

Hearing on FY 2002 Appropriations

**U.S. House of Representatives
Subcommittee on VA, HUD, and Independent Agencies**

**General Statement
of
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**DEPARTMENT OF THE TREASURY
Community Development Financial Institutions Fund
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INTRODUCTION

Chairman Walsh, Congressman Mollohan and distinguished Members of the Subcommittee, it is a pleasure to be before you today to represent the Department of the Treasury's Community Development Financial Institutions (CDFI) Fund in support of the President's FY 2002 budget. I am Jeffrey Berg, the Acting Director of the Fund. Joining me today is Owen Jones, Deputy Director for Management/CFO at the Fund.

The CDFI Fund is a wholly owned government corporation within the United States Department of the Treasury. The Fund promotes access to capital and local economic growth by directly investing in and supporting community development financial institutions (CDFIs) that provide loans, investments, financial services, and technical assistance to underserved people and economically distressed communities. CDFIs are specialized financial institutions working in market niches that have not been adequately served by traditional financial institutions. CDFIs include community development banks, credit unions, business loan funds, microenterprise loan funds, housing/facilities loan funds, and venture capital funds. To date, the Fund has certified over 400 institutions as CDFIs.

My testimony today will focus on three key areas: (1) the President's FY 2002 budget and related Fund initiatives, most notably the New Markets Tax Credit Program; (2) the implementation of effective financial and management controls at the Fund; and (3) a description of CDFI Fund programs.

PRESIDENT'S FY 2002 BUDGET AND BEYOND

The President's FY 2002 budget requests \$68 million in appropriations for the Fund. The Administration request should be considered in light of several factors. First, the recent enactment of the bipartisan Community Renewal Tax Relief Act of 2000 will devote substantial additional resources to new incentives for investment in low-income communities. This includes the New Markets Tax Credit, to be administered by the Fund, as well as creation of Renewal Communities and expansion of existing Empowerment Zones. These incentives are estimated to total over \$25 billion during the next 10 years.

Second, in line with his commitment to effective implementation of the Government Performance and Results Act within Treasury, Secretary O'Neill intends to make performance measures of this and all Treasury activities more useful and relevant to the decision-making process, and improve the timeliness and accuracy of the information systems that capture and report performance data. To move forward on this commitment, the Secretary has called for a fundamental review within all Treasury bureaus of what we do and why we do it, resulting in a determination of what measures of outputs and outcomes best capture what we are trying to achieve. This points out the need for consistent ways to evaluate the effectiveness of the various incentives for investment in low-income communities so that we know better what works and what does not work. Putting such measures into place will provide an opportunity to better assess the effectiveness of this program. The Fund is committed to working with the Secretary in this important initiative.

We anticipate that approximately \$37 million will be used to fund the Core and Intermediary Components of the CDFI Program and Training Program; approximately \$5 million will be made available for the Small and Emerging CDFI Assistance (SECA) Component of the CDFI Program; and \$16.5 million will be used to fund the Bank Enterprise Award (BEA) Program. The remainder will be used to cover the Fund's administrative costs, including the costs of administering the New Markets Tax Credit Program.

The Fund will continue to focus efforts on serving those markets, including rural and Native American communities that have relatively low levels of CDFI activity. In these areas, we will continue to conduct workshops (both in-person and via satellite broadcasts) detailing the CDFI certification and funding application processes. We also expect that the SECA Component and the Native American Technical Assistance and Training Component will be of particular benefit to CDFIs and CDFIs in formation that serve these difficult markets.

Another industry sector the Fund hopes to target is faith-based CDFIs. The Fund provides financial support directly to faith-based institutions -- institutions whose founding (through capitalization or otherwise), governance, or membership is derived from religious institutions -- through the CDFI Program. It is estimated that approximately 25 certified CDFIs are themselves faith-based institutions. To date, the Fund has provided 26 awards totaling \$10 million to faith-based CDFIs. Targeting faith-based CDFIs through the Fund's outreach efforts will not require any additional funding.

