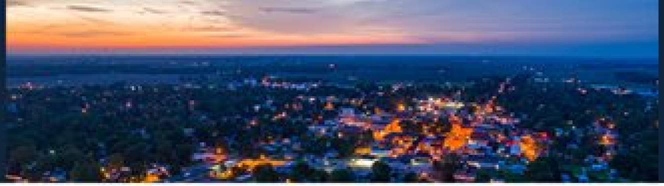

“Revitalize or Stabilize”: Does Community Development Financing Work?

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Federal Reserve Board of Governors

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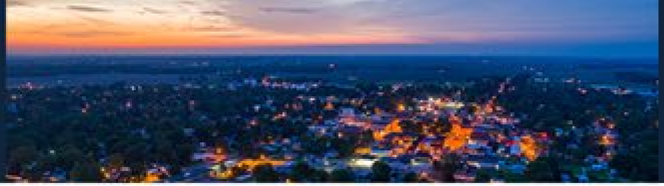
Disclaimer

- The analysis and conclusions set forth are those of the author and do not indicate concurrence by other members of the research staff or the Board of Governors.

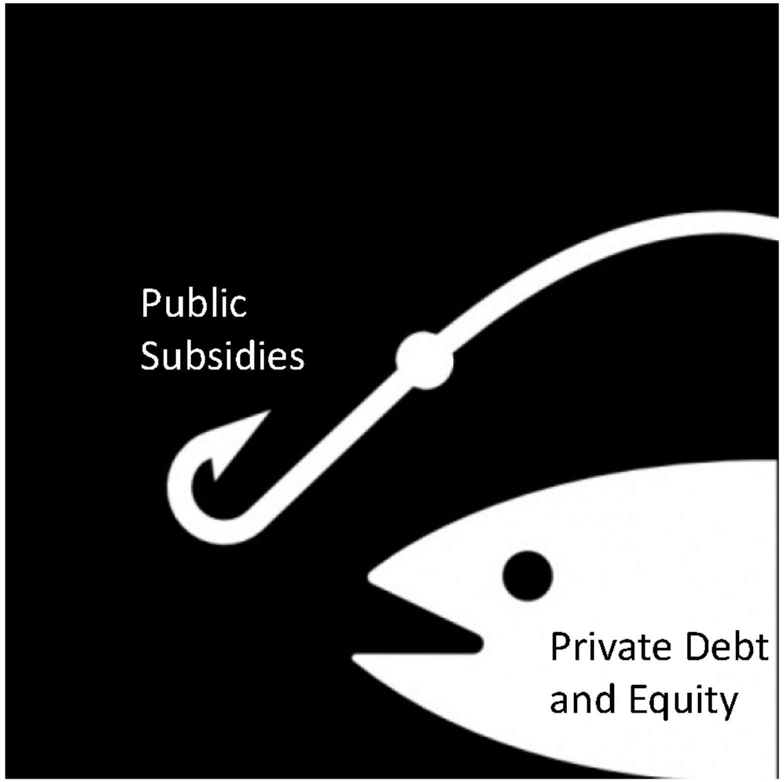


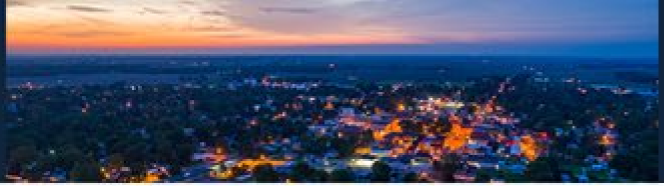
Community Development

- U.S. marked by persistent differences in economic outcomes across communities
- Policy response: place-based encouragement of private investment and lending
  - e.g. Enterprise Zones, Empowerment Communities, Opportunity Zones, New Market Tax Credit, Community Reinvestment Act (CRA)

Public and Private Efforts

- Public subsidies are bait for private capital
- Private community development (CD) money dwarfs public expenditures
  - $100+ billion in annual CD bank loans
  - More in CD investments held on bank balance sheets
  - Largest public subsidies are a few $ billion/year in tax breaks



