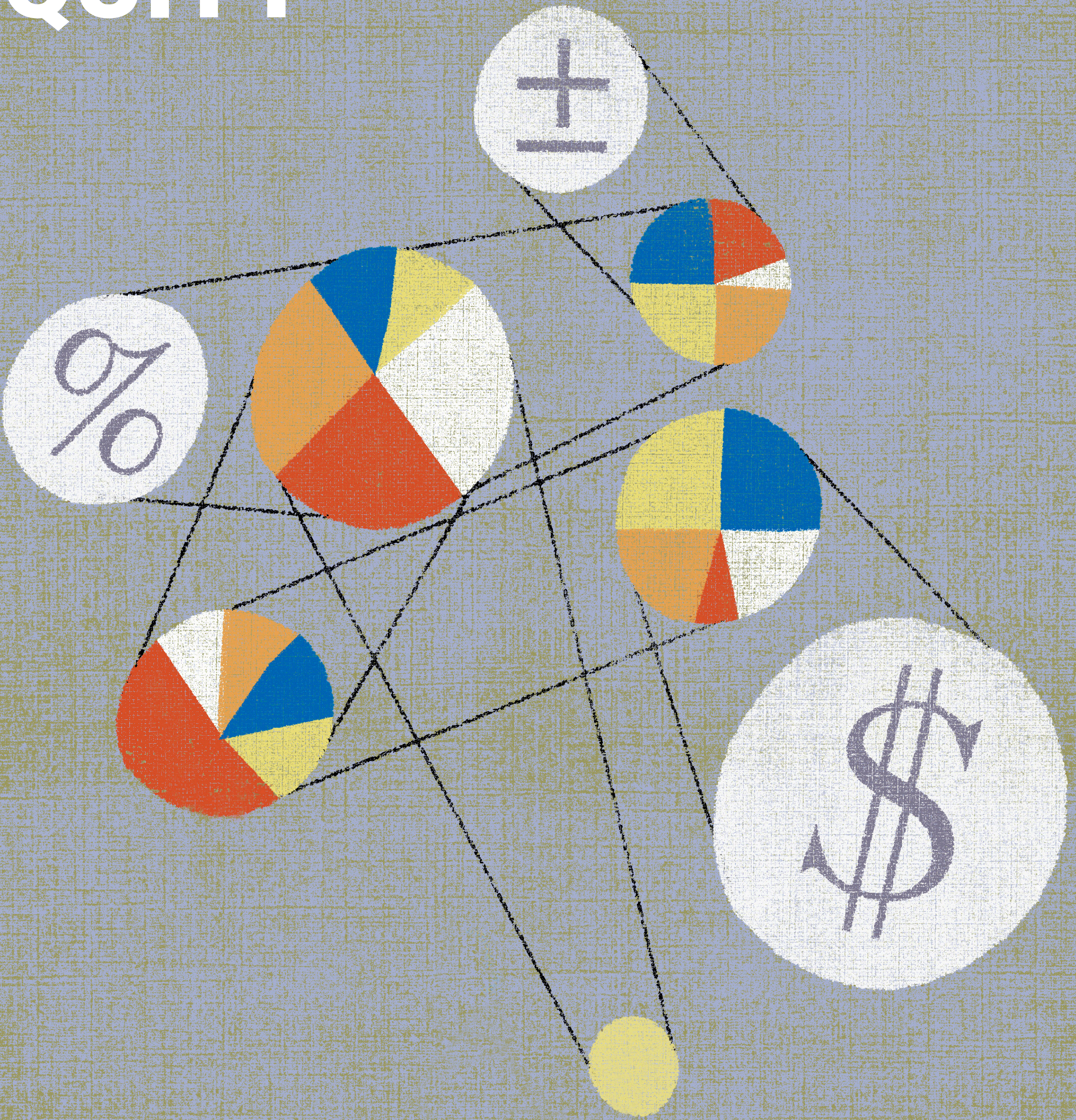
ASSET FUNDERS NETWORK | Grantmakers Advancing Economic Equity

LEVERAGING CDFIs TO INCREASE WEALTH GENERATION AND EQUITY



There is an urgent need to change the current course of the racial and ethnic wealth gap given the financial implications for the country. The most significant racial and ethnic wealth-related disparities are in real estate, investment, and private business assets.[1] Thus, targeted small-business asset accumulation is a viable strategy to increase wealth equitably.

Wealth accumulation, through the pathway of entrepreneurship, not only impacts owners themselves but also provides auxiliary opportunities for the people they employ and the communities in which they operate. Together with other sector-wide efforts towards equity in the larger financial ecosystem, economic growth and opportunity can yield community-wide progress.

CDFIs, particularly CDFIs led by people of color (aka minority-led CDFIs), understand persons of color who are small business owners.[2] They also understand the systemic barriers that may make flexible underwriting criteria more necessary. In response, minority business owners, who have a historic understanding of injustice in the banking sector,[3] often mistrust the larger financial system. Building trust with a minority-led or community-focused CDFI opens opportunities for the entrepreneur's business to be healthier and grow.