We are also interested in targeting other CDFIs that, while not themselves faith-based institutions, partner with such institutions to deliver products and services to their communities. Many such CDFIs rely on faith-based institutions as a valuable source of matching funds for CDFI Program awards and invite members of local clergy to sit on their governing boards and advisory boards. Other CDFIs use their award dollars to provide loans and investments to initiatives sponsored by faith-based organizations.

New Markets Tax Credit Program

The New Markets Tax Credit (NMTC) Program, enacted in December of 2000, was developed to spur investments in businesses located in low-income communities. Under the NMTC Program, taxpayers will be provided a credit against Federal income taxes for qualified investments made to acquire stock or other equity interests in designated Community Development Entities (CDEs). Substantially all of the proceeds of qualified investments must in turn be used by the CDE to make qualified investments in low-income communities. These qualified low-income community investments include loans to, or equity investments in, businesses or CDEs operating in low-income communities. The credit provided to the investor covers a seven-year period. In each of the first three years, the investor receives a credit totaling 5% 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 6% annually.

The NMTCs will be allocated annually by the Fund to for-profit CDEs under a competitive application process. These CDEs in turn will pass the credits to investors (such as banks, corporations, mutual funds, and/or individuals). To qualify as a CDE, an entity must be a domestic corporation or partnership that: (1) has the primary mission of serving, or providing investment capital for, low-income communities or low-income persons; (2) maintains accountability to residents of low-income communities through representation on a governing or an advisory board; and (3) has been designated by the Fund to be a qualified CDE. CDEs may be not-for-profit or for-profit entities, but only for-profit CDEs are eligible to apply for NMTC allocations from the Fund. Not-for-profit entities may nonetheless find it beneficial to gain designation as a CDE, since for-profit CDEs that receive qualified investments under the NMTC Program are permitted to use those investments to make loans to (and purchase loans from) other CDEs. All certified CDFIs, and all Specialized Small Business Investment Companies licensed by the Small Business Administration, will automatically qualify as CDEs.

The CDFI Fund has the authority to allocate tax credits to CDEs to support qualifying equity investments totaling \$15 billion through 2007. The Fund, working with the IRS, is currently in the process of designing the program requirements and developing the applicable regulations. On April 20, 2001, the Fund issued a guidance document that seeks feedback on a variety of key implementation issues. The Fund intends to use these comments, as well as comments received by the IRS under its Advance Notice of Proposed Rulemaking, to help it develop program guidelines and application materials -- with a goal of seeking applications for NMTC allocations in early calendar year 2002.

MANAGING FOR RESULTS

The CDFI Fund has implemented effective financial and management controls, as verified by independent auditors. I am pleased to report that the Fund's independent auditors (KPMG, LLP) provided an unqualified opinion on the Fund's financial statements for the fiscal year that ended September 30, 2000. KPMG's opinion affirms that the Fund's Statements of Financial Position, Operations, and Changes in Net Position and Cash Flow are fairly presented. This marks the fourth consecutive year in which the Fund has received an unqualified audit opinion. In addition, for the third year in a row, the Fund's independent auditors identified no material weaknesses or reportable conditions. These findings reflect the commitment of the Fund to sustaining and improving upon its internal controls, operating policies and procedures, and awards monitoring.

The Fund continues to comply with the Federal Managers' Financial Integrity Act (FMFIA) and the Federal Financial Management Improvement Act (FFMIA). The Fund's system of internal management, accounting and administrative control has been strengthened and is operating effectively.

As has been discussed with the Subcommittee in previous years, the Fund is committed to managing for results. Its mission is to promote access to capital and local economic growth by directly investing in and supporting CDFIs and expanding banks' and thrifts' lending, investment, and services within underserved markets. We will continue to ensure the highest level of commitment to effective management controls are maintained as the Fund moves forward.

