FIVE BUILDING BLOCKS to Increase Racial Equity in CDFI Lending

Lessons and Examples from Nonprofits and CDFI Practitioners

1 Community Trust

2 Client Service Orientation

3 Customized Technical Assistance

4 Flexible Capital Solutions

5 Appropriately Priced Capital

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Nonprofit Finance Fund (NFF) and Capital Impact Partners joined together to form the Catalyzing Finance for Racial Equity project to understand how nonprofits have experienced working with CDFIs, as well as how some local and national CDFIs have successfully taken steps to address inequity within their own lending practices. The goal of the project was to identify new ways that CDFIs can center communities of color in how they lend and invest. The following report captures learnings about effective practices for advancing racial equity.

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Contents

Dear Friends and Colleagues,

Community Development Financial Institutions (CDFIs) were born out of the civil rights movement to create more equitable access to financial services and resources for communities that had long been denied them, particularly communities of color and communities with lower incomes.

Yet CDFIs are part of a financial system embedded with racism. While some have made significant strides toward expanding access to financial resources, CDFIs must work together at a field-wide level to collectively address racist lending practices if they want to fully achieve their intended goal of equalizing access for all people.

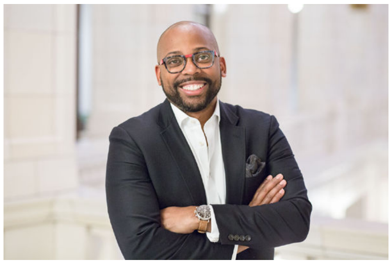
Nonprofit Finance Fund (NFF) and Capital Impact Partners (Capital Impact) are two CDFIs that provide loans to local and national leaders working toward social good across the country. Capital Impact is part of the Momentus Capital branded family of companies, including CDC Small Business Finance and Ventures Lending Technologies. In recent years, NFF and Capital Impact have increasingly recognized the racism fundamentally embedded in our own practices as CDFIs and are working to identify and correct policies and practices that contribute to it. With generous support from the W.K. Kellogg Foundation and research partnership from The Racial Equity Assets Lab (The REAL), we conducted research to understand how nonprofits have experienced working with CDFIs – the good and the bad – as well as how some local and national CDFIs have successfully taken steps to address inequity within their own lending practices. Our goal was to identify new ways that CDFIs can lend and invest to center communities of color.

We know that many CDFIs and other lending institutions are also on a journey to correct the racism and other inequities in the financial system. In this report, we offer what we learned from the nonprofits and CDFIs who graciously shared their wisdom with us, in the hope that other lending institutions may also benefit from their counsel.

Sincerely,

Aisha Benson
President and CEO, Nonprofit Finance Fund

Ellis Carr
President and CEO, Momentus Capital



Introduction

This report came out of a collaboration between NFF and Capital Impact entitled "Catalyzing Finance for Racial Equity" (CFRE), which was first conceived in late 2019 and concluded in 2022.

We had four goals for CFRE, all of which we continue to pursue in our ongoing equity work as CDFIs:

1. Continue to deepen awareness of and insights about racial equity dynamics and build the organizational structure to support this work within our organizations.

2. Develop new insights, tools, and approaches for embedding racial equity in investment practices.

3. Engage broader CDFI peers in learning and training.

4. Build links between CDFI sector and broader national movements for racial equity.

In the first research phase of this project, NFF and Capital Impact partnered with The REAL to gather insights from five Bay Area community organizations leading multi-sector, multi-collaborator initiatives to examine how CDFI practices and services could be improved to better support community health. Research findings were summarized with recommendations that helped form the CFRE framework of five building blocks, which are described below.

We also knew that other CDFIs were on a similar journey, and that it would be beneficial to hear about the approaches they had developed. Working again with The REAL, we interviewed 10 CDFIs in five states (Arizona, Michigan, Mississippi, New Mexico, and Louisiana). These CDFIs were both large and small, national and hyper-local, some with very specific target audiences, others with a broad bend. The REAL interviewed staff and leadership about their experience with community development and lending, specifically discussing the CFRE Racial Equity Framework and five building blocks, and how they resonated with their CDFI work.