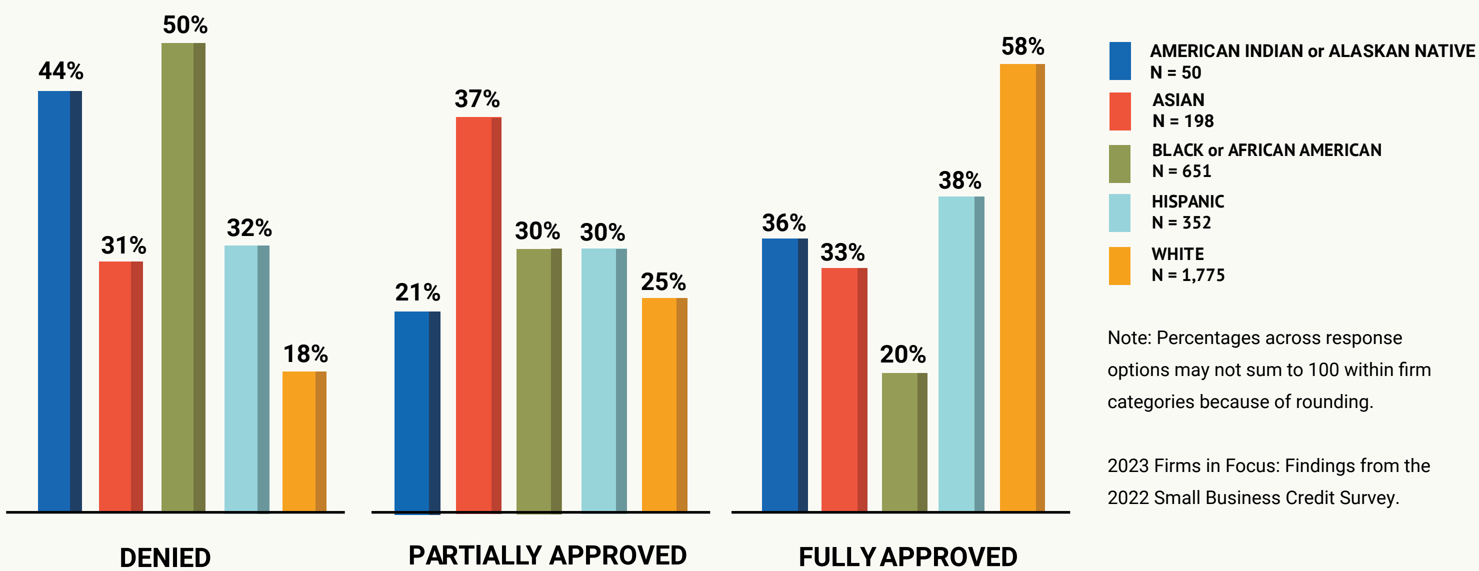
Over the last ten years, entrepreneurs of color have had the greatest growth in business ownership,[4] accounting for more than 50 percent[5] of the two million newly created firms. Yet, they have fewer assets, are less likely to be employer-based businesses than their White counterparts, and are undercapitalized.[6] As of the second quarter of 2023, private business assets of White households in America were valued at $14.16 trillion, as opposed to Black households with only $380 billion, Latinx households with $470 billion and all other racial groups with $2.01 trillion.[7] Small businesses owned by entrepreneurs of color accounted for approximately 20 percent[8] of businesses that employ others, an estimated 1.2 million employer businesses, in the 2020 census. Among these business, 2.4 percent are Black owned,[9] 6.5 percent Latinx owned,[10] 10.6 percent are Asian owned and less than 1 percent are owned by Indigenous people. These businesses employ approximately 9.9 million people and generate $357.4 billion in annual revenue.[11]

One of the most significant barriers to small business growth is access to capital. Entrepreneurs of color are less likely to raise capital from outside sources, be approved for a loan, and receive the amount of capital they request from capital providers.[12] Growing private business assets is a powerful tool to reduce the racial and ethnic wealth gap because it removes many of the barriers that stand in the way of wealth accumulation. In fact, Black business owners' net worth is 12 times greater than that of Black non–business owners.[13] Yet, small business owners of color still face significant barriers[14] and lack sufficient resources to grow and succeed at larger scales.[15]

CDFIs provide more flexible capital, because of their funding sources from the federal CDFI Fund and private investments, often with less traditional underwriting criteria and lower rates than banks. In the process, CDFIs borrowers access the financial system, build banking relationships, and, hopefully, graduate to other financial institutions.

This brief explores how CDFIs can be leveraged to strategically expand opportunity for wealth creation within Black, Latinx, and Indigenous communities. It both outlines innovative strategies that are currently being utilized to position CDFIs as wealth-building mechanisms and recommends how philanthropy and financial institutions can invest to narrow the racial and ethnic wealth gap through investments to expand small business.

Outcomes on loan, line of credit, an merchant cash advance applications
(% of loan, line of credit, and cash advance applications)



Note: Percentages across response options may not sum to 100 within firm categories because of rounding.

2023 Firms in Focus: Findings from the 2022 Small Business Credit Survey.

CDFIs – The Basics

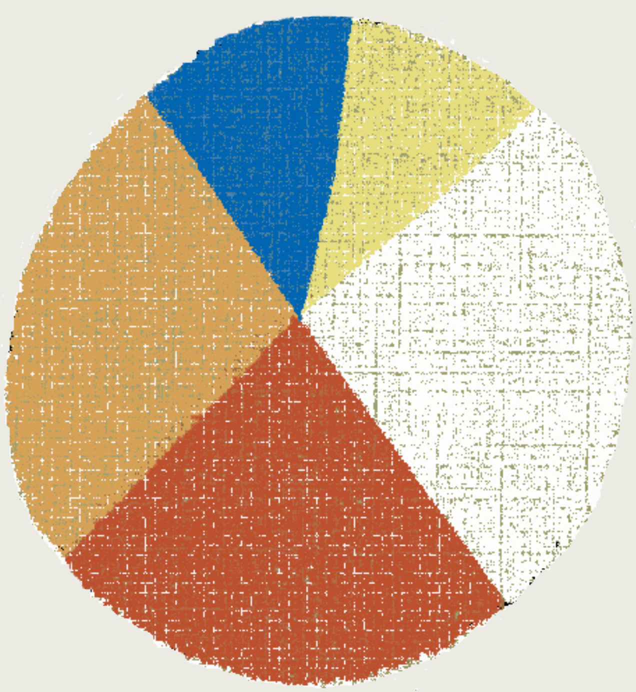
Community development financial institutions (CDFIs)[16] have been assisting minority small business owners since they were organized in 1994. CDFIs were created to address gaps in the financial sector by providing affordable lending products and financial services to underserved communities that are low income, low wealth, and undercapitalized. Every CDFI is regulated, guided, and monitored as a federal program.

A CDFI certification affords a mission-based organization access to funding[17] through the U.S. Treasury in the form of grants, equity investments, and awards to fund technical assistance and organizational capacity development. Offering more tailored services than traditional lenders, CDFIs have innovated programming and market practices that, when aligned with the CDFI's mission, speak directly to the needs of their community clientele.

CDFIs raise additional capital from other public funds, private investments, and philanthropic sources in the form of grants, investments, and program-related investments (PRIs) with low interest rates and flexible repayment terms that allow them to grow their assets and their capacity while still supporting the growth of economic opportunities in the communities they serve.

Today, there are more than 1,300 CDFIs across America. They are of varying size, can be for-profit or nonprofit, have different target markets, and mission-focused lending/investing strategies.[18] CDFIs may also be banks or credit unions, allowing them to benefit from equity investments, interest on loans, service fees, and deposits. Combined, the cost of capital for CDFIs is often below market rate, allowing them to offer more affordable rates and other supportive services to their borrowers. Their products may include mortgage lending (including federal government GSE products), small business lending (including federal government SBA products), community facility lending, equity investments (such as venture capital), technical assistance, and the promotion of development efforts in low-income communities within their target markets.

