



# CDFI 101 Webinar

July 27<sup>th</sup>, 2023



FALCON  
CAPITAL  
ADVISORS

# Who We Are & What We Offer

**Falcon Capital Advisors** is a business advisory firm based in Washington DC that provides strategic advice, technical expertise and engagement strategy to government agencies and financial institutions in real estate, mortgage finance, digital mortgage, banking, and capital markets.

Our **CDFI Advisory Group** has demonstrated, tactical experience in CDFI certification application support and strategic guidance; CDFI Fund compliance and reporting; loan portfolio and investment reviews and platform development.



# What You Will Learn Today...

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1. “CDFI” is a designation conferred by an entity inside the US Department of the Treasury known as the “CDFI Fund”-
  - *There is no prudential supervision/regulation associated with CDFI status.*
  - *There are 7 on-going eligibility criteria to meet to be a CDFI.*
2. There is nothing inherent in the CDFI requirements conflicts with a well-run non-bank mortgage operation.
  - *It is actual the other way around! CDFIs have a hard time taking on rigorous mortgage requirements.*
3. CDFI status confers certain benefits that can lower the cost of capital for mission-based lending.

# Understanding the CDFI Industry





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# Why Be a CDFI?: Lower Cost of Capital

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“The CDFI Fund can certify banks, credit unions, nonprofit loan funds, microloan funds, and (for-profit and nonprofit) venture capital funds that can demonstrate having a primary mission of promoting community development. After certification, CDFIs become eligible for financial awards and other assistance provided by the CDFI Fund that promotes community development in markets comprised of economically distressed people and places.” Source: CRS Report

## 4 Capital Advantages for CDFIs:

-  FHLB Bank membership (nonbank) and access to advances
-  Access to Philanthropic Capital
-  ESG qualification
-  CRA credit

# Why Be a CDFI?: Regulatory Considerations

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With a lower cost of capital, it is less expensive to engage in mission-based lending as a CDFI than as an ordinary mortgage bank.

## Considerations:

### 1. Exemption from ATR/QM

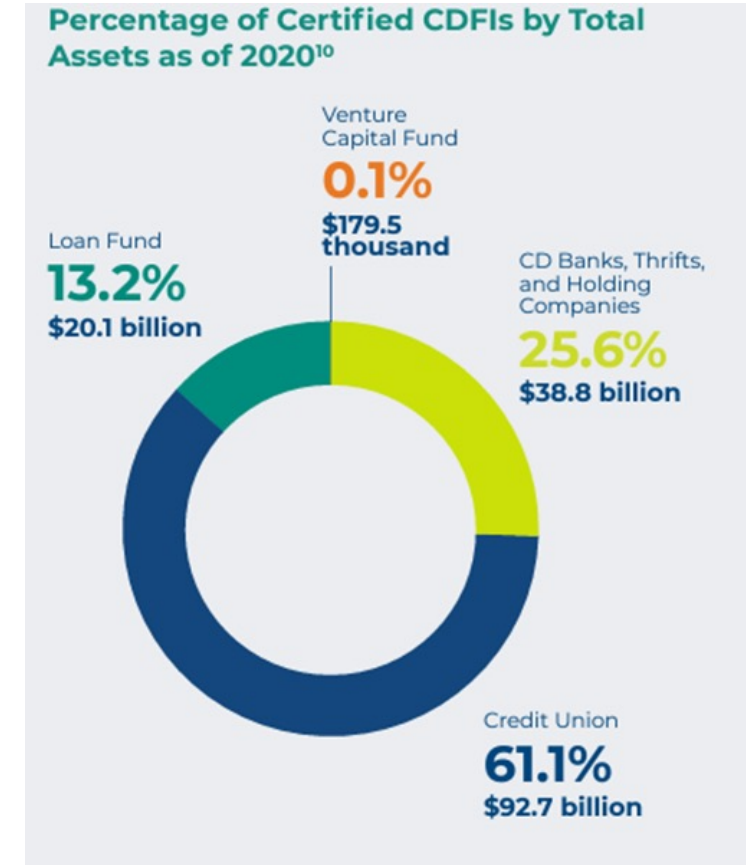
- Easier to lend to deeper credit borrowers without regulatory overlay compliance concerns,
- Deliver better pricing to underserved borrowers relative to non-CDFI peers