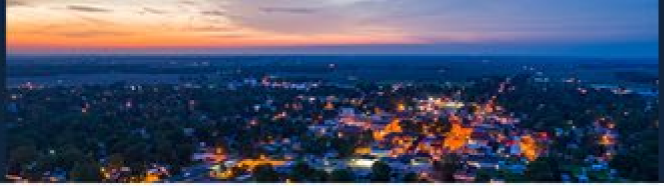


Financing Community Development

- Defined under CRA, CD activities intended to:
  - Create or retain permanent jobs, businesses and population in disadvantaged areas
  - Allow small firms to hire low- and moderate-income workers
  - Support affordable housing
  - Build essential infrastructure
- Financing with a particularly pro-social purpose
- **Does it work?**
  - Social return could be high if financial markets under-serve certain areas
  - However, federally-favored purposes may not be most efficient. Subsidies could distort allocation
  - Further, if financing is elastically supplied, limited net response

This Paper

- Uses unique data on bank CD financing at local level
  - Hand collected from thousands of CRA performance evaluation documents
- Observe the response when banks with a high (low) tendency to supply CD loans gain (lose) deposit market share
  - Exploits fixed bank tendencies to engage in CD lending across markets
- Finding: $56,000 in annual CD loans creates one net job. No effect on affordable housing supply, house prices



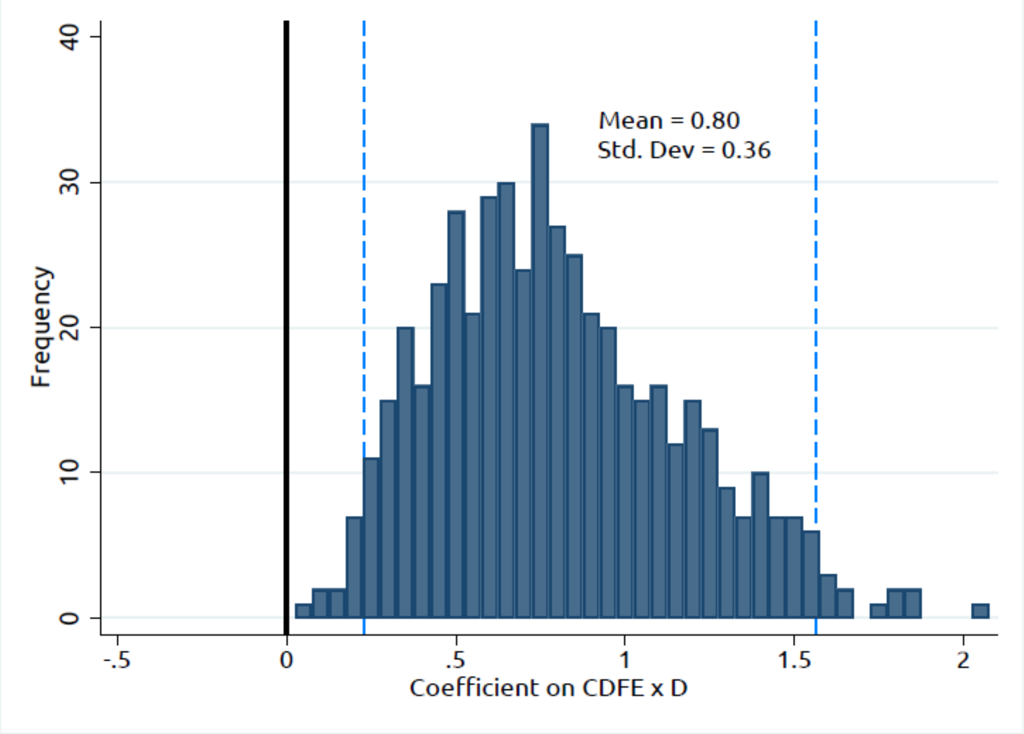
Community Development Data

- Hand collected from over 6,300 CRA performance evaluations
  - Covers full range of banks sizes
  - Exam years 2004-2017
- Recorded dollars of CD lending and investing for each bank, exam and assessment area
  - Assessment areas are generally collections of contiguous counties/tracts in MSAs or non-MSA areas of a single state

