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

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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
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
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.
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
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