MILKEN INSTITUTE

ISSUE BRIEF

Utilize Existing Financial Infrastructure to Build an Equitable Post-COVID Recovery

Scaling existing Minority Depository Institutions and Community Development Financial Institutions and leveraging Opportunity Zones will ensure the most vulnerable communities can participate in a post-COVID recovery.

SUMMARY

Faced with the COVID-19 pandemic and socioeconomic inequities, a national conversation has emerged around the efficacy of economic policies' ability to ensure that recovery is inclusive of underserved racial minorities and equitable equitable in terms of remedying the existing generational wealth divide.

The pandemic forced thousands of small and minority-owned businesses to close their doors permanently. Millions of Americans, largely in vulnerable communities, are now unemployed. Amid this economic crisis, public policymakers and the private sector must work together to develop the best strategies to support these communities.

To inform potential place-based solutions, the Milken Institute's Center for Financial Markets has examined the interplay of Opportunity Zones, Minority Depository Institutions (MDIs) and Community Development Financial Institutions (CDFIs), COVID-19 incidence and fatality rates, and population demographics. Opportunity Zones encompass counties hardest hit by COVID-19, and MDIs and CDFIs are powerful banking conduits for underserved populations. Including Opportunity Zones, MDIs, and CDFIs in strategies to enhance local access to capital will create meaningful new job and workforce development opportunities and promote underserved communities' participation in the post-COVID recovery. While existing economic development tools are available, targeted efforts to leverage these tools are needed. We come to this conclusion because we find the following:

1. **COVID-19 case rates correlate to income and race.** Across income levels, COVID-19 has hit lower-income communities hardest. Blacks and Latinos suffer a disproportionate share of COVID-19 cases, regardless of income strata.

2. **Community-based financial institutions are located in the worst-hit COVID-19 areas.** The counties in the top (worst-hit) quartile of COVID-19 case rates are two times more likely to have an MDI and CDFI banking presence than are counties in the bottom (least-hit) quartile.

3. **Community-based financial institutions play an important role in underserved communities.** The poorest counties have an MDI and CDFI banking presence that is seven times more dense than the richest counties.[1] MDIs and CDFIs are more present in counties with greater Black populations, with a presence in the top quartile that is three times higher than the bottom quartile.

4. **COVID-19 case rates are significantly higher in designated Opportunity Zones.** Counties in the top (worst-hit) quartile of COVID-19 case rates are 33 percent more likely to have Opportunity Zone designated tracts than are counties in the bottom (least-hit) quartile.

After the 2008 global financial crisis and early criticism of Opportunity Zones, some might be reticent to rely on the banking sector and Opportunity Zones to generate social returns. However, policymakers and practitioners should note that the most vulnerable communities by social, economic, and health impact are where mission-based lenders (i.e., MDIs and CDFIs) and Opportunity Zone census tracts lie. It is prudent to target these communities to bolster minority and lower-income communities nationally and to sharpen these tools to ensure their original intent.

Scaling the existing financial infrastructure of MDIs and CDFIs for place-based results and leveraging Opportunity Zone designation could be a critical element in recovery efforts. This can be done via four non-mutually exclusive recommendations, detailed herein.

BACKGROUND CONTEXT

Research shows that income segregation by neighborhood has significantly increased. From 1980 to 2010, lower-income households located in majority lower-income census tracts increased from 23 percent to 28 percent, and upper-income households located in majority upper-income tracts increased from 9 percent to 18 percent. This long-term rise in income inequality and the shrinkage of the middle class are rivaled only by the prevalence of racial isolation: In 2010, 42 percent of the Black population lived in a majority Black census tract.[2]

1. County affluence categorized on a percentage basis of the share of people living below the poverty line, as determined by the 2018 American Community Survey.

2. Richard Fry and Paul Taylor, “Residential Segregation by Income,” Pew Research, August 1, 2012, https://www.pewsocialtrends.org/2012/08/01/the-rise-of-residential-segregation-by-income/.

Central to perpetual poverty and spatial inequalities is the lack of access to affordable credit on reasonable terms. This leaves some zip codes well equipped with access to capital while others are starved for it, particularly during a crisis. The current twin economic and health shocks spurred by COVID-19 are having a disproportionate impact on minority communities. The National Bureau of Economic Research (NBER) reported the largest drop in business owners across industries on record: US business owners overall dropped by 22 percent from February to April. Specifically, Black businesses experienced a 41 percent drop; Latino, 32 percent; and Asian, 26 percent.[3] Despite trillions of dollars of economic stimulus that have flowed from the Coronavirus Aid, Relief, and Economic Security (CARES) Act across the United States, more still needs to be targeted to America's minority and lower-income communities. Spatial inequality of income and the correlated patterning of economic resources and opportunities is well-evidenced and spurs the need for place-based intervention. To this end, the Milken Institute has aggregated and analyzed information from multiple disparate programs, policies, and indicators to help provide adequate due diligence for strategies that produce the highest social return.