In the following report, we share the five building blocks with examples of how some CDFIs have put aspects of each building block into practice. In addition, we have a list of questions under each building block to get you started in thinking about how to implement aspects of these building blocks in your own institution.

Five Building Blocks to Advance Racial Equity in CDFI Lending

When we asked our community-based organization and CDFI advisors about positive experiences and effective practices that advance racial equity in CDFI lending, several consistent themes emerged. We call these the Five Building Blocks to Advance Racial Equity in CDFI Lending.

1. Community Trust
2. Client Service Orientation
3. Customized Technical Assistance
4. Flexible Capital Solutions
5. Appropriately Priced Capital

In the following pages, we provide a description of each building block, along with some specific examples of how CDFIs have implemented them. We present these examples not because they are the only path forward, but rather to inspire CDFI leaders with ideas for how to approach these building blocks within their own institutions.

1 Community Trust

Building Block 1: Build Trust with Communities

The most critical element of providing communities the support they need is to build trust with community members. This is an important step in developing the relationships needed to create positive social change. It requires embracing a racial equity perspective, which means connecting deeply and intentionally with the stakeholders who are negatively impacted by systemic racism.

1. **Show rather than state a commitment to racial equity and communities of color.**

2. **Identify strategies for creating and maintaining a presence in target communities.**

3. **Demonstrate responsiveness to needs and solutions identified by community members.**

Examples:

- Interviewees cited their strategies for showing up in their target communities, ranging from attending small business and local entrepreneur events, to attending ribbon-cutting ceremonies, to taking part in local fairs, networking events, technical assistance activities, etc. Several shared that it was a priority not just for business development staff but also for staff from other business functions – including lending staff – to attend community events and engage in relationship-building.
- CDFIs that did not have a physical presence instead prioritized building relationships with community-based organizations that already held trust and connectivity with potential borrowers. ProsperUS, LiftFund, and Nusenda all focused on direct outreach to like-minded, community-centered organizations that could be partners on programming, relationship-building, and in some cases, lending functions themselves.
- Several CDFIs were founded with a specific racial equity mission in mind, and as a result had been engaged with their communities for decades. Native Community Capital in New Mexico, for example, was developed and launched after conversations with tribal leadership. In places where traditional mortgage processes are incredibly challenging, this relationship between Native Community Capital and tribal leaders/members demonstrates the importance of co-creation predicated on acknowledgement of history.

Trust also implies accountability. CDFIs need to be accountable internally to organizational racial equity goals while also building a culture of accountability to stakeholders outside their organizations. The CDFIs involved in the CFRE project shared an understanding of the underlying reasons for mistrust in CDFIs and financial institutions broadly, and all emphasized the importance of building community connection and trust as a foundational prerequisite to the successful execution of racial equity-focused strategies and activities.

Responsiveness is also part of developing trust. Being responsive means truly listening to and understanding community needs and aligning products and services to meet those needs. By co-creating their offerings with community partners, CDFIs can more effectively foster the change those partners seek. Community partners need to know that they can count on CDFIs to do what they said they were going to do. If they call, they need to know the CDFI will respond in a timely manner.

While building trust is one of the most important aspects of this work, it is also the most challenging. There are no checklists or clearly defined processes for how to build trust and it requires people to engage in a relational way despite working in a transactional industry based primarily on systems and processes. Despite these challenges, building trust must be prioritized as the foundational building block.

Questions to get started:

- Marketing and outreach practices: How do we market ourselves? Do we have a tailored plan for marketing to communities of color and organizations that serve them? What intermediary and communications channels are we using to reach organizations that may not traditionally fall within our portfolio? Are there trusted messengers who can vouch for the credibility of the organization?
- Intake and sourcing practices: Are originators proactively working to build relationships with grassroots organizations serving communities of color?
- Staffing practices: Do we have staff that are specifically committed to building trust and relationships with organizations in our target audiences/communities? Are staff located in offices that are accessible to organizations and communities? Do staff possess the cultural and linguistic competencies to communicate and relate with local communities?

2 Client Service Orientation

Building Block 2: Cultivate A Client Service Mindset that Centers the Needs of Community-Based Borrowers

To best support the communities that they serve, CDFIs and financial institutions should find out what borrowers want and figure out how to provide options that respond to their particular circumstances.