Through investments in small businesses, affordable housing developments, commercial real estate, and nonprofit organizations, CDFIs foster opportunity in underserved markets. At a minimum, 60 percent of their financial activities must be provided to low-income communities. "Low-income" for CDFIs is defined by 12 CFR § 1805.104 as income, adjusted for family size, of not more than 80 percent of the area median family income for metropolitan areas or, for non-metropolitan areas, the greater of (i) 80 percent of the area median family income or (ii) 80 percent of the statewide non-metropolitan area median family income. More than 40 percent of the CDFI industry loans and investments have been made in majority-minority communities across America.[19] Their proximity to and position within low income communities helps build connectivity and trust for institutions that traditionally have faced issues of mistrust.



CDFIs As A Mechanism For Change

CDFIs are mission-driven investors, providing capital and resources that fill gaps in underserved communities to catalyze local economies, improve the physical environments in which they sit, and bolster the financial well-being of their fellow residents. CDFIs find new ways to attract capital, operate in novel sectors, and create unique programming suited to the needs of their clients in responsive and culturally relevant ways[20] through specialized off-balance-sheet funds, online impact investment platforms, or capital markets. For investors that seek to address the racial and ethnic wealth gap by investing in historically underserved communities, CDFIs can be the natural driver of their investments.

For deep community impact, CDFIs can deliver near-market returns aligned with the value-based, thematic, or place-based initiatives and objectives of philanthropy.[21] As valuable as CDFIs' mission-focused role in the community may be, minority-led CDFIs are often uniquely qualified to serve the needs of minority businesses and the communities where the majority of minority-owned companies are located.[22]

Shortchanged and Underfinanced

As a mechanism for intentional social impact on minority small business growth, CDFIs, especially those led by people of color, need to be better capitalized to do their best work. While federal funding is one of the greatest sources of capital for CDFIs, that funding alone is not sufficient to meet the capital needs of minority small businesses across the country.

- Despite the CDFI mission to decrease inequities in low-income communities, disparities exist in the federal funding allocated to support their work. A 2017 survey found that minority-led CDFIs are underrepresented in the field (26 percent of 316 CDFIs were minority led). More importantly, they are underfunded compared to White-led CDFIs: the average asset size of minority-led CDFIs was approximately $71.4 million as opposed to around $169.7 million for white-led CDFIs.[23]

- Asset size is important for acquiring collateral for investments and other funding opportunities. Also, private investors perceive large assets as an indicator of an organization's ability to manage more funds or lend more; thus, CDFIs with smaller asset sizes find their ability to leverage resources for growth in the communities they serve more limited.

- The lack of designated capital investment to explore technology product offerings, purchase them, and integrate them with current systems has left many CDFIs less competitive with online platforms.[24]

- Underfunding enhances this challenge by hindering CDFIs' ability to invest in the technology needed to expand equitable access to fintech services for the communities in which they are located.

An effective CDFI system must work both within and outside, on the margins, of the conventional financial system and small business network, bridging relationships within its own unique ecosystem to support the health of communities.[25] Minority-led CDFIs, with the closest proximity to the community, provide access to informed capital and tailored financial information for local minority businesses. They stand in the gap to fuel small business growth for minority entrepreneurs and small businesses that otherwise would lack access to affordable capital. As subject matter experts, culturally, they have direct knowledge of the needs of locally based small businesses and can be relied upon to advise the ecosystem. For philanthropy, the pathways of investment in this ecosystem both center CDFIs and reinforce systemic efforts.

How Philanthropy Can Help Catalyze Small Business Growth Through CDFIs To Narrow The Racial Wealth Gap

Philanthropy can fund strategies and innovative initiatives that, together, improve CDFIs' capacity to grow wealth-building businesses in community.

1. Support CDFIs led by people of color in accessing federal government programs through administrative grant support to increase capacity.

2. Optimize resource sharing and expertise utilization through talent-sharing programs.

3. Expand wraparound services and ecosystem-building programs.

4. Promote organizational responsiveness and sustainability through flexible capital solutions,allowing CDFIs to provide the right capital forgrowing businesses.

5. Foster accountability by standardizing data collection and reporting processes.

6. Support innovative solutions for employee ownership, longevity, and succession planning in minority-owned businesses.

1 Support for Access to Federal Government Funding for Minority-Led CDFIs

Financial support to help small and minority-led CDFIs navigate and apply for federal grant programs for CDFIs in competitive Requests for Proposals (RFPs) and other funding channels will enable them to increase revenue-generating opportunities and strategic partnerships. Looking back to the federal Emergency Capital Investment Program,[33] the application process required a quick turnaround, which was difficult for constrained CDFI staff. Most organizations incurred additional costs hiring consultants to help them apply. Several were not able to move quickly enough in the first round, though a second round of awards provided some relief. Now, with the recent passage of the Inflation Reduction Act,[34] CDFIs need to obtain specific technical and content knowledge, in a short amount of time, to realize the potential to drive their investment capacity, product offerings, and revenue growth. But creating competitive and successful applications will be difficult within existing resource restraints.

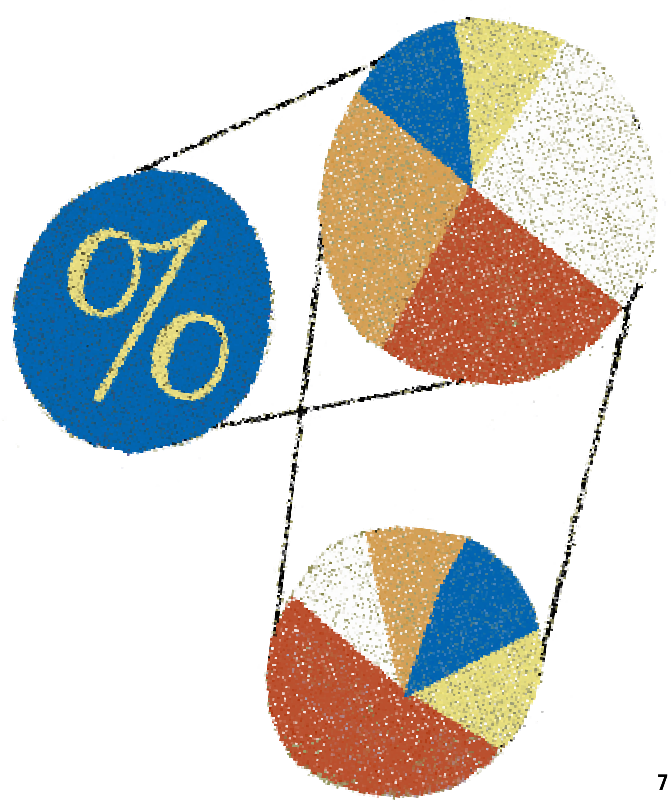
New Markets Tax Credit (NMTC) Initiative—To address accessibility to federal programs, the Kresge Foundation, Robert Wood Johnson Foundation, and US Bank, funded the New Markets Tax Credit (NMTC) Initiative with the African American Alliance of CDFI CEOs. This initiative assists Black-led CDFIs that are also Community Development Entities (CDEs) in their applications for NMTC allocation.[35] In addition to generating significant fee income, NMTCs allow recipients to create wealth-building opportunities through real estate development and business growth in low income communities. Understanding the program's myriad requirements and preparing an organization to submit a competitive application has been a tremendous challenge, particularly for Black-led CDEs, which have historically been under-awarded through the program. Philanthropic support for these targeted efforts helps to level the playing field.[36]

