



# Access to Capital and Credit in Native Communities: A DATA REVIEW

# Access to Capital and Credit in Native Communities: A Data Review



THE UNIVERSITY OF ARIZONA

**NATIVE NATIONS  
INSTITUTE**

Founded by the Udall Foundation  
& the University of Arizona

*Strengthening Indigenous Governance*

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# Acknowledgments

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# Executive Summary

With the release of its “Report of the Native American Lending Study” (NALS) in 2001, the U.S. Department of Treasury’s Community Development Financial Institutions Fund (CDFI Fund) drew national attention to the issue of capital and credit access in American Indian, Alaska Native, and Native Hawaiian communities (Native Communities). The report detailed seventeen specific barriers to access that resulted in substantially lower levels of capital investment in Native Communities than in the rest of the United States. Since 2001, capital and credit access in Native Communities has expanded, in part due to actions taken in response to the NALS. Economic growth in Native Communities is one signal of policy success. From 2000 to 2010, per capita incomes grew faster and family poverty rates fell more in the average lower-48 Native Community economy than in the U.S. as a whole. Yet the data also signal a need for further expansion of capital access. Even at current rates of growth, it will take another 40 years for the per capita incomes of Native peoples living on reservations to catch up to the per capita incomes of all Americans.

These observations raise critical questions: Where does Native America stand now in terms of capital and credit access? What has been the effect of new action and new approaches by policymakers and financial entrepreneurs? What are Native Communities’ ongoing and future capital and needs?

This document, “Access to Capital and Credit in Native Communities: A Data Review” (Data Review) begins to answer these questions. As the second part of a two-part follow-up to the NALS, it uses a range of datasets to document the evolution of Native Communities’ capital access since 2001. Its three main sections summarize data describing access to capital and credit for Native consumers, Native business owners, and tribal communities and governments. Its companion document, the “Access to Capital and Credit in Native Communities Report” (ACC Report), published in May 2016, identifies success stories within a more detailed topical analysis. The full two-part study is intended to provide research and analysis in support of further improvements in access to capital and credit in Native Communities.

## Native Consumers’ Access to Capital and Credit

### PROXIMITY TO FINANCIAL INSTITUTIONS

The distance Native Community residents must travel to reach a bank or automated teller machine (ATM) is a basic indicator of access to capital and credit. In 2013, for tribes in the lower-48 states, the average straight-line distance from the geographic center of a tribe’s reservation to the nearest bank branch was 12.2 miles (although driving distances may be farther). For half the tribes in the sample, the straight-line distance was eight miles. The geographic center of only three tribes’ land bases was more than 70 miles from the nearest bank.

The 2001 NALS used self-reported distance data from a survey of key informants to make similar calculations. Half of the survey respondents reported that there was a financial institution within 30 miles of the community. Six percent noted that the residents of their communities had to travel more than 100 miles to reach a bank or

ATM. Although the 2001 and 2013 estimation methods were quite different, judicious comparison suggests that geographic access to banking services has improved for residents of Native Communities. As of 2013, a greater number appear to live close enough to bank branches and ATMs to make banking a viable option.

Nonetheless, this improvement in access is in jeopardy as online and mobile banking become more commonplace. The Federal Communications Commission estimates that only 37 percent of tribal land residents have access to broadband. Further improvements in access to banking services may depend more on the deployment of broadband than on Native Community residents' proximity to bricks-and-mortar financial institutions.

## **CONSUMER CREDIT SCORES AND CREDIT UTILIZATION**

Data from the credit reporting agency Equifax show that from 2002 to 2012, average consumer credit scores for reservation residents of all races rose. In general, however, reservation residents of all races have lower credit scores than residents of nearby off-reservation lands. Among the 19 states for which researchers have calculated score differences, Arizona and North Dakota showed the largest gaps; in these two states, on-reservation average scores were more than 70 points lower than off-reservation averages (on a scale that ranges from 300-850).

Reservation residents' low participation in mortgage markets is one reason for the score differences. In 2012, per capita mortgage utilization on reservations was only 59 percent of the utilization rate in nearby off-reservation geographies. Low participation in mortgage markets may in turn be explained by ongoing challenges to mortgage lending on trust land. Yet on-reservation credit scores and mortgage credit utilization rates also are negatively correlated with the percentage of a reservation population that self-identifies as Native American. This relationship deserves further study. It may indicate bias—or it may reflect the effects of variables not yet taken into account, such as loan requirements, individual qualifications, and certain reservation characteristics.

## **MAINSTREAM MORTGAGE MARKET PARTICIPATION**

Home Mortgage Disclosure Act-generated data from eight representative states in the years 2003, 2006, 2009, 2012, and 2015 suggest that self-identified American Indian, Alaska Native, and Native Hawaiian borrowers living in Native Communities have been less able to access home mortgages from mainstream lenders than borrowers statewide. The data also show that Native Community members were more likely than mainstream borrowers to seek a loan for home improvements.

Indicative research suggests these experiences prevail even when controlling for select characteristics of borrowers and the market setting. Still more detailed analysis of the driving factors behind AIANs' access to residential mortgage loans (especially an analysis that considers the influence of strengthened tribal institutions, the presence of Native CDFIs, and innovations in tribal law) would be a useful next step.

## **HUD-GUARANTEED HOME MORTGAGES**

The Section 184 Indian Home Loan Guarantee Program (IHLGP) and the Section 184A Native Hawaiian Housing Loan Guarantee Program (NHHLGP), administered by the U.S. Department of Housing and Urban Development (HUD), provide borrowers with attractive loan packages and assure lenders that their investments will be repaid,

thereby providing Native Community members with better access to mortgage capital. From the program's inception in the mid-1990s through March 31, 2016, HUD used the IHLGP to back 33,280 mortgages for American Indian and Alaska Native borrowers and to issue \$5.46 billion in loan guarantees. Annual data show that lending activity increased markedly from 2001 onward. Although it was developed later and serves a narrower market, the NHHLGP secured 468 mortgages on Hawaiian homelands in the period 2008 to 2015; the cumulative value of these loan guarantees is \$114.95 million.

Both the IHLGP and NHHLGP have helped increase Native homeownership on lands held in trust. Nevertheless, since 2005, the IHLGP has guaranteed more lending on fee land than on trust land. Purchases in Oklahoma, where fee simple lands dominate tribal jurisdictional areas, are part but not all of the story. Going forward, it is essential for tribes, federal and state policymakers, and lenders to address the practices and attitudes that prevent lending on trust lands, an effort that should include research, policy innovation, and education. Without such concerted efforts, tribes' and tribal citizens' collective equity in trust lands will remain under-utilized.

## **Native Business Owners' Access to Capital and Credit**

### **NATIVE BUSINESS OWNERS' SOURCES OF CAPITAL**

Data from the U.S. Census Bureau's Survey of Business Owners show that self-identified American Indian, Alaska Native, and Native Hawaiian business owners rely heavily on personal/family savings and other personal/family assets as capital for both business startup and business expansion—but so do non-Native entrepreneurs.

By contrast, Native business owners appear less likely than business owners overall to obtain financing from banks. In 2012, for example, 5.6 percent of American Indian and Alaska Native business owners and 3.6 percent of Native Hawaiian business owners reported using formal bank financing for startup funds, as compared to 7.5 percent of business owners overall. Native business owners also report a slightly greater reliance on credit cards—a type of informal bank financing—for business startup and growth than do non-Native entrepreneurs. The specific reasons for these differences are as yet unexplored.