1. Know who target clients are.

2. Have honest dialogue with them to learn what they want and need.

3. Deliver targeted, community-centric services that clients want in a respectful way that makes continued dialogue possible.

4. Be able (when necessary) to say no in a way that preserves trust and mutual regard.

Examples:

- Several CDFIs with more narrowly defined geographic scopes have cultivated a client service mindset through explicit marketing and business development efforts focused on building relationships and being present in many ways in their markets. They also prioritize listening and learning about what prospective clients want and need. Often, this is spearheaded by staff who do not have explicit lending responsibilities or is done in partnership with lending staff as part of initiatives that aren't exclusively focused on loan production. For example, Invest Detroit created the Strategic Neighborhood Fund, an initiative with the City of Detroit, that focuses investment in ten different neighborhoods across Detroit through four pillars of investment: 1) patient loan capital for commercial corridor development projects, 2) catalytic park investment in local parks, 3) streetscape improvements along the historic commercial corridors, and 4) housing stabilization through strategic grants.
- NFF's Capital Advancing Racial Equity (CARE) Funds provided low- and no-interest loans to nonprofits in several urban markets during the first two years of the COVID pandemic, with a focus on supporting nonprofits led by people of color. In setting up the Funds, NFF engaged nonprofit leaders of color to both inform design of these products as well as to help market their availability to potential borrowers in communities of color.

Having a client service mindset sounds simple: a lending organization should find out what its borrowers want and focus on providing them options to meet their particular priorities. Yet while this sounds simple in theory, it is not easy to put into practice – especially in a context like the lending system in which there is a history of racism, racialized exploitation, disrespect, and consequent mistrust. Overcoming the racism that is built into the system – at levels that are so deep we may not always recognize all of it – requires a ceaseless focus on the needs of community-centered borrowers.

Centering those needs requires that lenders know who their target clients are, figure out how to get into honest dialogue with them to learn what they want, and deliver what clients want in a respectful way that makes continued dialogue possible. As lenders assess whether a potential borrower fits into their strategy, they should be prepared to explain the process with honesty and transparency, exercise timeliness in decision-making, and offer alternative resources or referrals if they are not able to offer a loan.

Furthermore, it is important to establish a due diligence process that is collaborative and that encourages employees to bring context and perspective to borrowers' work in these communities. Through research and interviews, we learned about the benefits of not pressuring staff to originate and close loans – recognizing the larger institutional shifts that are needed to support a lending team to function this way – and instead encouraging them to work collaboratively with existing and prospective clients. There is tremendous value in staff taking the time to know these clients, understand their needs, build relationships, and even advocate for them at times.

A client service mindset is also helpful for navigating the loan process, which can seem long and potentially adversarial to clients. This is especially important when working with communities that have historically been denied access to financial institutions.

The practices in Building Block 2 must be maintained over time to prevent trust that is built from being destroyed. It is not sufficient to engage with and take feedback from stakeholders up front and then cease to do so in later phases of the process; just as CDFIs are constantly interacting with and taking feedback from capital sources, they must have mechanisms to do the same with their borrower stakeholders, as well.

Questions to get started:

- Loan/investment origination practices: How does our origination function work? Are we focused on proactively building helpful, productive relationships that allow us to invest in communities of color, or are we focused on making the numbers and responding to whoever gets in touch with us?
- Organizational staffing practices: Are there staff who can focus on fostering relationships with organizations led by and serving people of color in addition to staff who are specifically assigned to build opportunities for lending/investing in communities of color? What support can we provide to staff so they can better assess potential clients' needs? What is our strategy to maintain knowledge of our clients' needs on an ongoing basis?
- Diligence practices: Is the due diligence process collaborative and are staff contextualizing the work of potential borrowers? Are staff familiar with a range of business models that organizations might be pursuing, including non-traditional ones such as cooperative ownership models?

3 Customized Technical Assistance

Building Block 3: Provide Technical Assistance Tailored to Projects and Practitioners

Clients need access to customized technical assistance that is responsive to a plethora of evolving needs.

