As CDFIs face headwinds, states bolster their support

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- **Key insight:** Rising interest rates have made it harder for CDFIs to offer affordable loans to small businesses, first-time homebuyers and others in the communities they serve.
- **Supporting data:** A total of nine states now have state-funded CDFI programs, most of which were started during the Biden administration. The programs help CDFIs provide less expensive loans.
- **Expert quote:** "In this high-interest-rate environment, it's really hard for us to access enough low-cost capital that we can make affordable loans to small businesses," —Elissa Sangalli, president and CEO of Michigan-based CDFI Northern Initiatives

For three decades, community development financial institutions sat in an uncontroversial corner of financial-services policymaking in Washington, D.C., supported by Democrats and Republicans alike. That's changed during the second Trump administration, which has derided CDFIs as part of what it calls the "woke" agenda.

The political turnabout at the federal level has left CDFIs more vulnerable, and high interest rates have compounded their problems. CDFIs offer affordable loans to small-business owners, first-time homebuyers and other borrowers who might have difficulty getting financing from a traditional lender. While some CDFIs are banks and credit unions, many of them don't have access to lower-cost deposit funding.

In many cases, CDFIs are now turning to the states for financial support. The latest state to step into the fray is Michigan, where last month a state-backed

fund approved a loan that's designed to provide the state's CDFIs more affordable capital to lend out.

"In this high-interest-rate environment, it's really hard for us to access enough low-cost capital that we can make affordable loans to small businesses," said Elissa Sangalli, president and CEO of Northern Initiatives, a Michigan-based CDFI.

She expects the state of Michigan's funding for CDFIs — a $10 million loan that supporters hope to use to leverage another $40 million of financing — to make a difference. "It'll help us grow our loan volume over time and grow our impact," Sangalli said.

The efforts in Michigan are part of a state-level trend — centered in blue and purple states — to provide public support for CDFIs.

In California, a state program provides grants to fund CDFIs' services and operations, as well as to supplement their net assets and increase their capacity to attract more funding.

In Virginia, grants can be used to help institutions achieve CDFI certification from the U.S. Treasury Department, and to create new financial products to meet identified market needs, among other purposes.

And in New Jersey, a state program provides 50% loan guarantees to eligible institutions.

At least seven states have dedicated CDFI funds, according to a list compiled by Opportunity Finance Network, a network of nearly 500 CDFIs across the country. Most of the state CDFI programs were established during the Biden era, as states were dealing with the economic fallout from the pandemic.

"We're working to … be able to present those models across the country, and support our members across the country, to be able to replicate this in their own states," said Mary Scott Balys, senior vice president of public policy at Opportunity Finance Network.

Though most of the state-level programs predate the second Trump administration, they have taken on greater importance at a time when CDFIs have lost key support in Washington.

In August, a network of CDFIs filed suit against the Treasury Department, seeking to force the release of congressionally approved funding, which the Office of Management and Budget had been withholding. This week, the Trump administration told a judge that the Treasury Department did obligate nearly $289 million in congressionally approved funding before it expired on Wednesday.

The Treasury Department on Wednesday also initiated a change to its CDFI certification process that would eliminate racial categories as a means of establishing underserved communities to serve, potentially putting some CDFIs' certifications at risk.

CDFIs have historically enjoyed bipartisan support both on Capitol Hill and at the state level, according to Sangalli, who's chair of the 3-year-old Michigan CDFI Coalition.

"That's come into question at the federal level in some ways this last year, but we've been able to really retain bipartisan support," Sangalli said. "At the state level, we also have bipartisan support, and I think part of what we're working on as a coalition is, we are in a really dynamic environment that has been challenging for CDFIs nationally, both politically and also because of high interest rates."

The Michigan program is designed to provide CDFIs a cushion against the impact from swings in interest rates. The $10 million state loan carries an interest rate of just 0.5%, which is well below CDFIs' typical borrowing cost. The state will also be in a first-loss position on any losses to the CDFIs.

The money from the Michigan Strategic Fund, an economic development agency created by the state legislature, can only be unlocked once the

Michigan CDFI Coalition increases the pool to $30 million. The group is seeking financial commitments from national banks, regional banks and foundations, and hopes to get to a total of $50 million.

"Those leveraged funds can then be pooled and loaned to their participating CDFIs," said David Meninga, senior vice president of community development at the Michigan Economic Development Corp., which provides administrative services to the Michigan Strategic Fund.

Sangalli said that Northern Initiatives, which doesn't have access to deposit funding, lends about $9.5 million to Michigan small businesses each year.

"The average loan size is $60,000. So that's a lot of $60,000 impacts into small businesses and Main Streets and families that are launching a company, or transitioning the ownership of their company, throughout the state," she said.