### **SMALL BUSINESS ADMINISTRATION LOANS**

Two Small Business Administration (SBA) loan guarantee programs—the 7(a) program for business startup and expansion and the 504 program for fixed asset purchase or renovation—promote small businesses' access to capital by reducing lending risks for banks. American Indian-, Alaska Native-, and Native Hawaiian-owned small businesses are eligible alongside other small businesses for these SBA loan guarantees. From 2008 to 2012, the SBA guaranteed more than 2,400 loans, totaling \$500 million, for Native-owned small businesses.

## **Services for Native Communities and Governments**

### **NATIVE COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS**

Since publication of the NALS, the number of Native Community Development Financial Institutions has steadily increased, growing from 14 in 2001 to 74 in 2016. Significantly, Native CDFIs provide Native Community residents and businesses with greater access

to capital and credit not only through direct lending but also through services such as financial education, homebuyer education, credit counseling, and business development assistance. By helping clients build stronger credit and better budgeting and business management skills, Native CDFIs also help make Native borrowers more attractive to other lenders.

Detailed loan origination information for the period 2003 to 2011 shows average annual loan values ranging from \$30,200 in 2007 to \$13,700 in 2011. In other words, loans made by Native CDFIs are relatively small. The general characteristics Native CDFIs' markets are one explanation. From the demand perspective, Native CDFIs serve customers with significant but lower-value capital and credit needs. From the supply perspective, many Native CDFIs are working to increase the credit worthiness of clients, justifying smaller initial loans.

Limited capital is another reason for relatively low loan values. It is also a cause for concern. The demand for Native CDFI lending—which increased from at least \$10 million in 2009 to at least \$20 million in 2014—exceeds the sector's capacity and will continue to increase as Native Community economies continue to grow. To address Native Community members' desire for more and larger loans, Native CDFIs must diversify and expand their revenue streams. Importantly, greater capitalization supports more lending, and more lending generates more fee income and spreads fixed costs, which together increase Native CDFIs' self-sufficiency.

### **NEW MARKETS TAX CREDIT PROGRAM**

Authorized by Congress in 2000 and administered by the CDFI Fund, the New Markets Tax Credit Program (NMTC Program) attracts new investment to low-income communities by providing investors with federal income tax credits in exchange for equity investments in financial intermediaries called Community Development Entities (CDEs). Certified Native CDFIs automatically qualify as CDEs.

While data are limited, they show mixed results for Indian Country in terms of access to capital generated by NMTCs. For the period 2004 to 2011, CDEs used the NMTC Program to finance 90 projects serving Native Communities in 15 states. These projects constituted 2.6 percent of the approximately 3,500 QALICB projects that NMTC financing supported during the period overall. Native-controlled CDEs were not as well represented among CDEs that applied for and received NMTC awards. From 2008 to 2011, Native-controlled CDEs submitted only 10 applications for NMTCs and three received NMTC awards. These allocations represent 0.8 percent of the NMTC awards made and 0.75 percent of the tax credits provided in that time span. Application success rates are yet another measure of Native Communities' NMTC Program participation. Native CDEs succeeded with 30 percent of their NMTC applications from 2008 to 2011, while non-Native CDEs succeeded with 35 percent.

### **NATIVE-OWNED DEPOSITORY INSTITUTIONS**

In 2016, there were 18 Native-owned banks in the United States, with total assets of more than \$2.6 billion. Three are national banks, the remaining 15 are state-chartered. While most Native banks do not serve Native Communities exclusively, they are an important factor in capital and credit access for Native America: Native consumers rely on them for depository services and loan finance, and tribal governments rely on them



to manage tribal payrolls, receive and hold inter-governmental transfers, invest tribal assets, process distribution payments, and provide lines of credit.

## **TRIBAL TAX-EXEMPT BONDS**

Like state and municipal governments, tribal governments can issue tax-exempt bonds to finance government functions. Interest income earned on these bonds is exempt from federal income taxes, which makes it possible for governments to borrow funds at lower interest rates.

Unlike state and municipal governments, which have been authorized to use tax-exempt bonds since at least the 19th century, tribal governments were authorized to issue tax-exempt bonds only recently, through the Indian Tribal Government Tax Status Act of 1983. Tribal governments also operate under a restriction that other governments do not: they only may use tax-exempt bonds to finance “essential governmental functions,” such as school construction and public infrastructure development, and not broader purposes, such as community and economic development. Since 2003, the Treasury Department has made repeated attempts to remove this restriction for tax parity and fairness reasons.

Tribal Economic Development Bonds (TED Bonds) are a special type of tax-exempt bond established through the American Recovery and Reinvestment Act of 2009. By statute, TED Bonds are not subject to the essential governmental functions test and may be used for a wider range of activities than traditional tribal tax-exempt bonds. Total authorization for the TED Bonds was \$2 billion, and tribes have made more than 130 applications for bond issuance. For reasons ranging from project readiness, to Securities and Exchange Commission registration requirements, to a desire to reduce lending costs, applicant tribes have been slow to use their authorized volume of bond finance. New rules issued by the Internal Revenue Service in 2015 may enhance tribes' access to this source of capital.

## **Conclusion**

Data from a variety of sources suggest that in the decade and a half following the release of the NALS, access to capital and credit in Native Communities has improved. Compared to 2001, Native individuals, Native-owned businesses, and tribal governments all have more financial options, and more funds are flowing to them. Still more positive change may be on the horizon: American Indian and Alaska Native per capita incomes are growing, Native Communities' financial infrastructure is broader and deeper than in 2001, and tribal governments are increasingly enacting laws and policies that support economic growth.

However, this Data Review also highlights both persistent and new concerns about access to capital and credit in Native Communities. Some programs designed to aid Native borrowers do not work as well as they might. Undue risk aversion and lender knowledge gaps may characterize some financial markets. Progress in access to banking services may be stymied by the slow growth of rural broadband. Even the good news of ongoing economic growth in Indian Country generates more demand for capital.

# Introduction

## **CAPITAL ACCESS AND ECONOMIC GROWTH IN NATIVE COMMUNITIES**

With the release of its “Report of the Native American Lending Study” (NALS) in 2001, the U.S. Department of Treasury’s Community Development Financial Institutions Fund (CDFI Fund) drew national attention to the issue of capital and credit access in American Indian, Alaska Native, and Native Hawaiian communities (Native Communities). The report detailed seventeen specific barriers to access that resulted in “a significant difference in the amount of capital investment when comparing the rest of the United States to Indian Lands and Hawaiian Home Lands” (CDFI Fund 2001, 2).

Since 2001, capital and credit access in Native Communities has expanded, in part due to actions taken in response to the NALS. The findings spurred critical policy and program development within the CDFI Fund (including formation of the Native Initiatives assistance programs described in Section III) and focused still other federal government administrators, lenders, and community leaders on access to credit and capital as a driver of Native Community development.

Economic growth in Native Communities is a signal that barriers to capital access may now be lower. From 2000 to 2010, the average real per capita income for American Indians residing on reservations increased by 10 percent, family poverty rates fell by 1.4 percent, and unemployment edged downward (Akee and Taylor 2014).<sup>1</sup> Remarkably, Native economies not only outperformed the U.S. economy in each of these categories but did so against the backdrop of national recession and a slow recovery.

Yet the data also point to the ongoing need for access to capital and economic growth. On average, the economic standing of American Indians, Alaska Natives, and Native Hawaiians continues to lag that of other racial and ethnic groups in the United States. According to the American Community Survey, the five-year (2006-2010) average per capita income for American Indian reservation residents was \$12,459, compared to \$26,893 for all races in the U.S.<sup>2</sup> Related analysis suggests that at current rates of growth, it will take another 40 years for the per capita incomes of Native peoples living on reservations to catch up to the per capita incomes of all Americans (ibid.).

These observations raise critical questions: Where does Native America stand now in terms of capital and credit access? What has been the effect of new action and new approaches by policymakers and financial entrepreneurs? What are ongoing and future needs?