CDFI FUND PROGRAMS

The Fund supports its economic development mission of providing capital to underserved persons and in underserved markets by investing in CDFIs, and by providing incentives for mainstream financial institutions to invest in CDFIs and increase their activities in distressed communities. The Fund does this through four programs: the CDFI Program; the Bank Enterprise Award (BEA) Program; the Training Program; and the Native American Training and Technical Assistance Program. These four programs are described in greater detail below.

CDFI Program

The CDFI Program provides financial assistance in the form of grants, loans, equity investments or deposits to CDFIs. Since its inception, the Fund has made approximately 500 CDFI Program awards totaling an aggregate of \$295 million. Awards are provided on a highly competitive basis to CDFIs under three separate funding components, each attempting to reach a different type of CDFI or market: the Core Component, the Intermediary Component, and the Small and Emerging CDFI Assistance (SECA) Component (formerly the Technical Assistance Component).

The ***Core Component*** is directed at building the financial capacity of CDFIs by enhancing the capital base -- the underlying financial strength -- of these organizations so that they can better address the community development needs of their target markets. The Fund selects awardees that demonstrate private sector market discipline and the capacity to positively impact underserved communities. The Core Component leverages additional private and public sector investments into these same organizations through the Fund's application requirements, particularly the one-to-one non-Federal matching funds requirement.

In FY 2000, the Fund provided 75 Core Component awards totaling over \$74 million. On August 14, 2000, the Fund published a Notice of Funds Availability (NOFA) announcing the availability of \$50 million in Core Component awards for FY 2001. The application deadline was December 21, 2000. We are currently in the process of completing site visits and due diligence reviews. We expect to make approximately 45 to 65 awards under this NOFA.

Since inception, the Fund has made approximately 275 Core awards totaling over \$267 million. The Fund recently evaluated its 1996, 1997 and 1998 Core Component awardees. These 106 organizations received \$118,387,800 in Fund awards. In 1999, awardees made \$1.38 billion in community development loans and investments. Credit union and community development bank awardees serviced 158,962 checking and savings accounts with balances of \$484,032,833 in 1999. Seventy-seven percent (77%) of these accounts are held by low-income individuals. The average awardee's client base is 70% low-income, 63% minority, 50% female, 73% urban and 34% rural. These 106 organizations provided business training, credit counseling, homebuyer training and other development services to 33,986 individuals and organizations. Fund awardees have leveraged significant additional capital. In 1999, for every \$1 awardees loaned or invested in their communities, \$1.1 was invested by other entities.

The ***Intermediary Component*** allows the Fund to invest in CDFIs through intermediary organizations that support other CDFIs and emerging CDFIs. These intermediary entities, which are also CDFIs, generally provide financial and technical assistance to small and growing CDFIs. Like Core awardees, Intermediary awardees are required to obtain matching funds in comparable form and value to the financial assistance they receive from the Fund.

Since inception, the Fund has obligated awards totaling over \$18 million to seven different intermediary institutions. On August 14, 2000, the Fund published a NOFA announcing the availability of \$5 million in Intermediary Component awards for FY 2001. The application deadline for this NOFA was January 18, 2001.

The ***Small and Emerging CDFI Assistance (SECA) Component*** was initiated in FY 2001. It replaces the Technical Assistance (TA) Component, which was first introduced in 1998 to build the capacity of "start-up," young and small institutions. Under the TA Component, the Fund directed relatively small amounts of funds -- generally \$50,000 or less -- to CDFIs that could demonstrate significant potential for generating community development impact, but whose institutional capacity needed to be strengthened in order to fully realize this potential. Some typical uses of TA grants included: computer system upgrades and software acquisition;

producing internal policies and procedures; evaluating current loan products and developing new ones; and training staff.

In FY 2000, the Fund provided 66 TA Component awards totaling \$3.3 million. Between 1998 and 2000, the Fund made 225 TA Component Awards totaling over \$10 million.

