The Community Development Financial Institutions Tax Credit

Background: Community Development Financial Institutions (CDFIs) play a critical role in filling market gaps, providing responsible and affordable credit and investment to underserved communities and individuals.[1] CDFIs receive funding from a range of entities including federal, state, and local governments, and regulated financial institutions. The external debt capital CDFIs receive tends to be short-term, which is not as helpful in supporting CDFIs ability to serve their communities. Equity is the hardest form of capital for CDFIs to raise, but is necessary to support their lending and investing and ability to expand. The Department of Treasury's CDFI Fund is the main source of equity for the industry; the CDFI Fund has awarded $5.6 billion in total funding to CDFIs since 1994. In 2020, to respond to the pandemic, Congress approved a historic, bipartisan $12 billion investment in CDFIs and Minority Depository Institutions. The funding included $9 billion for the Emergency Capital Investment Program (ECIP) and another $3 billion in grant funding through the CDFI Fund. Those investments were intended to allow CDFIs to sustain lending and investing in underserved communities and expand their financing activities over time.

The Problem: The CDFI Fund's programs and the historic emergency funding showed an enduring problem for the CDFI industry, which is that the demand for programs supporting CDFIs are constantly and significantly oversubscribed, particularly as the number of CDFIs has grown. For example, the ECIP program received $4 billion more in requests than it could fulfill and in FY21, the CDFI Fund's Base-Financial Assistance and Technical Assistance awards had $391 million in demand for the $140 million available.[2] The continued levels of demand demonstrate the industry's ability to absorb more capital. Therefore, additional tools are needed to unlock more equity and long-term patient capital for CDFIs.

The Solution: Since 2020, we have seen historic levels of private-sector commitments related to increasing access to capital for underserved communities. However, the private sector has disincentives to make the investments that would have the biggest impact for CDFIs and their communities. To leverage private sector funding for high-impact investments, Senators Warner and Wicker are proposing to create a CDFI Tax Credit, to provide a credit for private sector investors that make equity, equity equivalent investments or provide long-term patient capital to CDFIs (i.e., loans with a minimum term of at least 10 years). The bill would benefit CDFIs of all types – bank CDFIs, credit union CDFIs, venture capital CDFIs, and CDFI loan funds – and provide the institutions with the maximum flexibility and financial support they need to increase wealth in low- and moderate-income communities.

Bill Summary:

- *Credit:* The bill would provide a 3% credit for the first 10 years of a qualified investment in a CDFI, 4% for the following years, up to a maximum of 10 years. There is a 1% increase in the credit for equity or equity equivalent investments.
- *Qualified investments*: The bill provides the tax credit for qualified investments in CDFIs including equity investments, loans with a minimum term of 10 years, and equity equivalent investments for CDFI loan funds. Institutions receiving the investment must be a qualified CDFI.
- *Limitation*: The total credit available is capped, starting at $1 billion for 2022, $1.5 billion for 2023, and $2 billion for 2024 and each year thereafter adjusted for inflation.
- *Allocation*: To receive an allocation, eligible CDFIs are required to apply through the Fund. The bill directs the fund to allocate the credit based a CDFIs' past performance and ability to attract private capital. It also ensures small CDFIs and institutions and rural areas will benefit from the new resources.

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[1] https://cdfi.org/about-cdfis/what-are-cdfis/

[2] https://www.cdfifund.gov/sites/cdfi/files/2021-12/FY2021_Agency_Financial_Report.pdf