### 2. Regulatory alternative to OR complement to Special Purpose Credit Programs

- Fair lending requirements still apply
- “Target Market” captures overlapping consumers

# CDFIs at a Glance

- As of May 2023, the CDFI Fund reported 1,500 certified CDFIs in existence.
  - *45% loan funds*
  - *1% of venture capital funds;*
  - *30% credit unions, 13% banks, and 11% depository institution holding companies.*
- In 2021, CDFIs held roughly \$151B in loans.
  - *Compare: the 5,000 credit unions in U.S. hold \$1.2T in assets.*
- Consumer loans comprise 36.8% by dollar amount and 83% of products offered:
  - *Secured Credit cards*
  - *Short-term, small dollar*
  - *Installment loans*
  - *Loans to individuals for health, education, emergency, debt consolidation, transportation, and other consumer purposes*



## Award Recipients: Loan Originations in FY 2021



	Bank		Credit Union		Loan Fund		Venture Fund	
	Number of Loans	Percent	Number of Loans	Percent	Number of Loans	Percent	Number of Loans	Percent
Business and Micro	13,634	21.6%	6,129	0.7%	14,759	39.7%	262	70.8%
Commercial Real Estate	3,951	6.3%	1,163	0.1%	529	1.4%	2	0.5%
Consumer	30,491	48.4%	754,145	91.1%	13,410	36.1%	0	0.0%
Home Improvement and Purchase	8,384	13.3%	56,718	6.8%	6,225	16.8%	0	0.0%
Residential Real Estate	5,727	9.1%	601	0.1%	1,013	2.7%	23	6.2%
Other	874	1.4%	9,427	1.1%	1,211	3.3%	83	22.4%
<b>Total</b>	<b>63,061</b>	<b>100.0%</b>	<b>828,183</b>	<b>100.0%</b>	<b>37,147</b>	<b>100.0%</b>	<b>370</b>	<b>100.0%</b>

Source: TLR and CLR

Note: This analysis excludes the Paycheck Protection Program (PPP) loans.

## Single-Family Homeownership Under-Represented

- “Home Improvement and Purchase” =
  - *Home Purchase: Loan is for the purchase of a primary residence.*
  - *Home Improvement: Loan is for the renovation or other improvement of an owner-occupied home*
- Only represents a fraction of CDFIs in existence (~400) who were awarded CDFI Fund grants/loans.
- As of May 2023, there are 73 CDFI-certified Loan Funds that hold at least one kind of mortgage related license,



# Why are there so few CDFI Single-Family Non-Bank Mortgage Lenders?

## Virtually no secondary market participation:

- Most non-bank CDFIs usually rely on net assets, which consist largely of subsidized and donated funds (rather than short-term borrowing)
- Challenges with staff recruiting