1. Develop and design technical assistance offerings based on deep knowledge of the communities being served.

2. Provide in-house technical assistance, but also leverage local ecosystems and develop partnerships with local technical assistance providers/practitioners.

3. Provide customized technical assistance that can evolve and adapt to changing needs.

Examples:

- Representatives from Tiwa Lending Services in New Mexico's Isleta Pueblo community support clients in a holistic way, including distributing flyers about its financial education classes, which involved teaming up with the local housing authority. Its representatives also host financial education classes at a center for the elderly. It is considering reaching out to jails to educate inmates on counseling and financial education.
- A Detroit-based organization, ProsperUS, builds partnerships by collaborating with hyperlocal organizations that have already established trust within the community. Thus, ProsperUS's lending is an outgrowth of technical assistance that is developed and delivered in deep partnership with community-rooted partners, such that its offerings are organically connected to the Detroit communities where it works.

When lending to clients who are unfamiliar with the financial system and potentially mistrustful of lenders, it is important that those clients have access to customized technical assistance to support their varying needs during the loan process.

To develop and deliver deeply relevant technical assistance in the communities where they work, the lenders we spoke to are always interacting with and listening to their clients, building a nuanced understanding of what they might need, and intentionally designing technical assistance in response. Another way they are providing relevant, community-centered technical assistance is by engaging with local providers, in addition to whatever technical assistance is provided by in-house staff.

CDFIs that have partnerships with local providers and a deep knowledge of the communities where they are offering technical assistance can also more readily pivot to changing client needs. Providers that do not have deep community partnerships and relationships are likely to lack confidence in their ability to effectively customize technical assistance offerings. As a result, they are more reliant on models and best practices that, while they may be well-researched and tested elsewhere, were not designed with the communities where they are being offered in mind – and, as a result, can feel paternalistic and not useful.

Additionally, CDFIs should consider biases and inherent power dynamics when working with community-based organizations, as there is a dominant stereotype that perceives these groups as being in need of education by CDFIs. The truth is that, although CDFIs have expertise in lending, community organizations are experts in their own work and their missions in the very neighborhoods where CDFIs often have difficulty establishing a presence.

Questions to get started:

- Resource allocation: Are we allocating sufficient resources to either build our own internal technical assistance capacity or to partner with the right external providers?
- Technical assistance offerings: Do we offer technical assistance as a top-down process with a set curriculum and standardized services? Do we co-create or collaboratively design with the borrowers and/or technical assistance recipients? Are technical assistance and lending approached holistically with the goal of making prospective borrowers more investible?
- Technical assistance providers: Are we contracting with technical assistance providers led by people of color?
- Community engagement: Are we designing and delivering technical assistance in flexible, connected, and entrepreneurial ways? Are we looking at our services in a way that acknowledges the specific expertise and needs of partners?

Additional example for Building Blocks 1-3:

Capital Impact measured its Equitable Development Initiative, which provides capacity building to developers of color and supports wealth-building opportunities, against the first three building blocks to identify gaps and create pathways to embed equity into program and product design, including lending and technical assistance. With a keen lens on being responsive to community strengths and needs, this work resulted in the creation of a guidebook for equitable program design.

4 Flexible Capital Solutions

Building Block 4: Develop Flexible Capital Solutions to Meet Needs of Community-Centered Organizations

Community-centered organizations use community-driven processes to design their initiatives and programs. This allows them to be nimble and responsive, and they in turn need capital that is tailored to the unique specifications of their initiatives.

1. Take a total return approach to structuring investments, taking into consideration the social and economic impact in the community and ways clients can leverage loans for other funding or investment opportunities. The CDFIs we spoke to all prioritize very different types of lending (in terms of size, structure, and type of collateral), but they were all constantly assessing how their loan structures fit with their customers' and communities' needs and recalibrating accordingly.

2. Be able to vary terms such as loan or investment term, interest-only periods and interest reserves, and repayment schedules to fit the needs of the project.

3. Make a commitment to flexibility in loan structuring and honor that commitment by incorporating it into policies and loan agreements.