<sup>1</sup> | These population-weighted averages exclude the Navajo Nation. Because its on-reservation population is larger than the combined population of the next 19 largest tribes, incorporating Navajo data would obscure the results from other tribes. We note, however, that the real per capita income of American Indians living on the Navajo Reservation grew more than 10 percent over the period (from \$8,764 in 2000 to \$9,787 in 2006-1010) (Akee and Taylor 2014).

<sup>2</sup> | The geographic scope of this statistic is all reservations in the lower-48 states, all Tribally Designated Statistical Areas (TDSAs), and all Oklahoma Tribal Statistical Areas (OTSAs).

## TAKING STOCK

### *Native Community members as consumers:*

To what extent have tribal citizens been able to access to savings and lending institutions to increase their financial flexibility? To what extent do they have access to products and services that can help them establish or rebuild credit, purchase a vehicle, or buy a home?

### *Native business owners:*

Are tribal-citizen entrepreneurs able to access the capital they need to start, expand, and operate their businesses? Are they able to obtain the specific credit products they need (which can range from microloans to mezzanine loans to commercial lines of credit)?

### *Tribal businesses, governments, and communities:*

Do community financial institutions and mainstream banks provide services and programs appropriate to Native Communities' needs? Is the capital and credit available to tribally owned businesses appropriate for their new construction, business expansion, and operations needs? Are tribal governments able to access capital for major projects, such as the improvement of infrastructure, the development of housing, and the construction of government buildings?

## SCOPE AND METHODS

This document, “Access to Capital and Credit in Native Communities: A Data Review” (Data Review) begins to answer these questions. As the second part of a two-part follow-up to the NALS commissioned by the CDFI Fund, it documents the evolution, current state, and future of Native Communities' capital access needs since 2001, using a range of datasets describing opportunities for tribal citizens, entrepreneurs, enterprises, and governments. Part one, the “Access to Capital and Credit in Native Communities Report” (ACC Report), published in May 2016, is based on data from public comments, tribal consultations, focus groups, key informant interviews, and a broad-ranging literature review and identifies success stories within a more detailed topical analysis. The full two-part study is intended to provide research and analysis in support of actionable recommendations for improving access to capital and credit in Native Communities.

This Data Review is not intended to be a full survey of all sources of capital and credit available to Native Community residents, Native entrepreneurs, and tribal governments. Instead, it samples quantitative indicators to broadly assess how the type, magnitude, and volume of capital-access opportunities for Native Communities have changed. Certainly, additional data (for example, data from still other federal government departments and offices) would provide additional insights and have been excluded only on the basis of access and sufficiency. But it is also true that some information regarding the state of access to capital in Native Communities is simply unavailable. Not all lending activity is described in publicly available datasets, papers, and reports. Much cannot be aggregated at the regional or national level. For privacy reasons, some private market borrowing and lending activity cannot be collated into datasets at all. This paper cannot fill those gaps. In fact, the gaps underscore the importance of improved data collection, which would support an even more full-bodied understanding of the capital and credit opportunities available to Native Communities.

## DEFINITIONS

The CDFI Fund's definition of a Native Community is a Native American, Alaska Native, or Native Hawaiian population, land, or equivalent entity as defined by the Bureau of the Census (see, for example, CDFI Fund 2013). However, many datasets do not provide

information for this specific population, and as a result, various statistics in this Data Review refer to either a broader or a narrower population group.

This Data Review follows the U.S. Census Bureau in using the Office of Management and Budget’s definitions of “American Indian or Alaska Native” and “Native Hawaiian.” In their usage, “American Indian or Alaska Native” refers to a person who has origins in any of the original peoples of North and South America (including Central America) and who maintains tribal affiliation or community attachment” (Norris et al. 2012, 2); “Native Hawaiian” refers to “a person having origins in the original peoples of Hawaii” (OMB 1997, 58786).

In general, this Data Review also follows the CDFI Fund’s definition of Native Trust Lands, which derives from the United States Code (U.S. Code 38, §3765). Trust land is any land that

- is held in trust by the United States for Native Americans;
- is subject to restrictions on alienation imposed by the United States on Indian lands (including Native Hawaiian homelands);
- is owned by a regional corporation or a Village Corporation, as such terms are defined in section 3(g) and 3(j) of the Alaska Native Claims Settlement Act, respectively; or
- is on any island in the Pacific Ocean if such land is, by cultural tradition, communally owned land, as determined by the Secretary.

In some cases in the text, Indian Lands also may include non-trust lands under some measure of tribal government control—for example, non-trust lands within the exterior boundaries of American Indian reservations, Alaska Native Villages, and Tribal Jurisdictional Areas in Oklahoma.



# 1 Native Consumers' Access to Capital and Credit

## **PROXIMITY TO FINANCIAL INSTITUTIONS**

One of the most basic indicators of access to capital for American Indians, Alaska Natives, and Native Hawaiians living in Native Communities is the distance they must travel to reach a bank or Automated Teller Machine (ATM). If Native Community residents consider a bank or ATM to be too far away, using its services is not a viable option, and distance is a barrier to access.

Of course, simply having a financial institution nearby does not mean that Native Community residents will seek its services, or that the institution will have services appropriate to their needs. Consequently, distance to the nearest bank or ATM is best understood as an indicator of the possibility that a Native Community resident is banked.