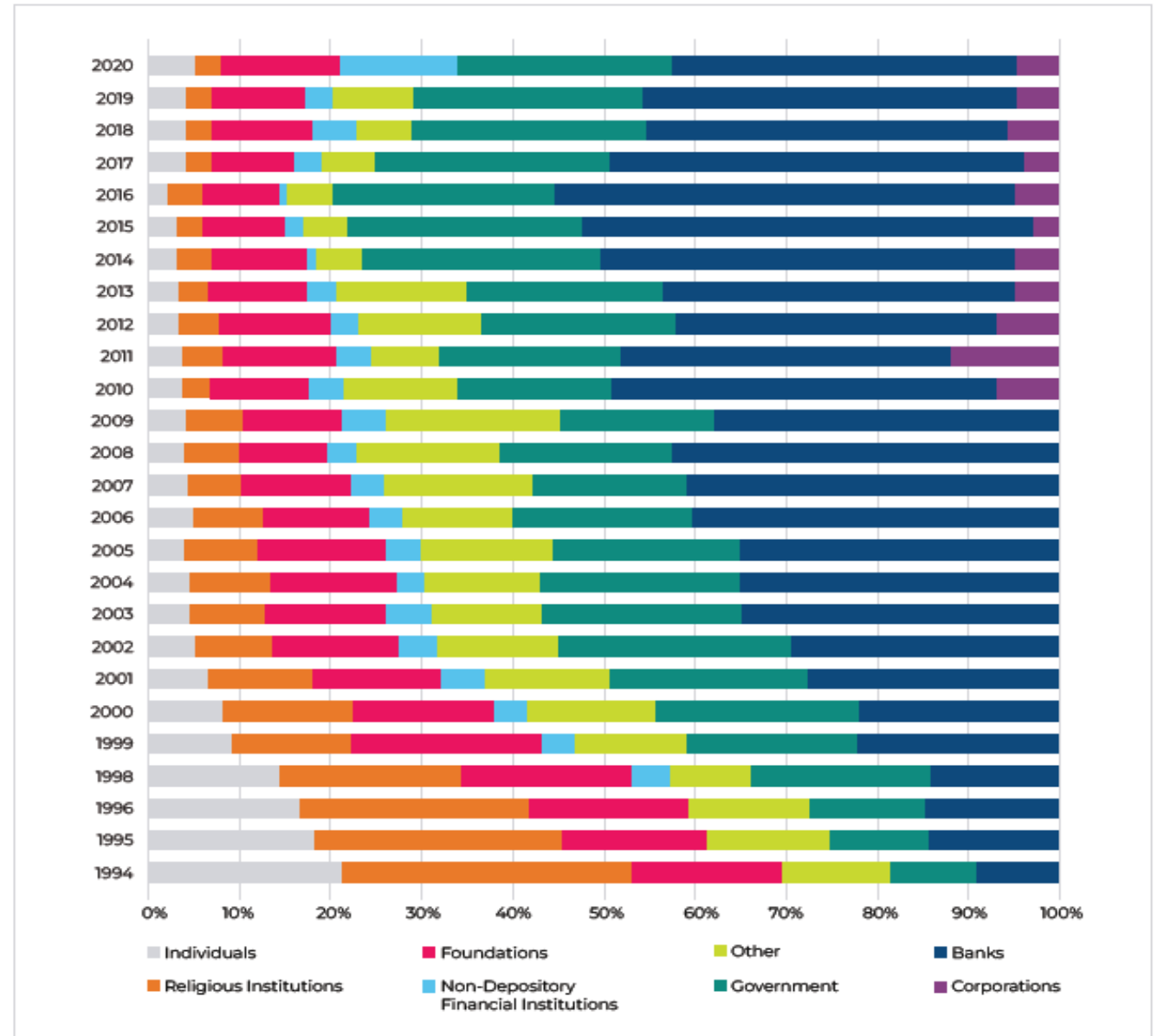
## Licensing and minimum net worth requirements:

- There are no CDFI exemptions for:
  - Mortgage licensing rules
  - Warehouse lenders,
  - GNMA, GSE and FHLB (depends!) minimum net worth requirements

# Source of Funds

- Most of the capital is coming from banks (CRA!)
- Govt support is significant for small business lending, large re-development projects (tax credits)- less so for homeownership (for now).

Average Distribution of Sources of Borrowed Funds for Loan Funds



# How Do CDFIs Access CRA Resources?

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Loans to CDFIs



Purchase of CDFI loans:

Qualifying CRA mortgage loans are based on loans to “low-income borrowers” (note: “household” test for LITP Target Market)

Open loan-purchase agreements and pay up for CRA-eligible loans from 100-400 bps



“Qualified Investments”

Banks often provide funds to CDFIs through equity equivalent investments (EQ2s), which are debt instruments issued by CDFIs with a continuous rolling (indeterminate) maturity.