This analysis incorporates data from multiple sources. We mapped data nationally by county for all banks and branches as reported by the Federal Deposit Insurance Corporation and Home Mortgage Disclosure Act Data, Qualified Opportunity Zones and non-banking CDFIs as reported by the CDFI Fund and the National Credit Union Administration, Johns Hopkins COVID-19 Dashboard, and the American Community Survey. We ran a multiple linear regression analysis to test the relationship between the current pandemic and county demographics. The data as of September 15, 2020, include only the census tracts for which all the above data were available.[4]

EMERGING RESULTS

This analysis has yielded four takeaways about the role of mission-aligned banks and Opportunity Zones in the current COVID-19 pandemic:

1

Race and poverty levels are related to COVID-19 case rates—especially race.[5] With an explained variance (r-squared) of 36 percent, our multiple linear regression model indicates that:

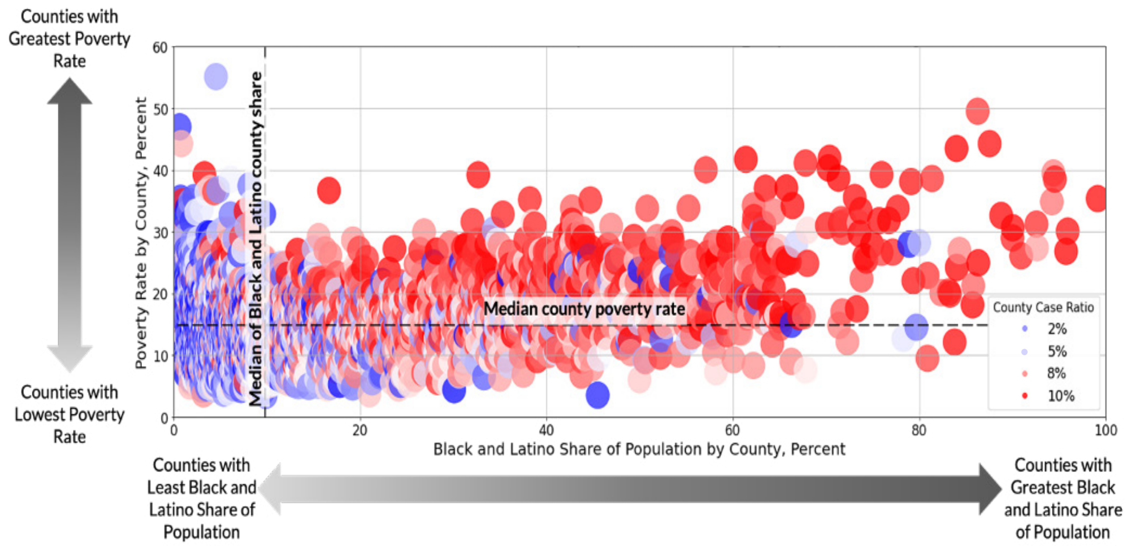
- a 1 percentile increase in the Black share of the population correlates with a 0.46 percentile increase in the COVID-19 case rate,
- a 1 percentile increase in the Latino share of the population correlates with a 0.21 percentile increase in the COVID-19 case rate, and
- a 1 percentile increase in the poverty rate correlates with a 0.17 percentile increase in the COVID-19 case rate.

3. Robert W. Fairlie, "The Impact of Covid-19 on Small Business Owners: Evidence of Early-Stage Losses from the April 2020 Current Population Survey" (NBER, July 2020), https://www.nber.org/papers/w27309.

4. This report covers 3,052 US counties, excluding 89 US counties and all territories, as data were not sufficiently available.

5. In this work, the COVID-19 case rate is calculated as the running total of confirmed cases in a county divided by the county population as of September 15, 2020. Moreover, multiple linear regression results were used to verify with randomized train/test split on ranked data. Additionally, June intra-county data from the Centers for Disease Control and Prevention has also demonstrated over-representation of minorities in COVID-19 cases. Milken Institute, "COVID-19 Community Explorer," last updated December 7, 2019, https://milkeninstitute.org/research/COVID-19-community-explorer.