Threats Facing CDFIs in Advancing Equitable Capital

For the foreseeable future, economic[26] and environmental uncertainty[27] will pose additional risks for small businesses. Macroeconomic factors, such as higher interest rates,[28] legislative challenges to investments centering race and gender,[29] economic and environmental uncertainty,[30] and lawsuits challenging explicitly race-based investments all pose threats to minority small businesses and the supporting ecosystem. Climate change and pollution will have a disproportionate impact on communities of color. Their ability to adapt will be critical to addressing the racial and ethnic wealth gap. Recession projections often cause a decrease in demand for products and services. At the same time, lenders' elevated perception of risk in lending to business owners reduces access to capital.

While these factors create competing priorities for capital and attention across the market, they have an outsized impact[31] on minority small businesses. As the cost of capital increases for many CDFIs, they are challenged to keep their rates unchanged for their borrowers. Loans with higher interest rates for small businesses further constrain the businesses, diminishing their access to capital overall. Offsetting these impacts on minority small business lending requires leveraging funds, finding synergies, and supporting innovation to keep the businesses in the community viable.

In response, philanthropic organizations can leverage public funds and invest strategically to allow CDFIs to continue to provide capital at affordable rates. In addition to CDFI Fund goals, government policy priorities, as reflected in the Inflation Reduction Act and the State Small Business Credit Incentive program, authorized support for minority business growth, must continue to be funding priorities. While governmental funding challenges[32] periodically surface, philanthropic resolve should continue to prioritize CDFIs and small businesses in defined communities. Doing so can help philanthropic funders not lose sight of overarching goals related to closing the racial and ethnic wealth gap. By investing in CDFIs themselves, investors will be collaborating with partners who are well rooted in community networks, economies, and cultural fabrics. Increased funding availability in this ecosystem for minority-led small businesses will provide wealth-building opportunities for business owners, their families, and their communities. As a best case, expanded entrepreneurship in low-income communities is a valuable component in closing the wealth gap, especially when combined with wealth gains from intersecting asset-building efforts (e.g., through home ownership, retirement savings, tax benefits, or reduced educational debt).



2 Resource Sharing and Expertise Utilization through Talent-Sharing Programs

Funders can cultivate talent development by providing financial support for programs and by sharing their expertise and skills, particularly with minority-led CDFIs. This collaboration enables the CDFIs to strengthen their capacities and better serve their communities, ultimately fostering economic empowerment and growth.

Talent-sharing programs, mostly created by financial institution funders, include hands-on experiences during which institutional leadership works in conjunction with CDFI staff or major banks to provide opportunities for CDFI staff to learn industry information and to network. Executive and senior management-level expertise that has been gained by working in a large financial institution can be transformational for minority-led CDFIs, and particularly for smaller CDFIs, which may have difficulty hiring talent who have the experience and can identify the synergies for private investment or leveraging of other capital. This talent-information share can help CDFI leaders learn what is most current in the marketplace, grow in their product offerings, better manage their internal operations, and mentor staff.

■ **The Action for Racial Equity MDI Rotational Program**—In 2020, following the murder of George Floyd, Citi's commitment to racial equity included a first-of-its-kind secondment program. The Action for Racial Equity MDI Rotational Program[37] was designed in partnership with a Houston-based Minority Depository Institution (MDI). The goal of the effort was to share knowledge of large bank operations and offerings with a small local bank so that the local bank's leadership team might learn best practices and be introduced to new products and services that could benefit their clients. Now in its second turn, the effort has expanded to include more MDIs, who have requested management-level talent with expertise in a wide range of areas, including mortgage lending, technology, and operations support. As a rotational program and marketing/branding partnership, the initiative gives Citi's leaders the opportunity to work directly with MDIs to share their expertise.

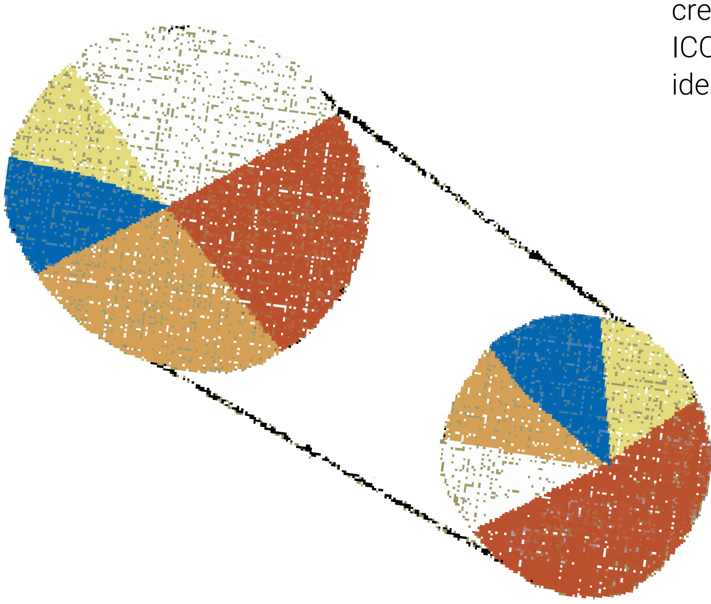
3 Expanding Wraparound Services and Ecosystem Building

CDFIs can offer customized technical assistance to borrowers as an accompaniment to lending. A 2013 study by the UPS Store found that, among entrepreneurs who received mentoring, 70 percent of businesses survived at least two times longer—five years or more—than those whose owners did not receive mentoring.[38] In this model, a CDFI shares expertise with borrowers, coupled with capital, to increase the growth of the business and the impact of the loan in the community. While capital fuels small businesses, a lack of understanding of how to maximize their value and leverage lending can make scaling and growth more difficult for even the best businesses. As opposed to funding education exclusive to general business needs, such as business planning, financial statement preparation, or bookkeeping, this CDFI customized technical assistance, paired with loans, to support small-business borrowers in a responsive way unique to their specific business needs.