Banks also provide Grants to support CDFI “Developmental Activities.”

# FHLB Membership

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- As of May 2023, 68 CDFIs were members of the FHLB system, representing 4% of all CDFIs.
- CDFIs are treated as member institutions and must place a minimum paid-in capital stock investment
- FHLB membership eligibility, requires non-depository institutions to have mortgage-related assets that reflect a “commitment to housing finance” as determined by the “discretion” of a FHLB.
  - *Regulations do not set a minimum threshold for the amount of home mortgage loans that an applicant must make (no 10% rule), but*
  - *Must meet the “makes long-term home mortgage loans” requirement: loans on one-to-four family properties, multifamily properties, residential properties with business components ,interests in longer mortgages ,and mortgage pass-through securities.*
  - *MAPS (see Slide 15)*
- CDFIs are also eligible for the Farm Credit System.

# Government Interaction & Regulatory Overlay

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# Regulatory Regime: How are CDFIs “regulated”?

Community Development Institution	Community Development Banks	Community Development Credit Unions	Community Development Loan Funds	Community Development Venture Capital Funds
<b>Structure</b>	Primarily for profit; Some mutually owned	Nonprofit, Cooperative	Primarily nonprofit; Some for profit	Typically for profit
<b>Regulation</b>	FDIC, Federal Reserve, OCC, and state banking agencies	National Credit Union Administration (NCUA); state banking agencies, COSSEC	Unregulated	Unregulated
<b>Capitalization Structure</b>	Insured deposits, subordinated debt, and equity	Insured deposits, subordinated debt, and equity	Unsecured and secured debt, EQ2, and equity (grants)	Equity (and potentially debt)
<b>Financial Services Offered</b>	Loans and depository services for housing, business, commercial real estate, and consumer	Promote asset building and savings; affordable credit and retail financial services for individuals and small businesses	Loans for housing, microenterprise, small business, consumer, community facilities, and commercial real estate	Equity and debt with equity features to mid-sized businesses with high growth potential and social impact

Most CDFIs are non-bank “loan funds”; Governed by state lending laws, and licensing requirements; Mortgage rules much more onerous than most state lending rules.

**Table I. CDFI Fund's Minimum and Prudent Standards (MAPS):  
Selected Metrics, Definitions, and Key Considerations**

MAPS Metric Name	Definition and Explanation	Considerations and Targets
Annual Net Charge-Off Ratio	The sum of total loans charged off minus recoveries, divided by total loans receivable.	Asset quality
Current Ratio	Total current assets divided by current liabilities.	Liquidity Target Value = 1.25 Target Value for Native CDFIs > 1.0
Deployment Ratio	The total gross loans outstanding divided by a CDFI's total available funds that can be used for lending.	Liquidity CDFI Fund historical target > 50%
Earnings Ratio (Income Ratio)	Total revenue divided by total expenses.	Earnings
Loan Loss (Reserves) Ratio	The total amount of loan loss reserves (that can be used to buffer against loan loss) divided by the total amount of loans outstanding. This ratio, which has similarities to certain bank capital-asset ratios, measures a CDFI's vulnerability to <i>anticipated</i> loan defaults.	Asset quality
Net Asset Ratio	Total net assets (equity) divided by total assets. This ratio, which has similarities to certain bank capital-asset ratios, measures a CDFI's vulnerability to <i>unanticipated</i> loan defaults.	Capital adequacy CDFI Fund Historical target > 20%
Net Income		Earnings Target value >0

# Minimum Requirements

- Minimum and prudent standards (MAPS)
- 3 months operating costs
- Annual report

# The Certification Process

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# Certification Overview

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To be certified as a CDFI, a financial institution must meet each of the following seven certification criteria at the time a CDFI Certification Application is submitted to the CDFI Fund:

- 1 Be a legal entity;
- 2 Have a *primary mission* of promoting community development;
- 3 Be a *financing entity*;
- 4 Primarily serve one or more *Target Markets*;
- 5 Provide *Development Services* in conjunction with its financing activities;
- 6 Maintain *accountability* to its defined Target Market; and
- 7 Be a non-government entity and not be under the control of any government entity

# Primary Mission

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1. A CDFI shall have a primary mission of promoting “community development.”
2. A “community development” primary mission may be evident if it’s **incorporating documents or board approved narrative statement (mission statement or resolution)** clearly indicates that it has a mission of purposefully improving the social and/or economic needs of:
  - Low-income individuals (80% AMI)
  - Individuals that lack adequate access to capital and/or financial services
  - Distressed communities
  - Other underserved markets

# Financing Entity

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CDFI must dedicate the predominance of its assets and staff time to closing, arm's length, transactions.

## Mortgage Product Test:

“12 full months immediately prior to submission of the CDFI Certification Application, for each of the Applicant’s mortgage loan products”

- *DOES NOT Offer loans that include negative amortization, interest-only payments, or balloon payments?*
- *DOES NOT Underwrite adjustable rate mortgages at less than the maximum rate in the first five years?*
- *DOES NOT Offer loans with an original maximum term longer than 30 years?*
- *DOES Verify the income of the borrower*
- *DOES NOT Charge upfront points and fees in excess of the Qualified Mortgage limits*
- *DOES have “measures to ensure the borrower has an ability to repay the loan according to the terms of the loan, meet any of the borrower’s other major financial obligations, and still pay basic expenses, without having to reborrow or refinance”*

# Target Market

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To be a certified CDFI, an organization must serve at least one eligible **Target Market** (either an Investment Area or Targeted Population).



An organization must direct at least **60%** of all its Financial Product activities (by dollar amount AND volume) to one or more eligible **Target Market**.\*

*\*On average, CDFIs devote 67% to their Target Markets\**

# Target Market: 3 Types

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## Investment Areas

Meet economic distress criteria and has significant unmet needs for Financial Products and Services, or are wholly located within an Empowerment Zone or Enterprise Community

## Targeted Populations

**Low Income Targeted Populations** – for a specified geographic unit, individuals whose family income (adjusted for family size) is:

- *For Metropolitan Areas, 80% of the area's median family income; and*
- *For non-Metropolitan Areas, the greater of 80% of the area median family income; or 80% of the statewide non-Metropolitan Area median family income*

## Other Targeted Populations

- *African-American\_*
- *Hispanic*
- *Native American*
- *Hawaiian/Alaskan*
- *Persons with Disabilities*