Figure 1: COVID-19 Case Ratio Compared to Demographics, County Level

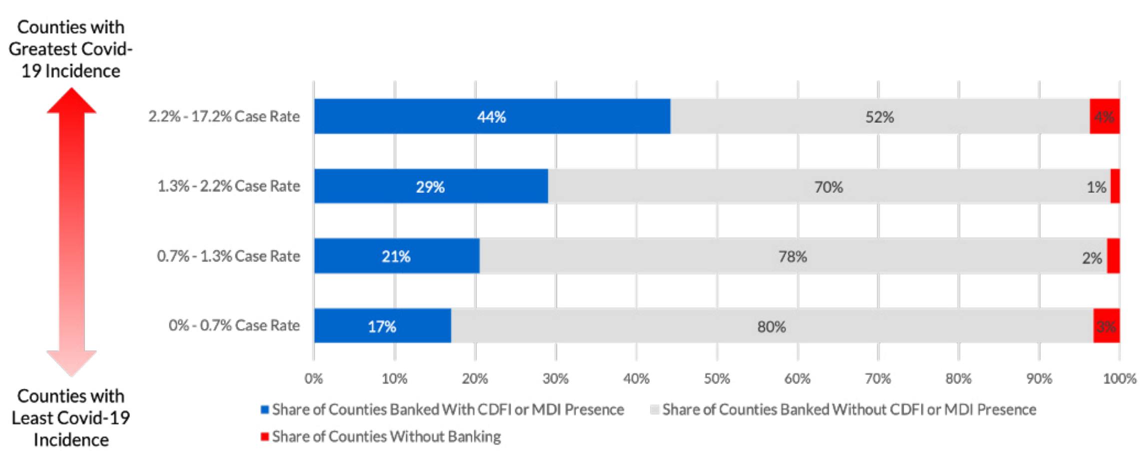


Source: Milken Institute

2

The counties in the top (worst-hit) quartile by COVID-19 case rates are over two times more likely to have a CDFI and MDI banking presence than counties in the bottom (least-hit) quartile. There are three times as many CDFIs and MDIs in the worst-hit counties than in the least hit counties. Comparing access to banking against the reach of COVID-19 in the US, we observe that while general bank and branch density in communities recedes in the worst-hit communities, CDFI and MDI banking presence increases. Notably, despite this trend, CDFI and MDI bank and branch density is a fraction of non-mission-aligned access to banking. This reflects the perspective offered by previous Milken Institute work, whereby MDIs are summarized as undercapitalized resources.[6]

Figure 2: CDFI and MDI Presence in Counties, Broken Out by COVID-19 Impact



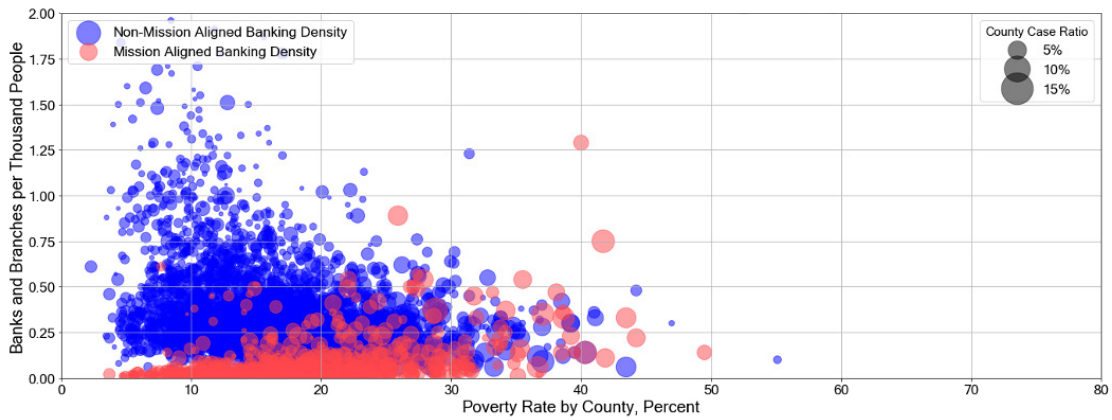
Source: Milken Institute

6. Aron Betru et al., “Minority-Owned Depository Institutions: A Market Overview” (Milken Institute, April 17, 2020), https://milkeninstitute.org/reports/minority-owned-depository-institutions-market-overview.