For underserved borrowers who might not know who to trust or where to obtain professional service providers to help them with their business, these programs are important catalysts. When initiated early in a borrower's relationship with a CDFI, programs like these that provide more than just the loan can build trust and foster a meaningful partnership, rather than a transactional relationship. This is particularly important for minority business owners, as they are less likely to have access to strategic advisory and business consulting services to support them.[39] In times of business stress, this kind of partnership can significantly reduce loan loss and default rates, as business owners feel more comfortable consulting mentors, communicating earlier with lenders, and reaching out to the networks they now have at their disposal.

Tap the Link—A pilot program funded by Citi with Connecticut-based CDFI Capital for Change launched a wraparound services program to small business owners who received loans. For example, Capital for Change helped an in-state restaurant owner who sought a real estate loan buy a much larger restaurant in their town, allowing business expansion. Coupling his loan with consultants who assisted the owner with things he did not realize he needed—store design, marketing, and menu offerings—maximized the impact of the loan.

Inner City Capital Connections—The Initiative for a Competitive Inner City (ICIC) has been elevating research and strategic practice towards inclusive economic prosperity in underresourced communities since 1994 and supports urban opportunity with innovative partnerships and programming that cultivate community-focused economic development through small businesses and entrepreneurship.[40] With support from Kaiser Permanente, Bank of America, and an array of other diverse funders, ICIC operates the **Inner City Capital Connections**[41] (ICCC) program, a 40-hour, tuition-free, high-level executive education program building the capacity of business owners in underresourced communities to generate sustainable growth and cultivate resiliency.



Functioning as a "mini-MBA" program delivered by university professors, local experts, and financial institutions, the program's overarching goal is to connect local entrepreneurs with capital source opportunities to create local jobs and nurture economically prosperous communities. Small to mid-sized business that operate in underresourced communities are the focus, with priority going to businesses that are BIPOC, women, veteran, or immigrant owned. ICCC has four programmatic components:

- Opening seminar covering finance, strategy, marketing, and talent management;

- Digital learning series to deepen learnings from the opening seminar;

- One-on-one general business and capital coaching; and

- An annual conference convening participants to grow their network.

The curriculum prioritizes principles of scale, growth, and sustainability by introducing small business owners to key business concepts, targeted and actionable strategies, and personalized deliverables. Since 2005, ICCC has grown to support more than 5,000 businesses in the United States and Canada with nearly $2.4 billion in capital. Participating business owners have realized 141 percent revenue growth and created over 26,000 jobs in their communities. In 2022, ICCC served over 800 businesses, of which 85 percent identified as BIPOC owned.[42]

Ecosystem Building: CDFI Efforts For Healthy, Sustainable Communities

Described below are a few CDFI models fostering neighborhood economic prosperity that catalyzes both ecosystem and network building. Learnings from these innovators will help to direct dialogues with other entrepreneurs, CDFIs, and policymakers on how to deliver these insights at scale and provide more quality-focused products that center the unique needs of entrepreneurs and more particularly those entrepreneurs who identify as people of color, women, immigrants, and refugees. To create sustainable communities, knowing how to highlight both social and financial investment outcomes helps to refine understanding of where and when to effectively deploy capital, which can increase impact in communities that need it the most.

Pacific Community Ventures and the Good Jobs Innovation Lab[43]

Pacific Community Ventures (PCV) created the Good Jobs, Good Business lending platform that includes a Good Jobs Innovation Lab, which utilizes behavioral economics, applied research, and data analytics to promote evidence-based, high-impact interventions that lead to a more inclusive economy. Good Jobs, Good Business has a two-pronged model that couples free advice with small grants targeted towards increasing jobs. In 2022, PCV allocated 80 percent of its capital to BIPOC-owned businesses and 98 percent to low- and moderate-income communities, with no change to default rates. PCV also provided pro bono business advising mentorship; of participating business, 72 percent were BIPOC owned. Working with its clients, PCV has created a community partner adaptive feedback loop that generates products and services that are tailored to their clients' needs.

PCV, in partnership with the Clinton Global Initiative and a diverse group of founding supporters and partners, introduced the Good Jobs Innovation Lab. The Lab grounds itself in concepts of behavioral economics, drawing upon applied research and data insights to identify and promote the implementation of evidence-based, high-impact interventions that improve job quality and magnify the economic impact of small businesses in their local communities. The Innovation Lab operationalizes strategies for small business owners to raise wages, offer benefits (e.g., employer-subsidized healthcare, PTO, stable schedules), and otherwise engage their employees in a way that still satisfies their business's needs. The Good Jobs, Good Business Toolkit,[44] the first of its kind, equips small business owners with the tools and resources they need to offer jobs with competitive compensation packages. The efforts that support this programming also contribute to field-building research practice. Alongside research and product development, programs like the Good Jobs Fellows program,[45] function[46] as learning opportunities in which proven job creators from PCV's lending portfolio pilot the design and delivery of PCV's innovative capital and advising strategies and tools to provide real-time feedback through tests of improvement methodologies.

Momentus and Nourish DC Collaborative[47]

Conceptualizing sustainable communities and economic prosperity through the framing of the social determinants of health, Momentus's Nourish DC Collaborative builds the capacity of neighborhoods to address the impact of systematic underinvestment through local food economics. In collaboration with the Government of the District of Columbia, the Bainum Family Foundation, the Morningstar Foundation, and Prince Charitable Trusts, the Nourish DC Collaborative was launched in 2021. To help small businesses grow, in turn fostering neighborhood vibrancy and health equity in DC communities, the Collaborative supports both emerging and existing food businesses, including grocery stores, food incubators, corner stores, cooperative businesses, farmers markets, food delivery businesses, urban farms, food processors, food hubs, restaurants, and caterers, through flexible loans, technical assistance, and grants. In this way, local food economies can generate economic opportunities throughout the food value chain and increase possibilities for high-quality jobs, healthier neighborhoods, and vibrant economic prosperity. In addition to Momentus and its subsidiary, CDC Small Business Finance, the lending partners include other area CDFIs: City First Enterprises, EatsPlace, the Latino Economic Development Center, and Washington Area Community Investment Fund. Collectively, they offer loans from $500 microloans to $10,000,000 real estate-secured loans. The flexible loans can be used for working capital, lines of credit, equipment, vehicle acquisition, predevelopment, real estate acquisition, renovation, new construction, leasehold or tenant improvements, and refinancing. Businesses also have access to one-on-one consulting, short-format modules through seminars, webinars and training, a kitchen incubator, mentoring, and cohort-based training. With direct funding support from the Morningstar Foundation, the Keeping it Cool Grant program[48] offers business owners support for cold-storage infrastructure and other equipment related needs, with grant sizes ranging from $10,000 to $50,000 in the DC metro area. In the last two years, this program has disbursed over $1.34 million in grant funds.