On November 27, 2000, the Fund published a NOFA announcing the availability of \$10 million under the new SECA Component for FY 2001. Unlike its predecessor TA Component, the SECA Component permits small and emerging CDFIs (generally those with less than \$5 million in assets) that have never received a Core Component award to apply for up to \$150,000 in financial assistance in conjunction with their requests for a technical assistance grant. Requests for financial assistance must be matched dollar-for-dollar with other non-Federal funds.

The SECA Component was developed in response to language in last year's appropriation bill that called for the Fund to establish a financial assistance program for smaller and newer entities, many of which serve some of the most difficult to reach populations.

The Bank Enterprise Award (BEA) Program

The Bank Enterprise Award (BEA) Program is the principal means by which the Fund achieves its strategic goal of expanding financial service organizations' community development lending and investments. The BEA Program recognizes the key role played by mainstream depository institutions in promoting the growth of CDFIs and the revitalization of distressed communities.

The BEA Program provides monetary incentives for banks and thrifts to expand their investments in CDFIs and/or to increase their lending, investment and service activities in distressed communities. BEA awards vary in size, 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.

To date, 433 awards totaling over \$135 million have been provided to banks and thrifts. Banks and thrifts receiving BEA Program awards have provided \$794 million directly to CDFIs, and \$2.14 billion to distressed communities in the form of direct loans, investments and services.

In FY 2000, the Fund increased both the number and total dollar amount of BEA awards. In FY 2000, we made 159 awards totaling \$45 million. On September 5, 2000, the Fund published a NOFA announcing the availability of \$30 million in BEA Program funds for FY 2001. The application deadline for this NOFA was November 21, 2000.

This past year, the Fund developed and administered a survey to all FY 2000 BEA Program awardees. Among other things, the survey asked: (1) how the prospect of a BEA Program award influenced the relationship between the awardee and CDFIs; (2) how the awardee's products or services may have been influenced by the prospect of receiving a BEA Program award; and (3)

how the awardee spent its award dollars. We are still collecting and analyzing surveys.

The Training Program

The Training Program, begun in FY 1999, is aimed at supporting the Fund's strategic goal of strengthening the organizational capacity and expertise of CDFIs. The Training Program provides funds that support the development and delivery of training products to CDFIs and other financial service organizations engaged in community development finance. Training will be addressed via classroom instruction, web-based distance learning, and other electronic formats.

In FY 1999, the Fund initiated its first activity under this program. We undertook a market analysis of the training needs and resources of CDFIs and community-focused financial service organizations. The purpose of the market analysis was to determine: (1) the quality and extent of training available for CDFIs and financial service organizations engaged in community development lending; (2) the training needs of such organizations; (3) impediments to obtaining needed and adequate training for such organizations; and (4) strategies for eliminating those impediments. The results of this analysis were instrumental in helping us to develop a training curriculum.

In FY 2000, the Fund awarded contracts to four training providers for curriculum development and the delivery of three courses: How to Do a Market Analysis; How to Prepare Financial Projections; and How to Develop and Operate a Community Development Lending Program. Training has already begun under each of these courses. By June of 2001 there will be 23 offerings of the three courses supported by the Fund. Each class usually serves from 20 to 30 participants. By the end of June 2001, it is estimated that 530 individuals will have participated in Fund supported training.

Native American Training and Technical Assistance Program

The Fund's FY 2001 appropriations bill set aside \$5 million for the Native American Training and Technical Assistance Program. The purpose of this program is to increase access to capital in Indian Reservations, Alaskan Native Villages and Native Hawaiian communities. Funds will be allocated under this program through direct grants to tribal organizations, CDFIs, other financial institutions, and non-profit organizations serving these communities. We expect to publish a Notice of Funds Availability for this program during the summer months of this year.

This program was the outgrowth of workshops related to the development of the Native American Lending Study/Action Plan. This study examines the key barriers to accessing debt capital and equity investments in Native American communities. It is anticipated that the final report will be submitted to the Congress and the President by June 1, 2001.

CONCLUSION

Mr. Chairman and members of the Subcommittee, thank you for giving me the opportunity to provide this information in support of the FY 2002 budget request.