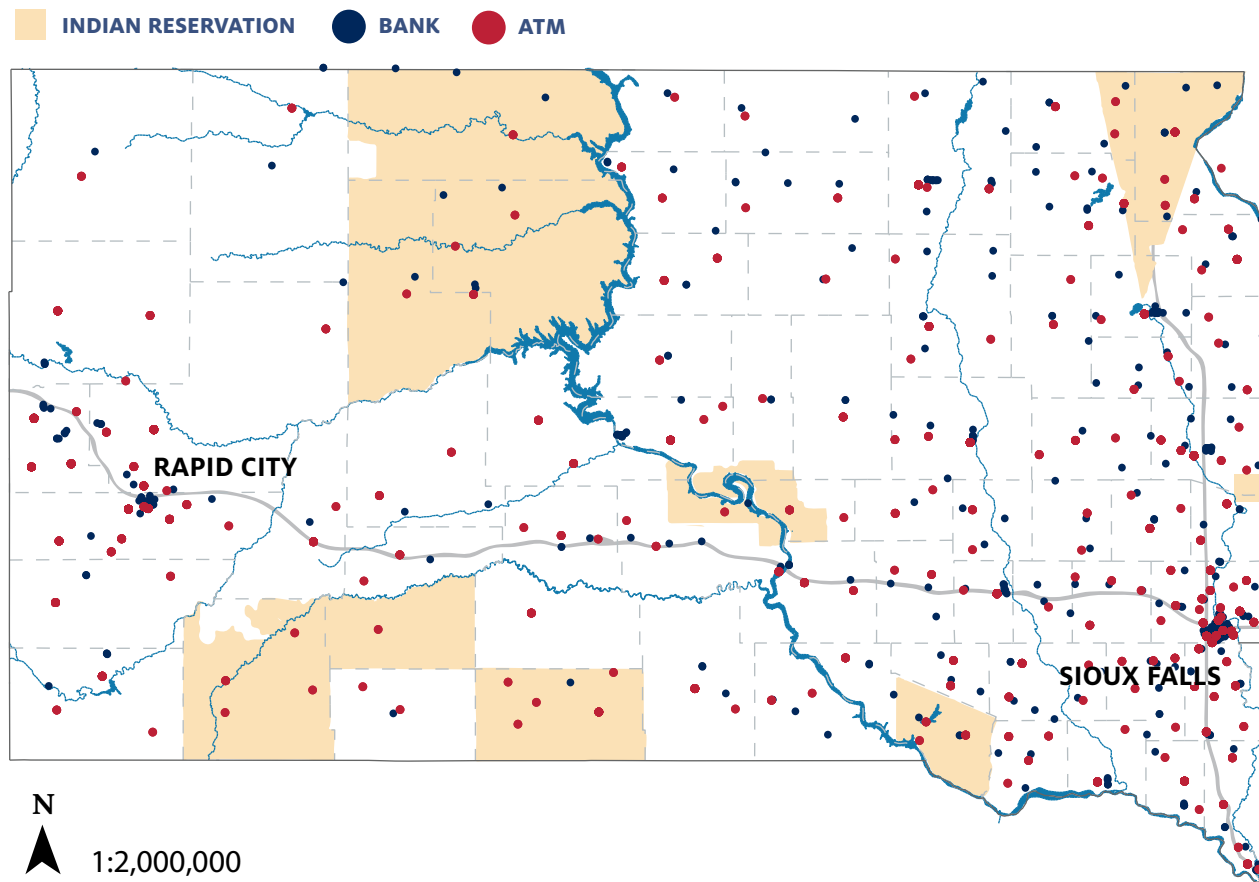
### *Examples from Three Regions*

The three maps below (Exhibits 1-3) show the proximity of reservations to bricks-and-mortar commercial banks and ATMs in three sample regions: South Dakota, Arizona, and Southern California. These examples offer visual evidence of the difficulty that many Native Community residents have accessing banking infrastructure. The blue dots are banks, the red dots are ATMs, and Indian Lands are shaded tan. In South Dakota (Exhibit 1), banks and ATMs are concentrated in the state's two main population centers, Sioux Falls (to the east) and Rapid City (to the west). Few financial institutions or ATMs are located on the lands of the nine tribes that share a geography with the state. Outside the main urban areas, distances between banks and ATMs are great throughout the state, on and off reservation lands.

The situation in Arizona (Exhibit 2) is similar. As expected, the location of banking services substantially reflects the distribution of population: banks and ATMs are located predominantly in the urban areas of Phoenix and Tucson. There are few banks and ATMs on the lands of the 22 federally recognized Native nations that share Arizona's geography.

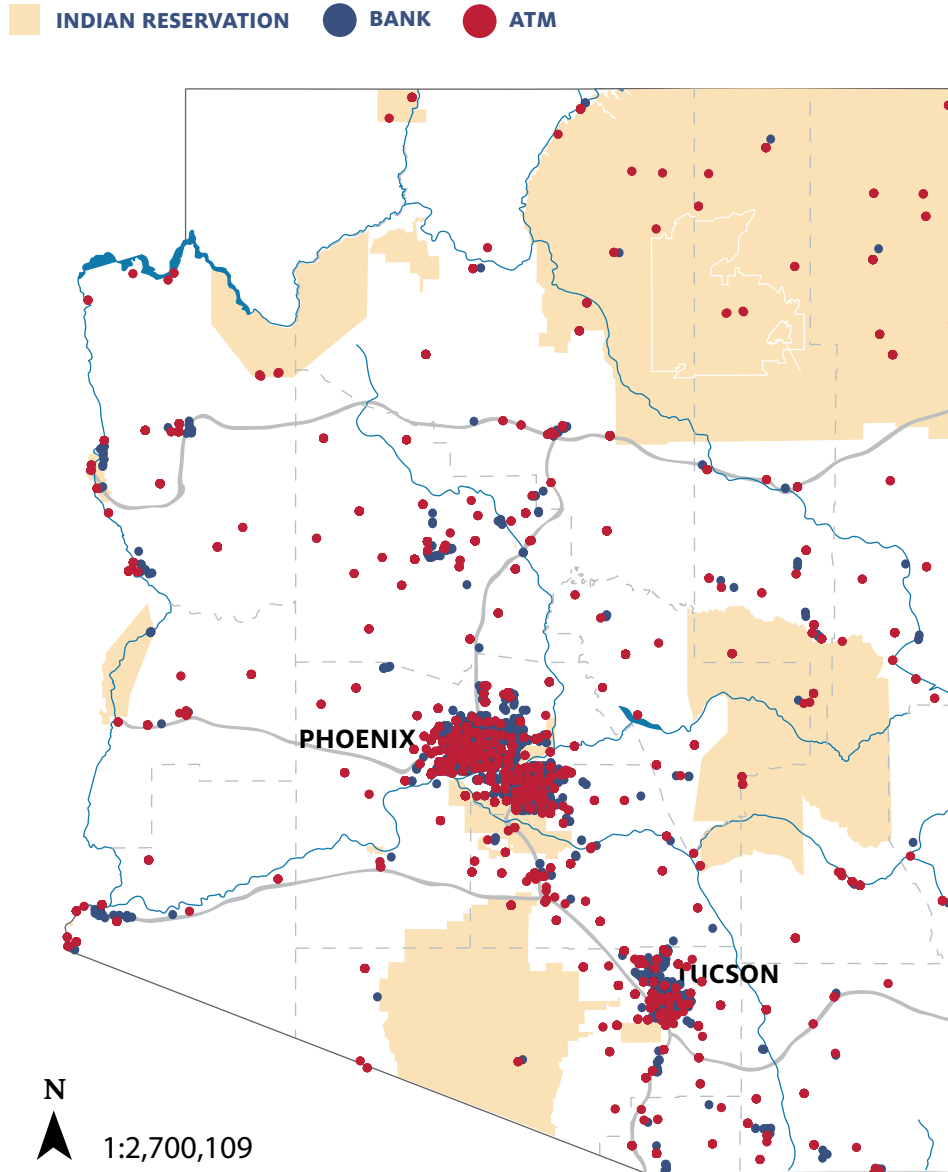
The Bureau of Indian Affairs serves 27 federally recognized tribes through its Southern California Agency (BIA 2015). As Exhibit 3 shows, most of these tribes' reservations are small and closely connected to the dense urban and suburban sprawl of Los Angeles and San Diego. Although it appears that few banks and ATMs are located on tribal lands, residents of most Southern California reservations need to travel relatively short distances to access banking services. (Note that the scale of the map in Exhibit 3 is quite different from the scales in Exhibits 1 and 2.)