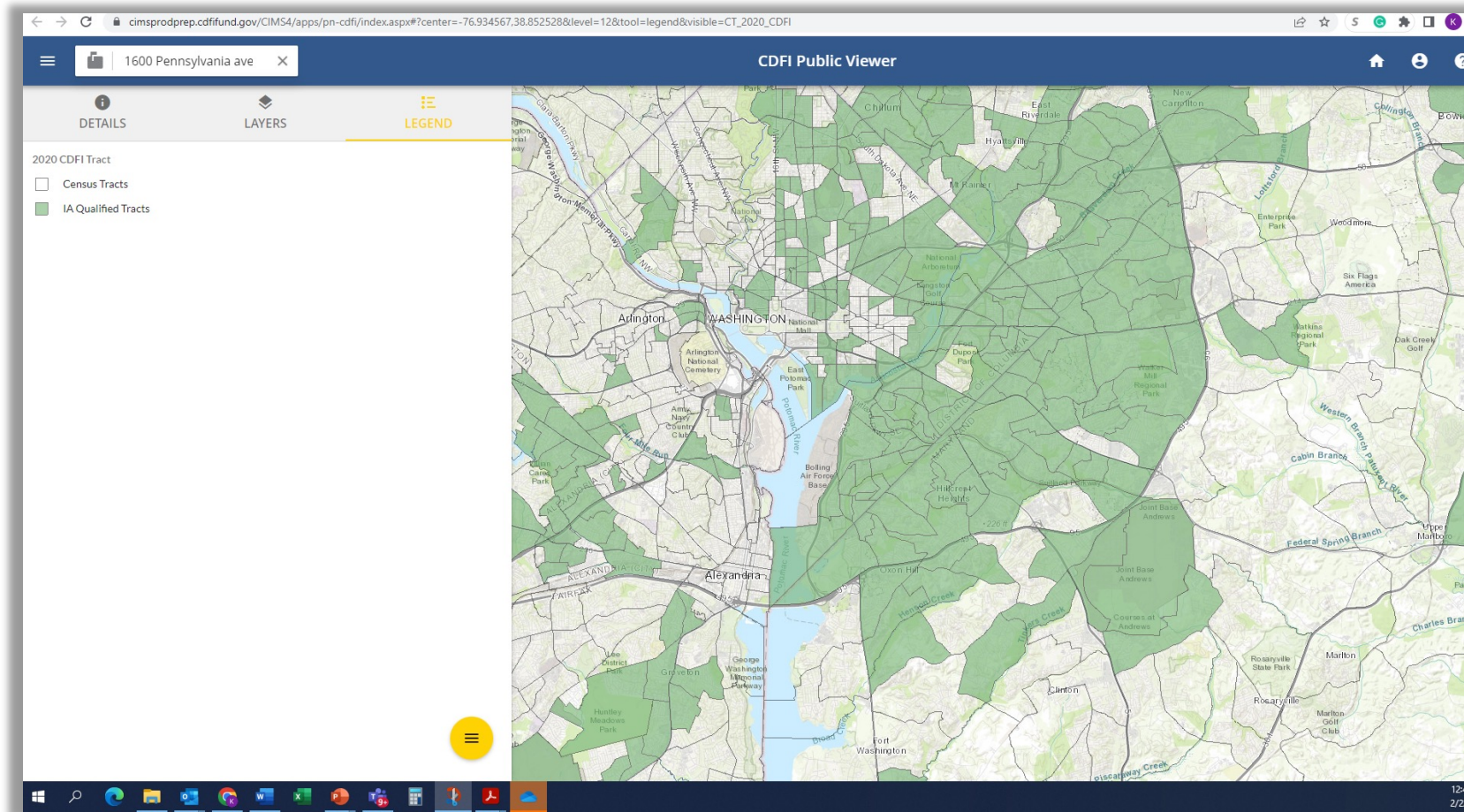
# Target Market: Example

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- ✓ **Investment Area:** MSAs like Newark, Philadelphia.
- ✓ **Other Targeted Population:** African- American
- ✓ **Other Targeted Population:** Hispanic

*\* 60% of the CDFI lending needs to be to borrowers that fall in 1 or more of those 3 categories.\**

# Target Market: Investment Area



# Accountability

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The Board of Directors or Advisory Boards must represent the interest of the Target Market(s)

## **If your primary borrowers are low-income individuals:**

- *Low-income individuals OR members who work for non-profit organizations who primarily serve low-income residents*

## **If your primary borrowers are minorities:**

- *Persons of color*

## **If your primary lending is in Investment Areas (IA):**

- *Individuals who live in IA, own businesses in the IA, OR work for non-profit organizations that primarily serve the IA*



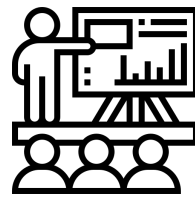
# Developmental Services

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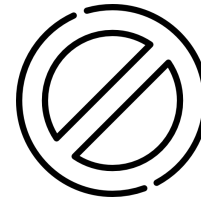
Must provide at least one Development Services activity in conjunction with the Financial Product. (e.g., offering first-time home buyer counseling to applicants for down-payment assistance loans).



