CDFIs Making History Interview

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Mark Pinsky, President & CEO of OFN, conducted this interview on July 30, 2014.

Mark: Is there an event or series of events, or few events, or ideas, or achievements, or anything like that really stand out to you as important in some way that you can share?

Ellen: I’m going to give you one that I suspect others have, maybe my perspective will be different. I think the advent of the New Markets Tax Credit was an incredibly important event for the CDFI world.

Ellen: I think it was important a number of reasons. First of all, it made an immediate scale change in what CDFIs could do, thereby making them a much more visible part of the financial and development landscape. Second, it did that in a way, and it took a little while, but it did that in a way that had three really important collateral benefits. It meant that development at a large scale could also be mission-oriented.

It brought the CDFIs into sophisticated financing relationships not only with some of their traditional funders like the banks and the foundations, but with a whole different group of players in ways that solidified some of the financial professionalism that was already growing in the field. Then the third thing, and this too took a while, and I think actually people were a little bit surprised about it. It has had the effect of stabilizing the balance sheet and to a lesser extent the income statement of some of the largest and most confident CDFIs, and enabling them to grow and stabilize themselves in a way that I think even the CDFI Fund which would have been the other thing I would have chosen, couldn't have gotten to, because the numbers just wouldn't have been there.

I think all of those things were just very important in transforming the industry, and I think even more importantly in many ways to the extent that people and the policy community now think of the CDFI industry as a partner at a scale level with the rest of the financial services industry. Even though obviously we’re still very small compared to the whole banking world. I think New Markets was the turning point.
Mark: It created a kind of...I'm not sure this is the right word, of reputational parity almost, but that's not the right thing.

Ellen: Yeah, I think that is right. I think that's exactly right, because it meant that even if we were bringing only a small part of the financing, to a project, what we were bringing was something absolutely critical. We were bringing a critical piece of the financing. Of course, this is the whole but-for problem.

We were also bringing the expertise that enabled that financing to get used, and to get used in a relatively efficient way without some of the ...I mean, "Yes. Yes, there are issues about exactly how high the fees are," and all of that, but it hadn't been nearly to the extent that you saw with respect to LIHTC [Low Income Housing Tax Credit].

Mark: Right. Do you think that New Markets had that impact, but it worked as expected, better than expected, worse than expected, different from...

Ellen: It hasn't worked as expected, it's worked better than expected, although also quite differently. When it started this, and the people who started it assumed this is going to be a business financing system. As we all know for a lot of reasons, some of them having to do with what happened with the way the statute was eventually shaped, and some of it having to do with the fact that with LIHTC as a model, it didn't take long for people to figure out that if you're going to use this to finance real estate, you could use it in a leveraged model and give it a good deal, more power.

It went from being a business financing tool, which has not done all that well with the exception of owner occupied real estate. I mean, there it's been just fine it's done exactly what it's supposed to do. To a financing tool that's been used, much more for real estate but particularly as time has gone on, I think the [CDFI] Fund has been quite good at directionally putting it in place, or choosing allocatees and rewarding allocatees who put it in places where even if you can't make pure but-for argument, it has certainly been an important factor in getting something done, and getting something good done.

Yeah, there've been a few abuses, but they really have been pretty minor in a program this large.

Mark: Yeah. I think that's right. It's really interesting when you look at what we're all tearing hair out about now in terms of small business finance,
right? Access, minority access, the products that are available whether they're good products, all that stuff. It’s important to think about.

Ellen: That's right. Perhaps that the statute...The statute was written, in an attempt to minimize abuse in the statute, they wrote it in a way that almost begged to use it for real estate purposes.

Mark: Yeah, right.

Ellen: If it hadn’t been written that way, perhaps it would have been used more for business purposes, but I suspect it would have at the very least taken longer for the leverage model to get developed.

Mark: Yeah. So let me just...

Ellen: Even just say, we don’t need a small business tool, but this one turned out to work much better for something else.

Mark: Yeah, right. Unintended consequences.

Ellen: Not to say it hasn’t created jobs, it has. It just could have done it in a slightly different way.

Mark: I want to make sure I don’t lose the opportunity to hear from you a little bit about the future, as you look forward at this stuff that you’ve been a practitioner in and a champion of, and some ways a regulator of it one point, right, and been involved within so many ways, what drives forward, what are concerns?

Ellen: I’ve got different thoughts on different categories. I think with respect to the large equitable real estate financing world, the TOD world, and some of these big integrated projects that involved health, and supermarkets, and housing, and a whole bunch of stuff, I think that particularly if New Markets continues, the CDFI industry will be sort of absolutely essential glue.

It will be the part of the system that knows how to put the projects together, and with New Markets, has the carrot to bring others to the table. With respect to business lending, particularly small business lending, I think that is a very big challenge particularly outside of rural America.

I think in rural America, CDFIs did a more effective job at building a niche that involves partnership with the local community banks, but
that really have the special niche all for them which is a little bit more on the startup side. Some subordinated debt, although I know that at CEI we’re working very hard to get ourselves away from being solely a subordinated debt lender. Again, some of the structuring expertise on business transactions that are somewhat more complicated. I think the role of CDFIs in small business lending, not micro learning, but in small business lending, in urban America is still unclear. I think it's pretty well established that there's a hole for loans somewhere between about a $150,000 and $500,000, it's where CDFIs ought to be. I think it's been very difficult to figure out how to fit the industry into that hole. I think it's really important.

On the consumer side, this could be the most interesting but at the same time to me, the most scary. It's scary because it tends to be a high volume, low margin business which is exactly the opposite of the way the CDFI industry is structured. It's scary because it's a highly regulated business with huge reputational risks. It's scary because if you're not a depository, the liquidity factor, is huge.

On the other hand, I despair of the broader financial services industry effectively serving, in particular, the lending part of this need. This bleeds over into the micro and small business lending that is really personal lending, which really is in many ways, the heart of micro lending in developing countries. There's a piece of me that says, this is what the CDFI credit unions ought to be doing.

Mark: Right.

Ellen: The non-credit unions oughtn’t muck with it because the liquidity issue is too risky for them, and the regulatory issue is a little bit too risky for them, and credit unions at least know how to play in that game. We ought to be ready to let banks put a good deal of their CRA money into funding the CDFI credit unions to do this.

That is contrary to traditional CRA advocacy, which essentially says, everybody has to do everything. But I worry that if we keep insisting on that, we will end up with the worst of all possible worlds, which is that the credit unions that could be doing it will not be well enough funded to do it. The banks won't do it, or will only do it in a shoddy fashion. And that will leave the door wide open for, at the worst, the offshore Internet players and, at the best, if they can do it at 36%, terrific because it's really hard, but nevertheless that's more than the credit unions can do it for.