## Exhibit 1: South Dakota Bank and ATM Locations



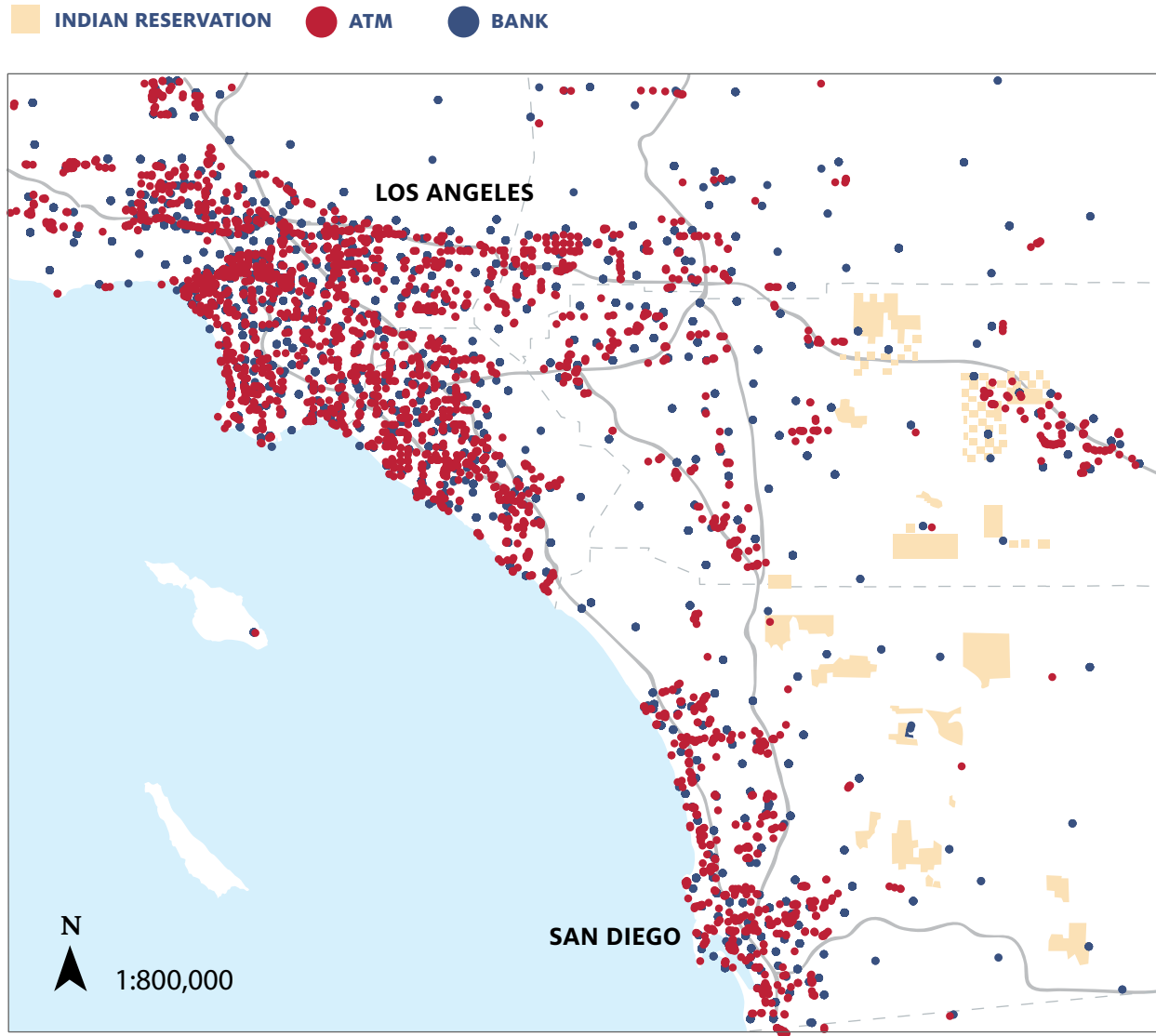
Data sources: FDIC (2013), Census Bureau (2012), and Digibits Media (2013); bank and ATM information current as of August 2013.

## Exhibit 2. Arizona Bank and ATM Locations



Data sources: FDIC (2013), Census Bureau (2012), and Digibits Media (2013); bank and ATM information current as of August 2013.

### Exhibit 3. Southern California Bank and ATM Locations



Data sources: FDIC (2013), Census Bureau (2012), and Digibits Media (2013); bank and ATM information current as of August 2013.



### Summarized Distance Data

Geo-located bank branch and ATM information also can be used to measure actual distances to banks and ATMs. Exhibit 4 summarizes data on the cross-country distance to the nearest bank and ATM from the geographic center of 201 tribes' U.S. Census-mapped reservations.<sup>3</sup> This analysis includes all reservation land belonging to federally recognized tribes in the lower-48 states.

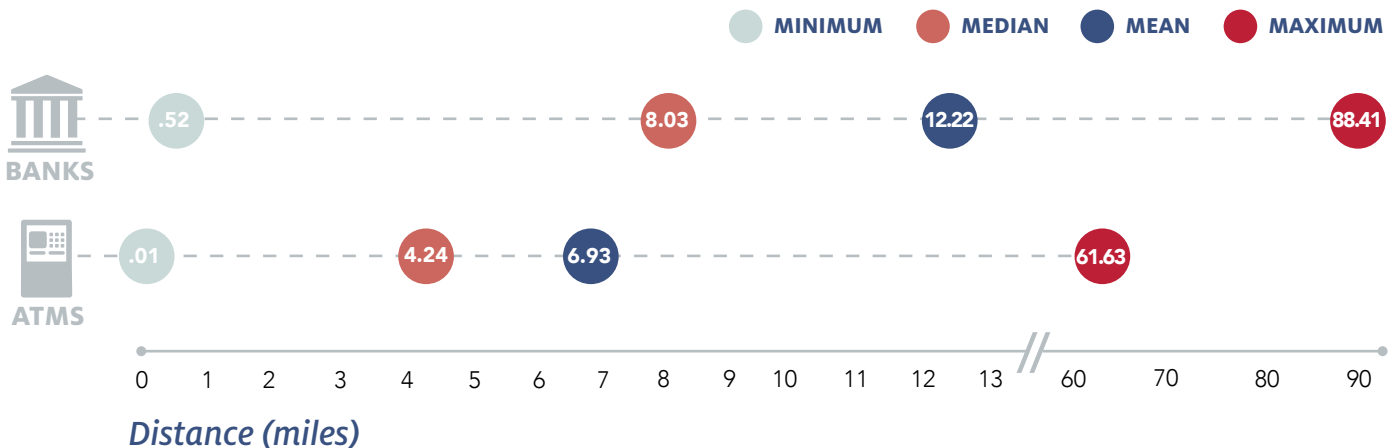
The mean cross-country distance from the center of a tribe's reservation (or reservations) to the nearest bank is 12.22 miles, and the mean distance to the nearest ATM is 6.93 miles, although the lower median values indicate the presence of a few very large "nearest" distances. For half the tribes in the sample, the distance from the center of the reservation to a bank branch is

no more than 7.93 miles, and the distance to an ATM is no more than 4.21 miles.<sup>4</sup>

Additionally:

- For 15 percent of tribes in the dataset (31 tribes), the distance from the center of the reservation to a bank is less than three miles (as the crow flies); there may be a bank on the reservation, or the tribe's lands may be near an urban area.
- For 94 percent of the tribes in the dataset, the distance from the center of the reservation to a bank is less than 30 miles, although driving distances are likely greater. For comparison (and to take rough account of longer driving distances), the straight-line distance is less than 20 miles for 83 percent of tribes.

### Exhibit 4. Cross-Country Distance from the Geographic Center of a Tribe's Reservation to Nearest Bank or ATM



**Note:** Calculations take account of 484 parcels that are part of 205 reservations belonging to 201 tribes. When a reservation consists of multiple parcels or a tribe owns multiple reservations, we first calculate a tribal mean and median distance and then use these single values in the calculation of the mean, median, and extreme values across tribes. Sources: FDIC (2013), Census Bureau (2012), and Digibits Media (2013); bank and ATM information current as of August 2013.

3 | Various distinguishing characteristics of Alaska Native Villages, Native Hawaiian Homelands, and Oklahoma Tribal Statistical Areas limit the usefulness and comparability of a similar distance calculation for these geographies, and thus, calculations were generated only for reservations in the 48 contiguous states. We also note that distances from each reservation's population centroid (center of mass for the population)—or some other population center—might be more informative than distances from each reservation's geographic centroid. Given the variety of settlement patterns in Native Communities, however—patterns which are dependent on federal policy, resource access, and tribal culture, among other variables—determination of the "best" distance measure for understanding reservation residents' banking choices is left for future research.

4 | To provide some perspective, in the largest 320 metropolitan statistical areas in the United States, the estimated average linear distance that any consumer must travel to an ATM is approximately 0.0097 miles, (Jeon 2012), a figure that is comparable only with the minimum value in the reservation sample. To our knowledge, comparable data are not available on access to ATMs in rural areas.