3

In the poorest counties and those with the highest minority representation, MDIs' and CDFIs' banking presence is strongest. The poorest quartile of counties have over seven times denser MDI and CDFI banking presence, as do the richest quartile. Most evident are the trends towards parity in the representation of mission-aligned and non-mission aligned banking in the poorest communities. Viewed differently, but still evident, is the size of the coronavirus impact on poorer communities.

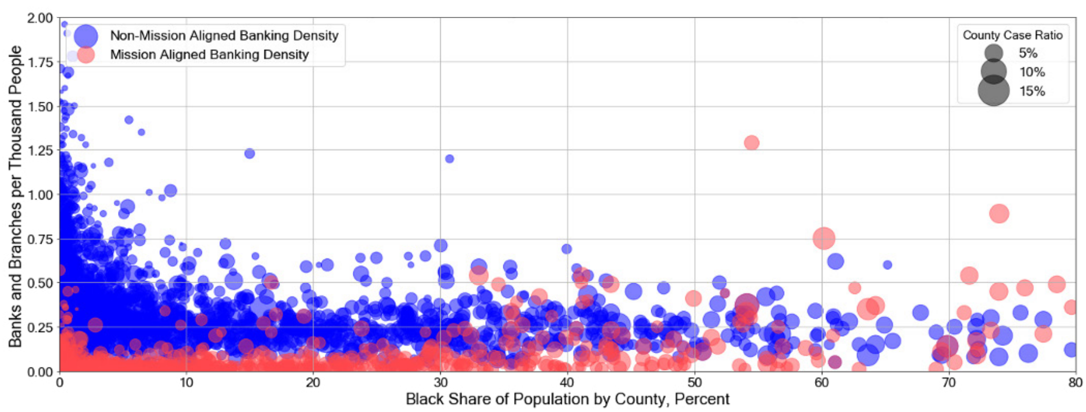
Figure 3: Poverty Rate Compared to Access to Banking, County Level



Source: Milken Institute

Counties in the top quartile of the Black population share have a three times denser CDFI and MDI banking presence than in the least Black counties. When examining the role of ethnicity and race in the spread of the current pandemic, poverty, and financial inclusion, from no other vantage is the COVID-19 health impact as potent as when viewed by Black share of the population. The coronavirus case rate grows as the Black share of the population increases. A non-mission-aligned bank presence recedes in counties with larger Black shares of their populations.

Figure 4: Black Share of Population Compared to Access to Banking, County Level

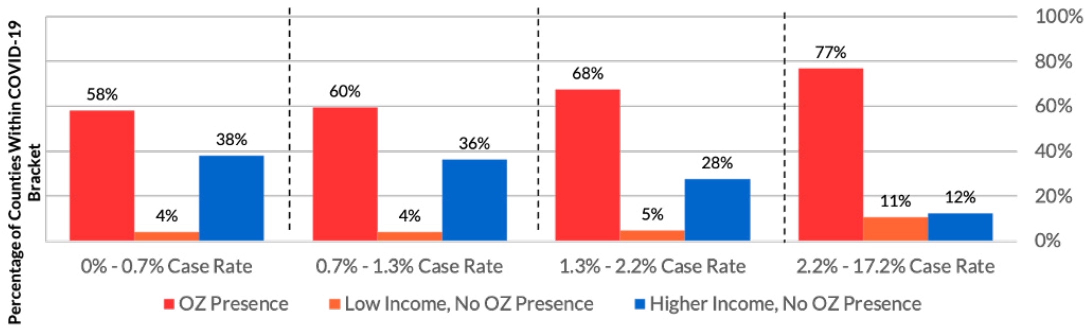


Source: Milken Institute

4

The worst-hit quartile of counties in COVID-19 case rates is 33 percent more likely to have Opportunity Zone designated tracts than the least-hit quartile of counties. Seventy-seven percent of the counties in the top quartile of COVID-19 caseloads contain Opportunity Zones. In the 700 most populous counties, this number rises to 94 percent. Opportunity Zones create an increased incentive for the larger financial institutions to channel capital in the form of Community Reinvestment Act credits and other tax benefits, making MDI and CDFI banks' field expertise in these communities all the more relevant.