JPMorgan Chase's PRO Neighborhoods Competition[49]

The PRO (Partnerships for Raising Opportunity) Neighborhoods Competition is a competition, funded by JPMorgan Chase, to find collaborative partnerships to produce innovative financial models that aid communities at risk of gentrification. The program has three aims: invest in CDFI partnerships, provide seed capital for affordable housing campaigns, and fund research that generates evidence for data-driven solutions. PRO Neighborhoods has facilitated small business growth, built health- and social-related services facilities that stimulated economic opportunities within communities, and provided local-level data to track impact and improve access to affordable housing in neighborhoods at risk of displacement.[50] As of 2022, PRO Neighborhoods has committed over $153 million, making 36,993 loans with 36 collaboratives, consisting of 134 partner organizations in 28 states. For example, one grantee, the Purple Line Collaborative,[51] was able to preserve 241 small businesses, retain 199 jobs, and disburse 24 small-business loans (17 with JPMC funding) amid construction-related disruption and displacement driven by improvements to DC area Metro Systems. The Purple Line Collaborative comprises three CDFIs: the Enterprise Community Loan Fund; the National Housing Trust (NHT), which manages the Purple Line Capital Pool; and the Latino Economic Development Center (LEDC). Taken together, these CDFI-anchored collaboratives raised an additional $1.1 billion in capital, helping to create or preserve 15,334 jobs and 5,897 housing units. The initiatives span small business expansion, affordable housing, real estate development, financial health, jobs and skills, and other focus areas.[52]

4 Organizational Responsiveness Through Flexible Capital Solutions

Increasing investment in small businesses, especially for entrepreneurs of color, requires the commitment and resolve to scale transformative solutions. Philanthropy can help CDFIs take bigger, more meaningful risks by providing support to test and prove concepts to increase small business ownership and seed sustainability.

Flexible capital solutions allow CDFIs to provide the right capital for growing businesses that have little track record and thin or lower credit scores, yet have great potential. Additionally, philanthropic funding of CDFIs is often limited to programmatic delivery as opposed to investing in overhead and operations gaps such as technology, data collection, capital allocation, and deployment. These gaps hamper transformative investment efforts to innovate or eliminate financial systems or practices that are barriers. Operating capital support, such as general operating grants or investments, in addition to programmatic funding helps to ensure the viability of CDFIs. Providing patient, long-term equity or deposit or grant capital to MDIs and credit unions (particularly those with CDFI designations) that primarily serve Black, Latinx, and Indigenous communities supports the other products and services they offer, creating more accessibility to the right capital as a borrower's lending and technical assistance needs change over the lifecycle of their business growth. Grants to fund loan-loss reserves is another way to encourage lending at-risk capital to growing small businesses with thin balance sheets. Targeted funding efforts can be structured to address the historic lack of access to capital.

- **The Entrepreneurs of Color Fund**[53] (EDCF) originated in 2015 as a collaborative effort by JPMorgan Chase and the Kellogg Foundation in Detroit. Launched with $6.5 million, the program grew to $52 million (including external capital) spread among twenty-five CDFIs in 10 markets across the country: Atlanta, Chicago, Detroit, greater Washington D.C., Los Angeles, Miami, Newark, New Orleans, New York City, and Oakland. Philanthropic partners have grown to include Fifth Third Bank, Prudential, the Rockefeller Foundation, and US Bank. EDCF supports micro-, small-, and medium-sized businesses with microloans up to $50,000 and commercial real estate acquisition loans up to $500,000. The flexible financing model allows business owners to decide how best to employ the capital they receive in order to support and scale their businesses. Business owners are also given access to technical advice through these partnerships to bridge knowledge gaps and build their expertise. As of 2022, the Fund had closed 1,850 loans totaling $85 million.

- **Bank of America's Neighborhood Builders program**,[54] with support from the University of California, San Francisco, enabled PCV to provide capital to business owners at 0 percent interest to counter displacement and gentrification of Black, Latinx, and Asian communities in Oakland. Other innovative capital solutions expanded market access for CDFIs in new lending products and increased balance sheet liquidity.[55]

- **Scale Link**—Funder investments made in platforms like Scale Link[56] allow CDFIs to increase liquidity and reduce balance sheet risk. CDFIs typically make small-dollar loans that are less lucrative and more expensive for major banks. Scale Link mechanistically addresses this barrier by aggregating CDFI loans, as a securitized loan product, for investment by banks needing Community Reinvestment Act (CRA) credit. The platform offers CDFIs a secondary market in which to access consistent, unrestricted, and long-term funding, helping close the small business financing gap that disproportionately impacts diverse entrepreneurs. By leveraging philanthropic partnerships, Scale Link can more effectively subsidize operations and build the balance sheet capacity of CDFIs. Scale Link launched in 2020, supported by the Bill & Melinda Gates Foundation, Citi Foundation, Robert Wood Johnson Foundation, and a diverse group of other funding partners. As a tool, Scale Link looks to address CDFI resource constraints and build resiliency. In the two years after launch and prior to January 2023, Scale Link had purchased 2,600 loans, providing $38 million in capital to CDFIs. In that time, Scale Link's revenue has grown to cover base operating costs and it has donated back $3.5 million of its new revenue to CDFIs.[57]

5 Foster Accountability by Standardizing Data Collection and Reporting

Investment in data collection, with longitudinal compilation and use for accountability in community contexts, helps to focus investments and lending with impact to increase economic justice and equity. CDFIs, like other market players, value good data. While some CDFIs have strong data and use it to inform programs, many others struggle with the quality and insufficiency of their data. CDFIs are constrained by staffing and technology limitations to collecting and using consistent, clean, and robust data.

Financial support to standardize processes, clean data sets, and aggregate and report on data will foster evidence-based accountability. Philanthropic support for the collection and reporting of quality data is essential so that CDFIs can be accountable to their mission and to the community. A common financial system and investor perception is that lending to Black, Latinx and Indigenous small businesses is risky, with outsized defaults. But more data is needed to confirm the validity, or lack thereof, of this belief. Indeed, with CRA modifications, the implementation of the 1071 Rule, the understanding gained from COVID-19 relief access to lending, and the broader awakening to the racial and economic injustice embedded into the financial system, data has taken center stage. Data reflecting CDFIs' responsiveness and effectiveness in addressing market needs over time will both articulate their business case and show their impact.