- 98 percent of tribes' reservation centroids are less than 30 miles from an ATM, and 94 percent are less than 20 miles.
- Only three tribes' reservations have a geographic center that is more than 70 miles from a bank, and only two have a geographic center than is more than 50 miles from an ATM.

These data may be compared to an oft-cited quartet of statistics in the 2001 NALS. Based on 212 unique answers by key informants to the survey question, "What is the approximate distance from the Reservation or Indian Lands to the nearest bank branch or ATM?" (CDFI Fund 2001, 64), the report noted that:

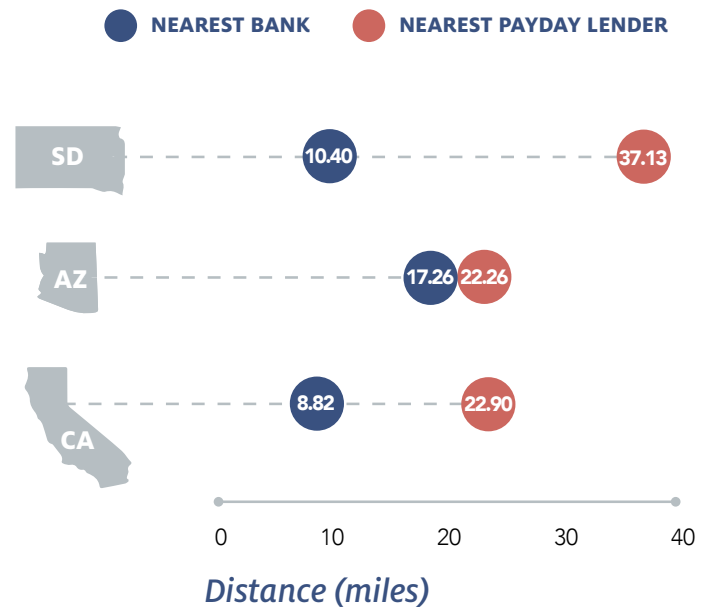
- Only 14 percent of communities on Indian Lands have a financial institution in their community
- Approximately half of these communities have a financial institution nearby (fewer than 30 miles away)
- Only about half have an easily accessible ATM
- Six percent of the residents of Indian Lands must travel more than 100 miles to reach a bank or ATM (Deloitte & Touche 2000, 20-21; CDFI Fund 2001, 39).

While the estimation methods for 2001 and 2013 statistics are quite different, and both incorporate known error (survey data are estimates only and GIS data do not take driving distances into account), judicious comparison suggests that access to banking services has improved for at least some reservation residents. Comparing 2013 to 2001, it appears that a greater number of Native Community members live close enough to a bank branch or ATM that using such services has become a viable option for them.

### Alternative Lenders

Banks and ATMs are not the only financial services options available to Indian Country residents. In the 1990s, many states relaxed their lending and usury laws, creating a niche for alternative lenders. By the

## Exhibit 5. Cross-Country Distance from Geographic Center of a Tribe's Reservation to Nearest Payday Lender and Bank



Sources: Graves and Peterson (data files for 2007 paper), FDIC (2013), and Census Bureau (2012); bank and ATM information current as of August 2013.

mid-2000s, payday loans (short-term cash advances on workers' paychecks) had become a top concern among community development finance specialists in Indian Country.<sup>5</sup> These products are expensive (with annual percentage rates as high as 400 percent) and are an easy way for borrowers to get caught in a cycle of increasing debt (Parrish and King 2009, Pew Charitable Trusts 2012).

In 2007, seminal research identified the clustering of payday lenders near military installations, noting that proximity led to easier access by consumers and increased opportunities for predation by lenders (Graves and Peterson 2007). At least in the three states mapped above, similar clustering near American Indian reservations is not evident. In fact, payday lenders are farther away from reservations than banks and ATMs<sup>6</sup>—although mean distances are still small enough to indicate relatively easy geographic access (Exhibit 5).

5 | For example, in a survey about predatory lending practices, attendees at the 2007 National American Indian Housing Council conference identified concerns about payday loans as second only to their concerns about loans against anticipated tax refunds (Jorgensen, Dewees, and Edwards 2008).

6 | An important caveat on this finding is that the data on payday lenders are from 2007 while the banking and ATM data are from 2013.

Moreover, and as noted above with regard to banks, physical proximity is only one aspect of accessibility. Consumers may perceive that alternative lenders are more accessible than mainstream lenders if they feel more welcome at such businesses or qualify more easily for their services. While the expansion of access to credit is generally considered to be a good thing, access to predatory credit is not, and more information is needed about Native Americans' engagement with the alternative lending sector. National studies typically do not include American Indians, Alaska Natives, and Native Hawaiians in large enough numbers to draw conclusions about the population—although they should, given that the characteristics of payday borrowers match up well to the characteristics of Native Community residents (people of color who make less than \$40,000 a year, rent their homes, and are between the ages of 25 and 44) (Pew Charitable Trusts 2012).

### *The Impact of Online and Mobile Banking*

In places where broadband is readily available, many consumers now depend on the Internet to conduct banking activities that formerly required a trip to a bank or ATM. Survey data suggest that as of 2014, 74 percent of American consumers with a bank account engaged in at least some online banking activities and that 39 percent of all mobile phone users with a bank account used their phones to access banking services (Board of Governors of the Federal Reserve System 2015).<sup>7</sup>

The use of online and mobile banking options in Native Communities is more difficult, in part due to the limited availability of wired and wireless broadband services. The Federal Communications Commission estimates that only 37 percent of tribal lands residents have access to broadband (FCC 2015), and service through anchor institutions such as tribal libraries is seen as key to wide-spread Internet use in Indian Country (Jorgensen et al. 2014).

In fact, the trends actually may represent a setback in Native Community members' access to banking services. If the mainstream shift toward online banking leads to bank branch closures, and broadband deployment and Internet access in Native Communities changes only slowly, residents will have fewer physical banking options and comparatively worse Internet banking opportunities. As observed in a Federal Reserve Bank of Kansas City Center for the Study of Rural America publication more than 15 years ago, "lack of high-speed Internet service may become more of a handicap as more advanced online banking services are offered" (Keeton 2001, 49, emphasis added). In this setting, improved banking access many depend more on broadband deployment and Internet access than on access to bricks-and-mortar financial institutions.

### *Summary*

Access to banks and ATMs appears improved for many Native Community residents since 2001, but the growing importance of online banking means that the physical presence of banks and ATMs may no longer be key to increasing access to financial services.

7 | The Federal Reserve study used these definitions: "Online banking involves checking your account balance and recent transactions, transferring money, paying bills, or conducting other related transactions with your bank or credit union using the Internet," and "Mobile banking uses a mobile phone to access your bank or credit union account. This can be done either by accessing your bank or credit union's web page through the web browser on your mobile phone, via text messaging, or by using an app downloaded to your mobile phone" (Board of Governors of the Federal Reserve System 2015, 37 & 39).

