bonds, including principal, interest, and call premiums, will be 100 percent guaranteed by the federal government with a maximum maturity of 30 years. The Federal Financing Bank will be the sole purchaser of these bonds.

Decisions regarding commitment of the 2013 Guarantee Authority are expected by the end of September. OFN believes that the program was oversubscribed by at least \$100 million, indicating strong CDFI industry demand for the availability of affordable, long-term debt capital.

Greg Bischak, financial strategies and research program manager of the CDFI Fund, said that the program was "a hallmark of the maturation of the industry."

<sup>6</sup> Community businesses include small businesses, microenterprises, nonprofits, commercial real estate firms, and firms engaged in affordable housing.

<sup>7</sup> See [ow.ly/oQZf3](http://ow.ly/oQZf3).

## CDFIs: What's in a Name? ...continued from page 1

- Constrained resources that limit the ability of governments at all levels to respond to opportunities and needs; and
- Sustained economic and social distress in opportunity markets.<sup>3</sup>

CDFIs grew out of the civil rights movement and the war on poverty. Long before there was a federal CDFI Fund, CDFIs borrowed money from Catholic women's orders and other investors who expected these organizations to focus single-mindedly on benefiting very poor people. By the early 1990s, when legislation to create the CDFI Fund started moving through Congress, community development loan funds and other CDFIs had proved that it is possible to lend to benefit poor people on a profitable, but not profit-maximizing, basis.

The CDFI Fund makes investments — almost exclusively equity or net worth — on CDFI balance sheets to

The CDFI Fund is thriving, while other important community and economic development programs are struggling for funding and support.

support strategies for financing businesses (both for-profit and nonprofit) and affordable housing. In contrast, almost all other federal programs tie their funding to specific pre-identified projects or individuals. This form of support can be effective, but it can also be inflexible when market conditions change. A key to the success of CDFIs is their agility in responding to dynamic market conditions, such as when there is an increase in small business demand for credit.

In 1995, when the CDFI Fund opened its doors, there was a surge of organizations that sought certification. Many organizations thought that they fit the certification requirements. Others were attracted by the funding possibilities.

There was a second surge of interest in 2005–06 when congressional appropriations for the CDFI Fund rose after the Bush administration's efforts to eliminate the fund failed. More recently, the fund has experienced a third rush; the CDFI Fund is thriving, while other important community and economic development programs are struggling for funding and support. In 2010, for example, Congress assigned the CDFI Fund responsibility for the CDFI Bond Guarantee Program, which has the potential to spur billions of dollars of new long-term debt financing for distressed communities.<sup>4</sup>

The fund's current recertification efforts must sift through 20 years of changing criteria under the CDFI Fund to ensure that CDFIs remain focused on the people and communities they exist to serve. For instance, the fund has diluted its own definition of a "financing entity." In 1995, according to the fund, a CDFI's "predominant business activity" must be providing "loans or Development Investments."<sup>5</sup> At the time, the fund set a threshold for predominant business activity as 50 percent or more of a CDFI's total activities.

Initially, at least half of a CDFI's activities had to consist of financing. Over time, that threshold requirement has steadily declined both in practice and in the fund's rules.<sup>6</sup> This has allowed some CDFIs whose predominant business activities are nonfinancing activities, such as training and technical assistance, to get certified by the fund. Although nonfinancing activities are important to CDFIs, the fund's authorizing statute differentiated finance-led organizations (CDFIs) from other community development organizations and intended that resources go to finance-led organizations.

A growing number of financial intermediaries are citing CDFIs as their models but are focusing on very different purposes than CDFIs. First,

<sup>3</sup> Opportunity markets are emerging markets that are outside the credit boundaries of conventional markets due to perceived risks. These are markets in which CDFIs have successfully financed businesses, affordable housing, and nonprofits.

<sup>4</sup> Public Law 111-240, §1703 (12 U.S.C. 4713(a)).

<sup>5</sup> 12 C.F.R. §1805.200(a)(3)(d) as published in 60 Fed. Reg. 54,117 (October 19, 1995).

<sup>6</sup> In 2005, the fund issued an interim revised rule that said that a CDFI's predominant business activity must be "Financial Products, Development Services, and/or similar financing." The rule said that "Development Services" may include such services as "financial or credit counseling to individuals for the purpose of facilitating home ownership, promoting self-employment, or enhancing consumer financial management skills; or technical assistance to borrowers or investees for the purpose of enhancing business planning, marketing, management, and financial management skills" (70 FR 73889). See [www.gpo.gov/fdsys/pkg/FR-2005-12-13/pdf/05-23751.pdf](http://www.gpo.gov/fdsys/pkg/FR-2005-12-13/pdf/05-23751.pdf). See 12 C.F.R. §1805.201(b)(2) as published in 70 Fed. Reg. 73,891 (December 13, 2005).

social impact bonds — an alluring but unproven model of government funding on a “pay-for-performance” basis — promise positive social outcomes, but they are expensive to create and sustain because they require large subsidies. In addition, they are a poor choice when factoring in opportunity costs. Second, impact investing — based on the unsustainable promise of maximum financial return and high social impact — is a bubble in the social investment market today; the promise far exceeds actual production and value.

CDFIs rely on concessionary pricing to maximize benefits for their borrowers. As a result, critical financing for CDFIs is getting diverted to other purposes, such as social enterprises, which are important but do not benefit people in greatest need. In addition, both public and investor attention are distracted from the dangers of income and wealth inequality

that are dragging down long-term economic growth.

CDFI leaders talk about CDFIs in name only — organizations seeking access to the CDFI Fund and other financial opportunities without a demonstrated commitment to low-income and low-wealth people and communities and, at best, a sketchy future commitment. Federal taxpayer resources and subsidies should go only to organizations that are providing significant benefits to disadvantaged people and communities.

Many investors, funders, and government policymakers are confused. Social innovation has trumped poverty alleviation for investors who think economic opportunity is “old school.”

The CDFI Fund’s decision to review all of its existing CDFI certifications this year indicates that

the fund seems to recognize the need to ensure program discipline and prudent use of limited federal resources. Because government and private resources for CDFIs are limited, it is important to distinguish what is, and is not, a CDFI. That will help ensure that scarce and vital funding and investment capital will be used to address poverty and create opportunities for low-income, low-wealth, and other disadvantaged people.

*The Opportunity Finance Network (OFN) has 206 CDFI members, which are predominantly community development loan funds. OFN is a policy advocate for the CDFI industry and is itself a CDFI. For information, contact Mark Pinsky at 215-320-4304 or [markpinsky@opportunityfinance.net](mailto:markpinsky@opportunityfinance.net); [www.opportunityfinance.net/](http://www.opportunityfinance.net/).*



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