Figure 5: Opportunity Zone Designations and Coronavirus Incidence Across All Counties



Source: Milken Institute

RECOMMENDATIONS

We must align measures to advance the US economy from recovery to resilience by improving socioeconomic determinants of health that affect the spread of COVID-19. Where significant patterns in the minority share of the population, poverty rates, and access to banking exist, complementary patterns in the presence of Opportunity Zones, MDIs, and CDFIs also exist. Therefore, scaling the existing financial infrastructure of MDIs and CDFIs for place-based results and leveraging Opportunity Zone designation could be a critical element in recovery efforts. This can be done via four non-mutually exclusive recommendations:

1. **Any forthcoming government stimulus should include specific carve-outs for MDIs and CDFIs as conduits for access to capital.**[7] Specifically, it should provide $2 billion in federal resources of non-dilutive equity to enhance the tier 1 capital of MDIs that support underserved communities, which is nonrecourse if a particular impact threshold is met (e.g., aligned to CDFI Fund's requirement that 60 percent of the portfolio is for disadvantaged communities). And it should ensure a minimum $500 million carve-out dedicated to Black-owned MDIs per section 308 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 mission to "preserve and encourage the creation of new MDIs." Moreover, it should provide $1 billion in appropriations to enable the CDFI Fund to award grants to CDFIs serving small businesses and nonprofits in lower-income areas, including a $500 million carve-out for Black-led CDFIs that serve minority-owned small businesses.

7 . Aron Betru, "11 Ideas to Advance African American (Financial) Access to the American Dream," Milken Center for Advancing the American Dream, June 22, 2020, https://www.mcaad.org/explore/view/11-ideas-to-advance-african-american-financial-access-to-the-american-dream.

2. **Congress should leverage Opportunity Zone designations, given their targeted focus on underserved communities, as focus areas of recovery efforts.** Namely, it should amend the 2017 Tax Cuts and Jobs Act by adding to either the Expanding Opportunity for MDIs Act[8] or the Ensuring Diversity in Community Banking Act,[9] a provision that would allow investments in MDIs and CDFIs to qualify for Opportunity Zone benefits.

3. **Private sector institutions should prioritize strengthening and scaling MDIs and CDFIs through tier 1 capital investments to address systemic racial issues through banking.**[10] Corporations willing to engage MDIs and CDFIs should be willing to not only provide deposits but also enhance the tier 1 equity base of these banks—a far more needed solution that would result in greater institutional stability and scalability.

4. **State and local leaders should identify dedicated predevelopment capital and technical assistance resources to accelerate the critical linkages that need to occur between community-led development initiatives and existing community capital and capacity in MDIs and CDFIs.**[11] Public sector leaders can be powerful agents of change to ensure public-private alignment on critical economic development actions and scale existing tools to accelerate the same.

Achieving a multiplier effect to scale the social return in strategies is critical to positioning the US economy from recovery to resilience. Creatively using Opportunity Zone designations, counties that were hard-hit by COVID-19, and MDIs and CDFIs can be a winning strategy for all Americans. In lower-income communities, it will create meaningful new jobs, workforce development opportunities, and accelerate economic development multiplier effects. The country at large will enjoy a more resilient economy that can withstand future shocks. Only then can we say that the American Dream is available to everyone.

8. "Expanding Opportunity for MDIs Act," HR 5315, 116th Congress (2019), https://www.congress.gov/bill/116th-congress/house-bill/5315.

9. "Ensuring Diversity in Community Banking Act," HR 5322, 116th Congress (2019), https://www.congress.gov/bill/116th-congress/house-bill/5322.

10. Aron Betru, Chris Lee, and Ragini Chawla, "Empowering Communities and Their Banks: Strategies for Enhancing Minority Depository Institutions" (Milken Institute, February 2020), https://milkeninstitute.org/reports/empowering-communities-and-their-banks-strategies-enhancing-minority-depository.

11. Daniel Carol, Ragini Chawla, and Aron Betru, "From Recovery to Resilience: How Opportunity Zones Can Accelerate Post-COVID Economic Resurgence" (Milken Institute, June 23, 2020), https://milkeninstitute.org/reports/recovery-resilience.; "Opportunity Zone Vignettes," Milken Institute, Kirkland & Ellis LLP, and E&Y, March 2020, https://milkeninstitute.org/sites/default/files/2020-03/Milken%20Institute%20-%20OZ%20-%20Vignettes%20Updated%20for%20Final%20Regs%20March%202020_vFinal.pdf.

ABOUT THE MILKEN INSTITUTE

The Milken Institute is a nonprofit, nonpartisan think tank that helps people build meaningful lives in which they can experience health and well-being, pursue effective education and gainful employment, and access the resources required to create ever-expanding opportunities for themselves and their broader communities.

ABOUT THE CENTER FOR FINANCIAL MARKETS

The Milken Institute Center for Financial Markets conducts research and constructs programs designed to facilitate the smooth and efficient operation of financial markets—to help ensure that they are fair and available to those who need them when they need them.