## CONSUMER CREDIT SCORES AND CREDIT UTILIZATION

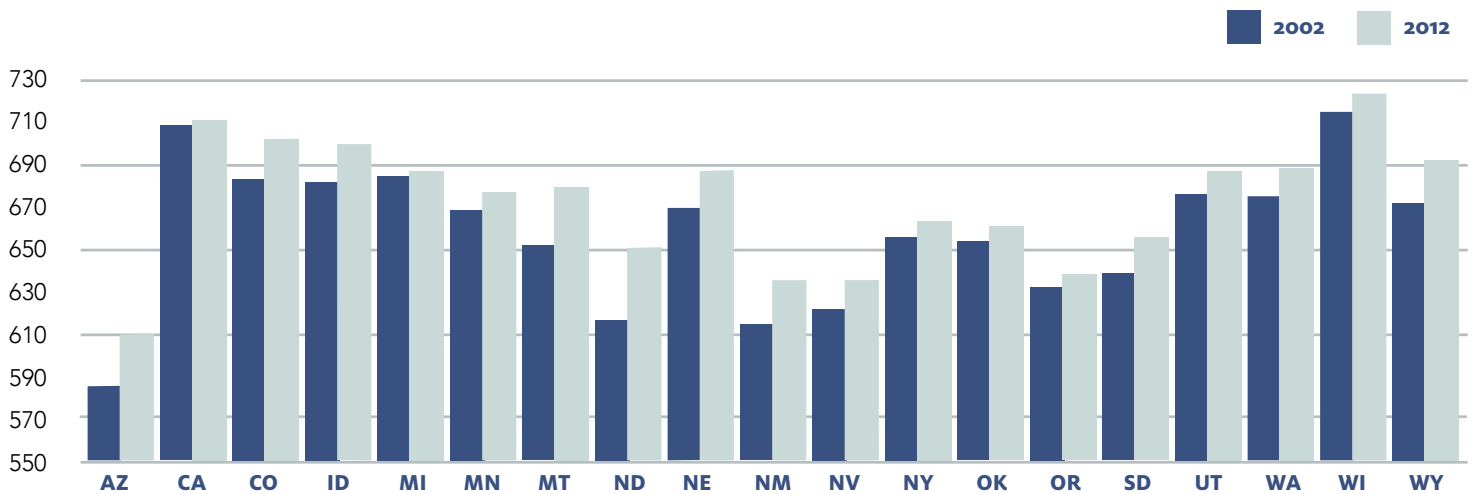
Access to credit within the banking system generally depends to some degree on credit worthiness. Dimitrova-Grajzl et al. (2015) shed light on Native Community residents' credit worthiness by matching a sample of credit files from the Equifax Consumer Credit Panel to census block groups within and nearby American Indian reservations. As the authors define them, "nearby" census block groups are within 10 miles of reservations but neither straddle nor abut reservation boundaries, and "within" census block groups are fully contained by reservation boundaries. The study draws data from 19 states, which encompass 99 percent of the usable reservation geographies, for the years 2002 to 2012. The data reflect the credit scores of all Native Community residents, regardless of race.<sup>8</sup>

### On-Reservation Consumer Credit Risk Scores

Mean Equifax Risk Scores associated with on-reservation census block groups have risen over time, which suggests that the creditworthiness of Native Community residents of all races is improving (Exhibit 6).

Comparing on-reservation and nearby off-reservation populations, however, credit files for reservation residents (again, of all races) are more likely to be "thin"—in other words, they contain too little information for a credit score to be calculated. Where credit scores do exist, reservation residents' scores are lower, on average, than comparison population scores.

**Exhibit 6. On-Reservation Mean Credit Scores**

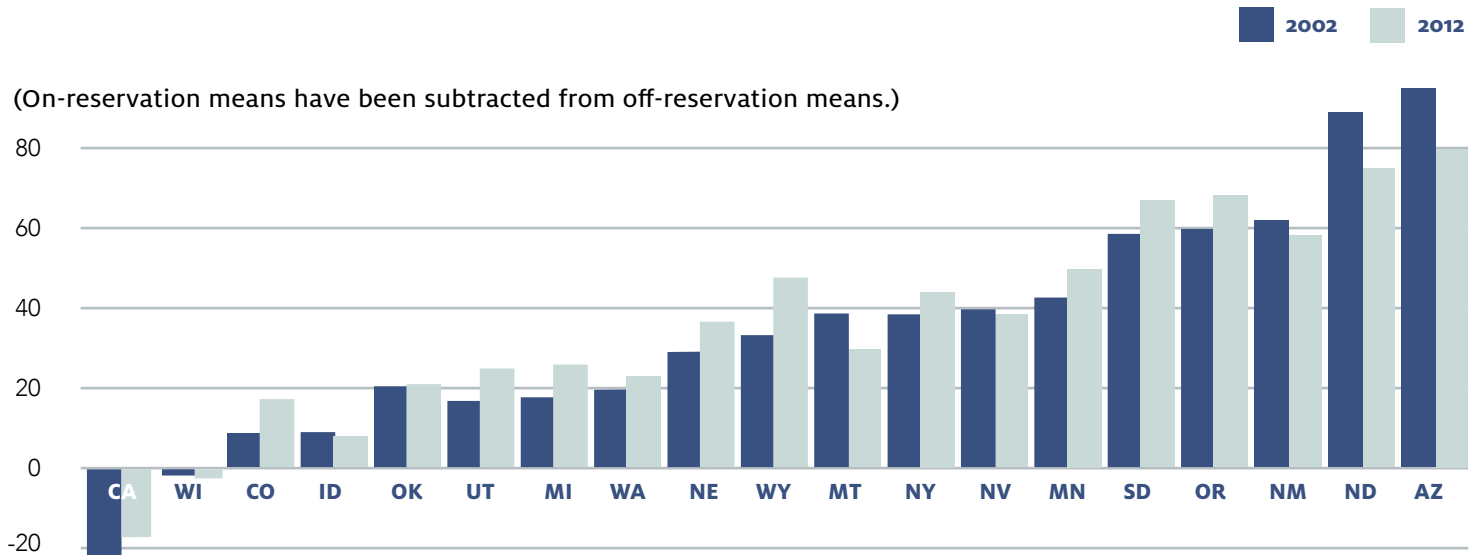


Notes: 1) Scores are for all races, that is, for Natives and non-Natives. 2) On-reservation scores include block groups fully contained within reservations. Source: Dimitrova-Grajzl et al. (2015, Table A3).

8 | It is not possible to segregate the credit files by borrower race.



## Exhibit 7. The Gap between On-Reservation and Off-Reservation Mean Credit Scores



Notes: 1) Scores are for all races, that is, for Natives and non-Natives. 2) Off-reservation scores are for "nearby" Census blocks, where "nearby" is defined as a block group within 16 km/10 miles but neither contains nor borders reservation land. On-reservation scores include block groups fully contained within reservations. Source: Dimitrova-Grajzl et al. (2015, Table A3).

There is wide variation by state, however. In 2002, the gap between on- and off-reservation scores ranged from 94 in Arizona to -22 in California. (The gap is the number of points by which the credit scores for nearby census block groups exceed or fall short of the scores for within-reservation census block groups.) Exhibit 7 charts these gaps. Because credit scores among nearby off-reservation populations also rose from 2002 to 2012, and often rose more than on-reservation scores, the exhibit also shows a widening of credit score gaps over time.<sup>9</sup>

### Types of Credit Utilized

The Equifax data permit categorization of outstanding loans and credit lines by census block group. Credit utilization by loan type is measured as the number of files per capita that have balances. Averaging across the "within" and "nearby" block groups, the data show that credit usage varies greatly by type and that there are disproportionalities in reservation residents' use of certain types of credit:

- In both 2002 and 2012, consumers on and near reservations utilized retail credit and consumer finance loans at similar rates.
- Mortgage credit utilization is low on reservations. However, on-reservation mortgage credit

utilization as a fraction of nearby off-reservation mortgage credit utilization rose from 56 percent in 2002 to 59 percent in 2012.

- Residents of on-reservation census block groups tend to utilize auto loans at higher rates than residents of nearby off-reservation areas.

Numerous factors may account for these differences, including the trust status of reservation lands (as highlighted in the NALS),<sup>10</sup> the greater difficulty in qualifying for a mortgage loan than for other types of credit, the large number of alternative lenders that specifically market to car buyers with weak credit (Melzer and Schroeder 2015), and even the accessibility of public transport.