Banks' CD Lending Similar across Markets

1. Divide markets into training sample (A) and test sample (B)
2. Estimate individual bank tendency to make CD loans relative to in-market peers from (A)
3. Correlate tendency from (A) with actual lending in (B)
4. Repeat 500x

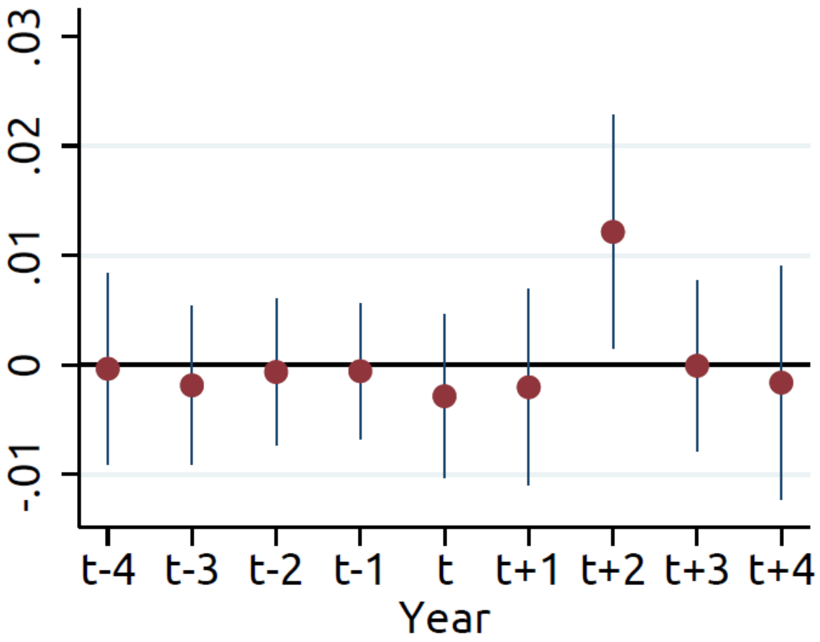
Out-of-Sample Cross Validation



Elasticity of County Total Wage Bill to CD Supply

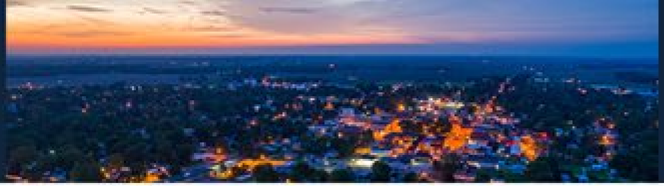
- CD “generous” banks gain deposit market share in a county in year *t*
- Wage bill rises 0.012% in year *t+2* for every 1% increase in CD loan supply
    - Similar results for employee counts (0.008%)
- No pre-trends in years *t-4* to *t*
    - Suggests CD “generous” banks aren’t differentially entering growing/shrinking markets

Annual Wage Bill Growth (Percent)



Other Outcomes

- No apparent effect of CD loan supply on number of affordable housing units or house prices
- Effects of loans on employment and wages are robust to:
  - County and state-by-year fixed effects
  - Rich set of controls for changing banking/deposit market conditions
- No change in mortgage lending, small increase in small business and farm lending



Implications

- 150 million jobs in U.S. and $100 billion in CD loans
  - Estimated elasticity of employment was 0.082
  - Adjusting for 30% crowd out, implies $56,000 in CD lending creates one net job
- Increasing the supply of CD lending does demonstrably lead to better economic outcomes for communities
- However, missing complete counterfactual
  - What else could those funds have supported?
  - If in a non-local market, opportunity cost is invisible