- **The African American Equity Scorecard**[58]—With an eye towards transparent, trackable impact metrics, the Scorecard was designed out of a desire to see more institutional accountability and holistic evaluation of lending practices. The Scorecard is a product of multiyear, unrestricted funding and a partnership between the African American Alliance of CDFI CEOs (Alliance), a member organization of more than 70 Black-led CDFIs; Community Vision; and the California Endowment Fund. As part of a three-year grant to develop innovative programs, increase sector capacity, and apply a racial equity lens to impact investing within Black communities, this investment allowed the Alliance time and patience to innovate. The Scorecard quantifies investment impact in five key areas: wealth building, leadership support, access to land, culture and place keeping, and racial equity. As a longitudinal learning tool across portfolios, the Scorecard can highlight the evolution of organizational impact and growth in geographical footprints and identify organizational blind spots and opportunities for disruption and future impact. The Scorecard serves as a tool to help shape and inform approaches to business practice and underwriting protocols. The data can be used to drive accountability and continuous improvement. The Scorecard supports how organizations innovate as they think about value, financial analysis, impact analysis, and risk. By uncovering where and how racial economic equity is facing barriers in investment practices and lending behaviors using the Scorecard, CDFIs can apply systemic levers to interrupt the embedded outcomes from institutionalized practices of anti-Blackness and racial discrimination and track progress towards mitigating or dismantling their impact.[59]

Data to reflect the impact on small business growth and the racial wealth gap starts by asking the right questions.

Are we measuring the right outcomes? Currently, many practitioners are focused on counting the jobs created from their lending programs in their low-income communities. While that is helpful for CRA and required for funding in other reporting, jobs, even quality jobs, do not necessarily correlate to wealth creation. Therefore, community indicators, not just performance indicators, should be collected. We should be measuring indicators of changes in wealth,[60] such as homeownership, retirement savings assets, college educations, and home equity growth untainted by redlining appraisal values, to ascertain whether CDFIs are addressing the racial wealth gap in their lending.

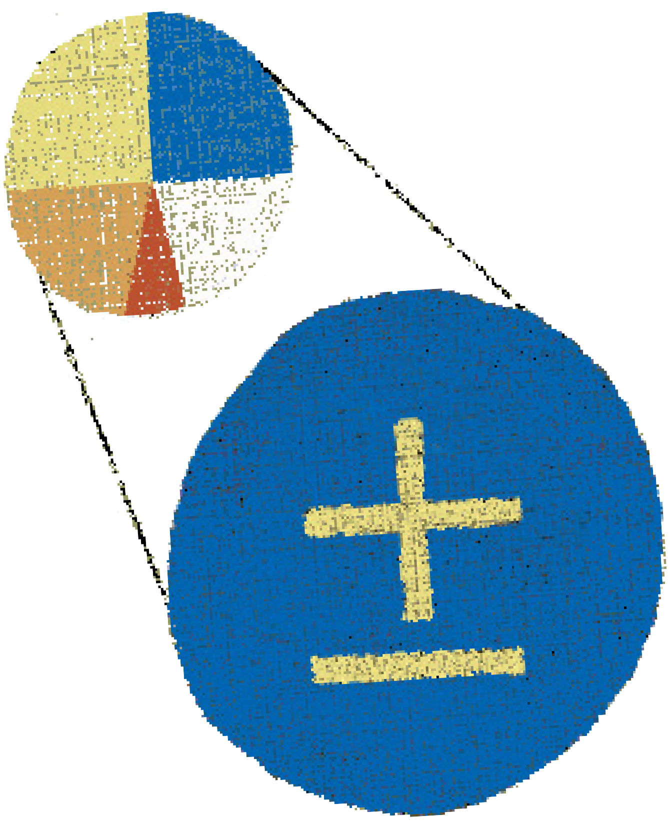
Is the data disaggregated by race, ethnicity, and gender? Data disaggregation by race and other indicators, while it is starting to be collected and reported on by more CDFIs, has not been a robust, standard practice. It is not available at scale or longitudinally to inform policy and measure accountability. Disaggregated, transparent reporting of demographic data, as required by the 1071 Rule, is an instrument for racial economic justice because it makes visible the unique needs, disparities, barriers, and opportunities of specific groups rather than portraying a generalized minority or low-income community experience that erases the nuances of racial, ethnic, and gender realities.

Are underwriting policies evaluating risks appropriately? Historically rooted, systematically discriminatory banking practices[61] in underwriting have been the focus of growing transformational change efforts.[62] Exploring the use of alternative data and risk assessment strategies in underwriting practice can enhance inclusion efforts that may make financing more equitable and combat racial discrimination.

Can we use data for narrative change? CDFIs can reshape perceptions with narrative change efforts that personalize entrepreneurs and their businesses to investors, media, and the community. CDFIs require assistance in crafting compelling narratives and effective storytelling to reframe their efforts. Staff at minority-led CDFIs are often too small and funding is rarely available for marketing and public relations, much less narrative change efforts that can challenge the dominant narrative and replace myths and factual errors rooted in racism that reinforce investor risk aversion and create barriers to persons of color getting loans. CDFIs can be more effective as they articulate their relevance and impact.

Dedicated funding to support local, regional, and national media coverage of impact stories can help CDFIs accomplish wealth building within their community. For example, racial disparities in wealth have rippling implications for communities. Economic positioning shapes opportunities, as well as economic and health outcomes.[63] By focusing on wealth accumulation efforts that can lead to better community-focused outcomes and overall local economic prosperity, funders can ultimately catalyze the capacity of communities to revitalize, generate wealth, and capitalize on opportunities to flourish.[64]

Underwriting for Racial Justice Lender Pilot Program—In 2023, the Beneficial State Foundation launched its pilot program.[65] The program assists banks and community-based lenders, such as CDFIs, with internal endeavors to innovate their underwriting practices to increase capital access for people of color. The two-year program[66] is designed as a Community of Practice in which peer lenders are introduced to new practices, standards, and products that are ready to be piloted by their financial institutions. As a part of this process, the program helps with implementation efforts by facilitating peer shares around the application of these practices. By gathering aggregate and institutional-level data, the Lender Pilot Program helps document how these practices increase access and their impact on borrower experiences and loan performance. Lenders in the pilot not only employ a loan program with a new underwriting strategy, but also build their capacity for community engagement and dialogue and develop paired technical assistance programming.



6 Innovative Solutions for Employee Ownership[67] With the anticipated waves of Baby Boomer retirements and the acknowledgment of the disparate impact retirement could have on minority business owners, who tend to have fewer assets, are less likely to have succession plans, and are more likely to have created companies that are service based and thus harder to sell, funders can support CDFI roles with employee stock ownership plan (ESOP) or cooperative financing models.