Minimum One Development Service:  
 Available at least four times per year



Limitations on use of publicly available online training material



List of ineligible services include workforce training, newsletters, marketing events/activities, etc.



Can be provided under a contract by another provider (most typical).

# On-Going Compliance

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## Annual Certification Attestation

### Data Collection Reports (ACR):

- **Certification Transaction Level Report**, which is designed to standardize and automate the data collection process.
- **CDFI Information Mapping System (CIMS)**, which maps census tracts and counties for each borrower.



# Mortgage Finance Considerations

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# The Universe of CDFI Participation in Single-Family Purchase Loans

~~Seller-Servicer (GSE, GNMA, PLS)\*~~

Warehouse Lender\*

Mini-Correspondent;  
Wholesale\*

Counseling +  
Mortgage Broker

Downpayment  
Assistance  
(Second Liens)\*

State HFA\*

Portfolio  
"Relationship"  
lending\*

*\*Denotes CDFI eligible "Financing Activity"\**

# Process Recommendations: How to Become a CDFI

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- ✓ Consider your Target Market- Who do you want to lend to and what product do you want to offer?
- ✓ Determine if a separate entity is necessary
  - *60% test*
  - *non-profit or for-profit ?*
  - *Regional or National?*
  - *Shared Services agreement for ministerial tasks?*
- ✓ Start lending for 6-12 months
- ✓ Apply for CDFI Certification!

Engaging a CDFI expert is helpful in the planning stages as many of the certification requirements overlap or collapse into one another!

# Certification:

*Manageable with a little help from an expert*

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1	<b>Accountability</b>	- "Organizational Accountability Policy"  - Target Market defined - Board Vote
2	<b>Primary Mission</b>	#NAME?  - Draft statement - Align with Loan Policies  - Board Vote
3	<b>Community Development Strategy</b>	- Draft  - Board Vote
4	<b>Financial Product</b>	- Loan Policies  - Summary description  - Loan Procedures  - Complete TLR for prior activity  - Loan Committee Composition and Policy Board Vote
5	<b>Developmental Services</b>	#NAME?  - Contract  - Memorialize in Staff chart
6	<b>Detailed App Information Entry</b>	- SAM number  - EIN Number  - FTE & Staffing Analysis