Examples:

- Some CDFIs have taken a flexible approach to capital at the program or product level rather than at the loan level. For instance, ProsperUS responded to the needs of early-stage Black-owned small businesses by designing an uncollateralized small business product.
- Nusenda's Co-op Capital program is a particularly strong example of both the diversity of effective approaches and the necessity that it be community-rooted; it empowers and supports its 18 partners to design their own loan structures, all of which are different.
- CDC Small Business Finance's Activate business loan product includes customized repayment schedules for each loan that are based on borrower projections; these projections are developed in partnership with a community-based business advisor, who is part of the lending team.

CDFIs working with grassroots organizations must be able to take a total return approach to structuring investments and be able to vary terms such as loan or investment terms, interest-only periods and interest reserves, and repayment schedules to fit the needs of the project. Ideally, lenders or investors should be able to offer payment options beyond a simple interest rate, such as revenue-based financing, project-based return triggers, or other non-traditional return structures.

Building Block 4 requires lenders to make a commitment to flexibility in loan structuring and honor that commitment by incorporating it into their policies. Working with clients to build trust, understand their needs, and deliver the right supports (as described in Building Blocks 1-3) will be counterproductive if CDFIs do not state and institutionalize their commitment to delivering capital to communities of color. This requires CDFIs to dismantle existing, non-race-informed lending policies. It also requires that CDFIs deliver a specific outcome – more capital to communities of color – even if that requires greater flexibility.

The most successful lenders we spoke to tailor their capital offerings to what they learn from the constant back-and-forth with communities that is inherent in building community trust and centering client service. This is always a balancing act between what clients want and what is possible with available capital sources, and lenders are not always able to provide exactly what their borrowers and prospective borrowers want. However, lenders that operate with an intention to tailor their lending products to their clients' preferences and needs also often proactively seek non-traditional capital sources that can fund those products if conventional bank capital is not appropriate. They also negotiate for better terms (which they can then pass on to borrowers).

Questions to get started:

- Level of integration of lending with philanthropic and other support: Do we look for opportunities to bring grants to community organizations alongside loans? How are we supporting community-responsive organizations in finding the financing that they need (convening foundations, other investors, etc.) – not just stopping at our own direct role? If we don't have sufficiently flexible capital in-house, are we set up to play an arranger/investment banker role, sourcing capital from third parties to get transactions done?
- Flexible capital: Are we seeking non-traditional sources or our own capital that gives us greater ability to flex to customized client needs? If not, where can we start?
- Role of CDFI lender: How should we balance the goals of maintaining traditional best practices and getting transactions done? What opportunities exist to provide capital that allows communities to retain economic benefits? How should we best acknowledge histories of discriminatory lending policies and show that we are on the path to making change?

Building Block 5: Offer Appropriately Priced Capital

Commit to delivering affordable capital to communities of color and reflect that commitment in policies and procedures.

1. Advocate (individually and collectively) for systemic change in the pricing practices of their own lenders and investors.

2. Push internally to best leverage our own balance sheet and creatively blend capital to bring down the cost for borrowers.

Examples:

- The CDFIs we spoke to were proactive about seeking opportunities to work with or negotiate with capital sources on behalf of their borrowers when possible. Raza Development Fund, for example, faced the misfortune of expanding its small business lending strategy shortly before the COVID pandemic – but rather than continuing with its loan program as designed, it went back to its capital sources and successfully petitioned for it to be converted to a grant program. Raza Development Fund staff reported that this has been successful in building their connections with the community and in helping expand their underwriting mindset. This assertiveness and willingness to push for cheaper capital and concessions on existing capital demonstrates these lenders' commitments to racial equity and to the communities in which they are working.
- Southern Bancorp is unique among the CDFIs that we spoke to in that it includes both nonprofit lending and for-profit community bank divisions; this structure means that it can access and lend a wide variety of funds at different sizes and price levels to different borrowers.
- ProsperUS has characterized concessionary capital (i.e., financing that offers more favorable terms than commercial capital) as a form of reparations. The Black urban core of Detroit has been so decimated by racist, extractive economic practices that, from a community-centered perspective, only very low-priced capital could be effective in helping reverse that extraction.