Infinity Point CDFI & Local Ownership Catalyst Fund (LOCF)—The LOCF,[68] established in 2021, leverages impact capital to scale employee ownership transitions. By facilitating sales from retiring owners to employees, LOCF keeps local businesses thriving and community rooted. This transfer of ownership empowers individual workers and addresses significant barriers, like owner education and setup costs. Using impact-investment capital, LOCF makes compelling buyout offers on behalf of employees, aligning their interests with company goals. This ownership culture fosters continuous learning, improvement, and employee empowerment, leading to outperformance compared to conventional businesses and better economic and social outcomes for the retiree and employee owner.

Summary Of Recommendations For Funders

Philanthropy is a key source of capital for CDFIs supporting small business growth in underinvested communities. To support entrepreneurs of color and help close the racial wealth gap, increased capital and targeted funding to CDFIs and other institutions that support the ecosystem is needed. Intentional investments to increase CDFI impact on wealth building should include:

1) Increasing capital deployment, with a special focus on supporting minority-led CDFIs in accessing federal government funding streams.

2) Replicating rotational and mentoring programs to open more entry points to larger financial institutions and optimize resource sharing to increase synergy across institutional investment strategies.

3) Funding programs that provide borrowers with technical assistance as well as capital to expand wraparound services and ecosystem building.

4) Promoting organizational responsiveness and sustainability through flexible capital solutions; approaches can include:

- Providing general operating grants allowing CDFIs to strengthen their operations or tied operational grants, in the form of grants or equity-like investments such as program-related investment or forgivable loans, that provide funds for programs or increase organizational capacity for efficiency and effectiveness.

- For CDFIs that are also credit unions or banks in the primary corporation, parallel entities sharing the same parent as a credit union or bank, or subsidiaries of a credit union or bank, making equity investments and deposits in their institutions to provide catalytic capital for scale.

- Directly providing CDFIs with flexible capital, for use at their discretion to advance their mission related investments, removing the burden of having to spend according to a funder's predetermined manner.

- Providing flexible enterprise capital as general operating grants or program-related or impact investing for equity-focused, mission-related, or community-driven investments to help CDFIs innovate and scale efforts to build evidence and achieve desired impact.

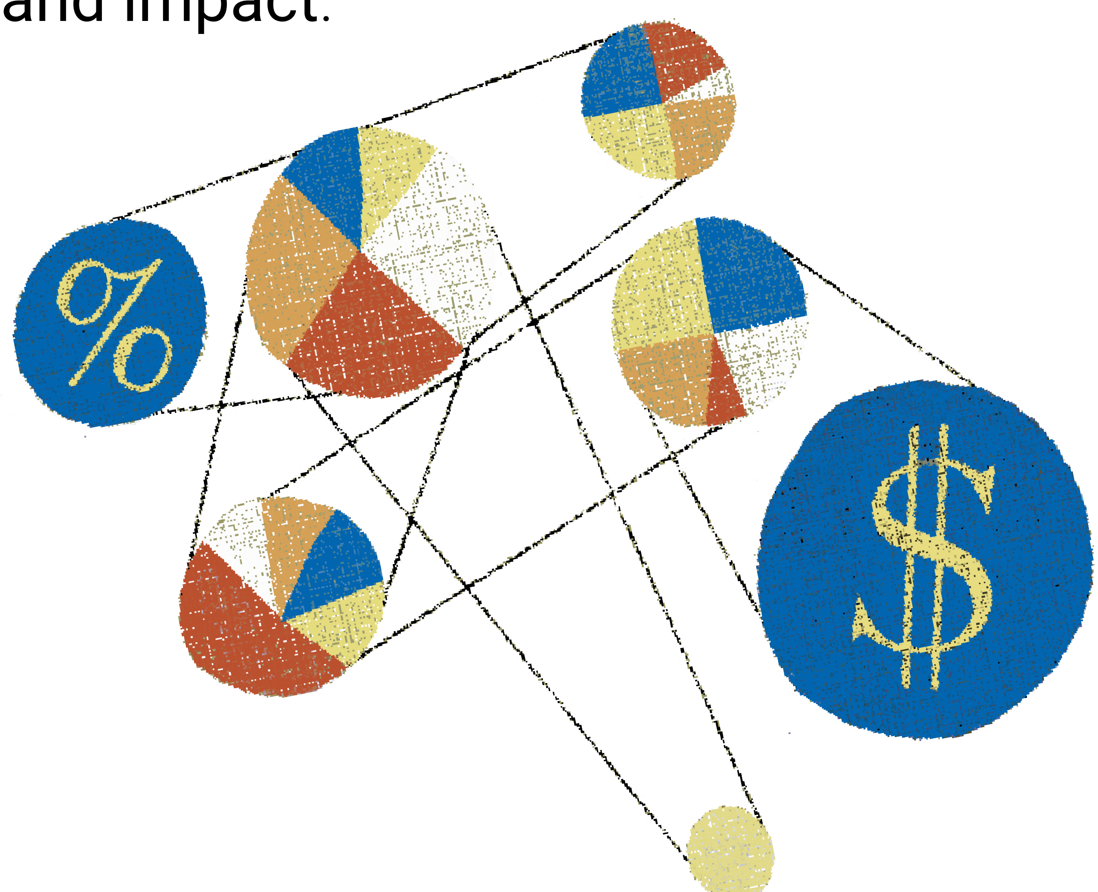
- Investing or helping attract venture-like capital to launch new products that can compete with other lending platforms such as FinTechs while being tailored to the unique service needs of underserved clients, protecting low-income borrowers from predatory lenders in the marketplace, and delivering culturally and community responsive products.

5) Investing in data collection, including longitudinal compilation, for accountability to focus investments, grants, and lending with impacts to increase equity, build small business in community, and contribute to narrative change efforts.

6) Supporting innovative solutions for employee ownership (ESOP and cooperatives) to preserve businesses and expand workers' ownership interests and support longevity and succession planning in minority-owned businesses.

Conclusion

Sustained commitment to uplifting and investing in CDFIs and the Black, Latinx, and Indigenous small business owners they support requires a long view in funding that considers the whole community's health and the cost to our entire U.S. economy. Patient reasonably priced capital is essential. Time for solutions to work and community dynamics to change, with transformative, patient investments, gives CDFIs the capacity to pilot, take risks, inform, innovate, and impact.



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Interviewees (in alphabetical order)

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Brenda Loya, Chief Operating Officer, BlueHub Capital

Bill Bynum, President, Hope Enterprises

Bulbul Gupta, President & CEO, Pacific Community Ventures

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Nicole Elam, President & CEO, National Bankers Association

Shannan Herbert, EVP, Inclusive Credit

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