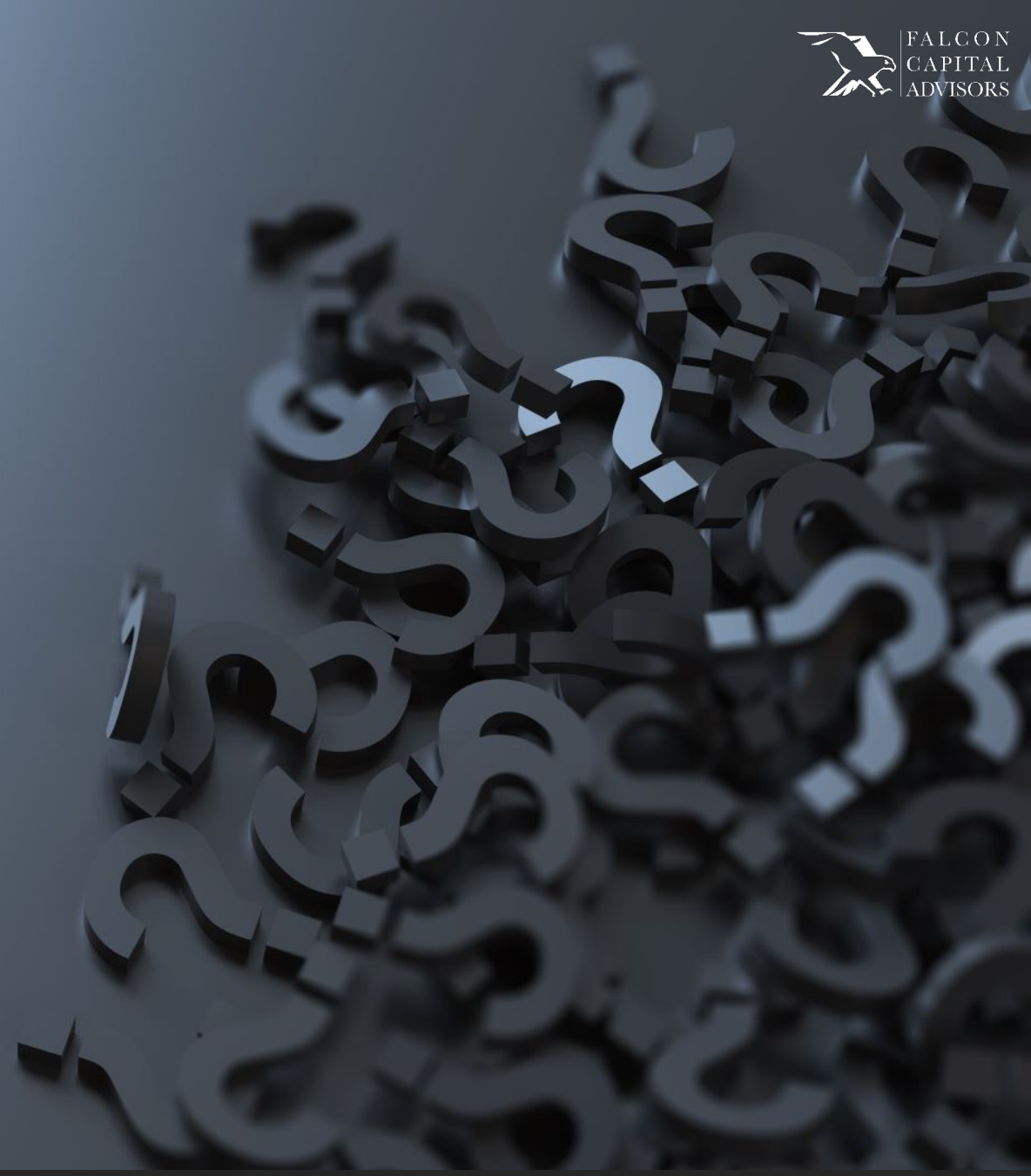
# Questions?

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# Acronyms

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# Acronyms

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**ACR** – Annual Certification and Data Collection Report, a CDFI Fund requirement

**AMI** – Area Median Income

**ATR** – Ability to Repay

**CDFI** – Community Development Financial Institution

**CDFI Fund** – The U.S. Department of the Treasury’s Community Development Financial Institution Fund

**CIMS** – CDFI Information Mapping System, a CDFI Fund functionality

**CLR** – Consumer Loan Report, data banks and credit unions submit

**CRA** – Community Reinvestment Act

**CRS** – Congressional Resource Service

**EIN** – Employer Identification Number

**EQ2** – The Equity Equivalent, a long-term deeply subordinated loan commonly used by CDFIs

**ESG** – Environmental, Social and Governance

**FCA** – Falcon Capital Advisors

**FDIC** – Federal Deposit Insurance Corporation

**FHLB** – Federal Home Loan Bank

**GNMA** – Government National Mortgage Association (Ginnie Mae)

**GSE** – Government-Sponsored Enterprise (Fannie Mae and Freddie Mac)

**HFA** – Housing Finance Agency

**IA** – Investment Area, a CDFI term of art

**LITP** – Low-Income Target Populations, a CDFI term of art

**MAPS** – Minimum and Prudent Standards, a CDFI term of art

**MSA** – Metropolitan Statistical Area

**NCUA** - National Credit Union Administration

**OCC** – Office of the Comptroller of the Currency

**PLS** – Private Label Securities issued in the secondary mortgage market

**PPP** – Payroll Protection Program

**QM** – Qualified Mortgage

**SAM ID** – Unique entity identifier used in SAM.gov

**TLR** – Transaction Level Reports