Almost uniformly, the community-centered organizations The REAL spoke to in Phase I brought up high interest rates as a significant barrier to working with CDFIs. They said CDFIs have consistently quoted them interest rates in the 5-8% range, significantly above the prime rate, and that commercial banks were often more cost-effective options. When CDFIs respond by citing their higher cost of capital and operating cost pressures, community-based organizations often find these responses inconsistent with CDFIs' statements about their mission orientation and commitment to community development.

To paraphrase one of our interview subjects, CDFIs were created to make sure that capital went into underserved communities, and so when CDFIs require interest rates that are more comparable to those charged by high-yield or opportunistic lenders than bank rates, borrowers question whether CDFIs are really committed to the purpose for which they were created. It is a fair question. CDFIs may have to push (individually and collectively) for systemic change in the pricing practices of their own lenders and investors.

Minimizing the cost of capital is a difficult challenge for all CDFIs. Most of the CDFIs included in this report are smaller, and so sourcing low-cost capital is especially difficult for them – they do not have access to the public bond markets and other non-bank capital sources, and they often do not have staff resources to find low-cost capital as effectively as larger CDFIs. So, for smaller CDFIs in particular, pricing their capital appropriately for their markets is a constant balancing act between what they would like to do and what is possible.

These lenders approach that challenge in several different ways. The most consistent approach was aggressively seeking grant and concessionary capital to allow them to offer special loan products or test innovative approaches with the potential to be riskier. This approach is by no means novel – nearly all CDFIs seek grants for special programs. In keeping with their broader client service orientation, equity-focused CDFIs tend to regard lower-cost special funds and balance sheet funds as existing on a relatively seamless internal range of capital that is designed with client service in mind.

Questions to get started:

- Capital raising practices: To what extent are we pushing banks or other capital sources to reduce pricing, or seeking opportunities to raise more capital directly from short-term debt markets at rates comparable to what banks pay?
- Pricing practices: Are we empowered to price loans as aggressively as possible?
- Communication practices: If we genuinely have limited control over our pricing, can we more clearly communicate and frame that pricing for borrowers? What are the other benefits that we can provide in terms of flexibility, technical assistance, relationships, etc.?

Conclusion

Since this project began in 2019, the COVID-19 pandemic and nationwide racial protests that followed George Floyd's murder proved that we have the capacity to substantially boost financial commitments to racial equity. But the sector's commitments to racial equity should not wait for national emergencies.

This task may seem daunting at first. However, when we consider all the ways racism shows up in people's lives, when we listen to those most affected, work together, and focus on our spheres of influence, we know we must achieve change and greater racial equity.

We don't have a playbook for becoming anti-racist financial institutions. Just as NFF and Capital Impact are in different places along the spectrum of changing or improving internal policies and practices to center racial equity, each CDFI's racial equity journey will follow a different path. But by working together and sharing our discoveries, truths, and successes, we can create a better industry for now and in the future.

We remain steadfast in our commitment to have hard conversations, address the realities of inequity, and hold ourselves accountable. As we explore opportunities to make a greater impact, we reinforce our commitment to being in this for the long term.

Please continue to stay informed by visiting: https://nff.org/catalyzing-finance-racial-equity

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Acknowledgements and Gratitude

We are grateful to the W.K. Kellogg Foundation for recognizing the importance of centering racial equity in CDFIs' lending practices, and for supporting our effforts to learn how we can better work towards that goal.

Thank you to those individuals, organizations, and financial institutions who shared insights with us for this work – you are at the vanguard of the field, leading CDFIs in our commitment to racial equity.

NONPROFITS (BAY AREA, CA) INVOLVED IN PHASE I RESEARCH:

- Causa Justa :: Just Cause
- East Bay Permanent Real Estate Cooperative
- Planting Justice
- Restore Oakland
- The Unity Council

CDFIS (MISSISSIPPI-DELTA; MICHIGAN; NEW MEXICO; NEW ORLEANS) INVOLVED IN PHASE II RESEARCH:

- Communities Unlimited (Mississippi)
- First Independence Bank (Michigan)
- Native Community Capital (New Mexico)
- Invest Detroit (Michigan)
- LIFT Fund (New Orleans)
- Nusenda (New Mexico)
- ProsperUS (Michigan)
- Raza Development Fund (Arizona)
- Southern Bancorp (Mississippi)
- Tiwa Lending Services (New Mexico)