10 | Much but not all reservation land is trust land, which may be owned either by individuals or by tribes. As noted in the Introduction, Indian trust land is defined in the U.S. Code; title is held in trust by the U.S. government for the beneficial use of individual Indians and/or tribes; and there are conditions that must be met prior to the encumbrance or alienation of trust land. Much as any other property owner, an individual can mortgage, give, or sell his allotment (an individually owned parcel of trust land) as he sees fit, although he must secure the approval of the Bureau of Indian Affairs (BIA). Many tribes have constitutional prohibitions on encumbrance, alienation, or sale of tribal trust land that are more restrictive. In situations where this isn't the case, a tribe must likewise gain approval from the BIA to sell or encumber trust land, including authorization for leases (unless the tribe has approved leasing regulations under the Helping Expedite and Advance Responsible Tribal Homeownership, or HEARTH, Act). Individuals or other entities that have leased tribal trust land also must seek BIA approval for leasehold mortgages. Lenders generally view these characteristics of trust land as barriers to mortgage finance in Indian Country.

9 | Even in California, where the data show that, on average, reservation residents had higher credit scores than the off-reservation comparison group in both 2002 and 2012, the score differential narrowed, which means that by 2012, reservation residents' scores decreased relative to non-residents' scores.

### *Modeling Credit Scores and Credit Utilization*

Dimitrova-Grajzl et al. test several possible correlates of credit scores and credit utilization. For example, credit utilization models show that both the per capita number of on-reservation home mortgages and per capita number of on-reservation auto loans are positively correlated with household income. There is also a negative, statistically significant correlation between a block group's percentage of self-identified American Indians and home mortgage utilization—but no evident relationship between block groups' racial composition and the uptake of auto financing.

As the authors note, these relationships deserve further study. One critical question is whether the correlations between credit access and the racial composition of reservation populations indicate bias—or if they instead reflect the confounding effect of variables that are not directly tested in the models (land trust status, loan requirements, applicant qualifications, etc.).

### *Summary*

Average consumer credit scores for American Indian reservation residents of all races rose from 2002 to 2012. In general, however, reservation residents' credit scores are weaker than scores for residents of nearby off-reservation lands. Reservation residents' low participation in mortgage markets is one reason for the score gaps (and vice versa). Looking to the future, it will be important for Native Community residents to leverage their success at accessing retail, consumer finance, and auto loans into more successful mortgage loan access. Lenders also must address explicit and implicit policies that limit the extension of credit on reservation lands.

## **MAINSTREAM MORTGAGE MARKET PARTICIPATION**

The Home Mortgage Disclosure Act (HMDA), enacted by Congress in 1975 and amended several times thereafter, requires qualified banks and other lending institutions to report on the home mortgage applications, loan originations, and loan purchases they process each year.<sup>11</sup>

### *The Value and the Limitations of HMDA Data*

HMDA-generated data help policymakers, lenders, and community leaders assess whether financial institutions are serving their communities' housing credit needs. Relevant to this Data Review, the HMDA mandates collection of a broad set of borrower and loan characteristics, which can provide further perspective on the use of home mortgages in Native Communities:

- HMDA datasets include borrower income and race variables, which contrasts with the Equifax data panels discussed in the previous section.
- HMDA datasets include information on applicant income, mortgage purpose, property type, and the interest rate.
- HMDA requires banks to report not only on conventional mortgages but also on mortgages insured or guaranteed by the Federal Housing Administration, Veterans Administration, Farm Service Agency, and Rural Housing Service.

<sup>11</sup> | Qualified lending institutions include banks and other for-private entities that make mortgage loans and process a "high enough" volume of such loans, both in terms of percentage of business activity and in terms of dollar value. See Federal Financial Institutions Examination Council (2010).

- HMDA datasets associate the property in each mortgage application with a census tract, which facilitates additional geographic and community-level analysis.

These are significant advantages. Nonetheless, the data also have limitations, especially for the task at hand. For one, because census tract boundaries do not replicate reservation boundaries, it is only possible to evaluate Native Community members' mortgage credit experiences within geographies that approximate reservations. Second, while HMDA captures the vast majority of mortgage activity in the United States, small-scale community development lenders and some other specialty lenders are not required to report. This is a very small fraction of overall mortgage lending activity, yet it may be a large fraction of the lending that occurs in any given Native Community (see, for example, Jorgensen and Taylor 2015).

### *A Snapshot of Mortgage Lending in American Indian and Alaska Native Communities*

Using a broadly defined subset of American Indian and Alaska Native (AIAN) borrowers<sup>12</sup> and comparing AIAN mortgage applicants living on or near Indian Land<sup>13</sup> to all applicants in a state, Exhibit 8 presents the home mortgage experiences of AIANs in seven states in the period 2003-2015 as captured in HMDA data. In other words, the table captures two critical variables affecting Native Community mortgage market outcomes—geography and national economic conditions over time.

The states selected represent the range of Indian land holding patterns across the United States:

- Alaska and Oklahoma each share a geography with only one reservation, although there are modest amounts of additional tribal and individual trust and restricted fee land within state borders.
- In Montana and Arizona many Indian reservations are large and rural, and a substantial amount of Indian Land is held in tribal or individual trust.
- In Oregon and Wisconsin, Indian lands are found on a mixture of urban and rural reservations.
- In California, most Indian reservations are relatively small, and many are urban.<sup>14</sup>

The observations of housing market activity at three-year intervals starting in 2003 capture the full range of economic conditions surrounding the late 2000s housing market upheaval: in 2003 lending activity was high volume; in 2006 activity had slowed but rates were still low and capital free-flowing; in 2009 the market was in distress; in 2012 the economy was in a cautious recovery; and by 2015 the crises seemed well in the past (Bhutta and Ringo 2016).

12 | Either the primary applicant or the co-applicant may identify as single- or multi-race AIAN.

13 | Our method is to overlay reservation boundaries on census tracts to create an “on or near Indian lands” geography; data from all the census tracts that contain reservation lands are used to calculate summary statistics.

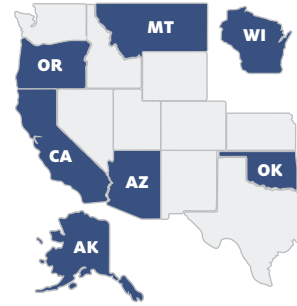
14 | The 18 reservations in San Diego County, for instance, span 124,000 acres. On average, this is only 6,889 acres each (fewer than 11 square miles). By comparison, two-thirds of all Indian reservations “cover an area of less than 50 square miles each, while seven percent comprise more than 1000 square miles” (Frantz 1999, 45).

## Exhibit 8. Mortgage Loan Applications by AIANs on or Near Indian Lands Compared to All Applications in at State (2003, 2006, 2009, 2012, & 2015)

*As compared to all applicants in the state, AIAN applicants on or near Indian Lands:*



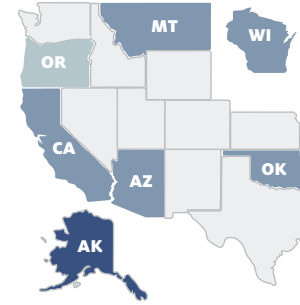
*requested lower loan amounts.*



*had a higher loan denial rate.*



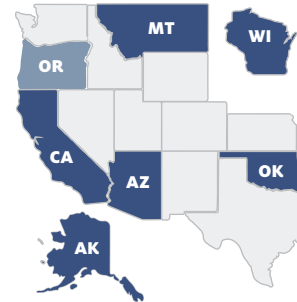
*were more often denied because of a poor credit history.*



*were offered loans with a higher mean rate spread.*



*applied for proportionately more manufactured housing loans.*



*applied for proportionately more home improvement loans.*



○ STATE NOT SELECTED FOR ANALYSIS

*Note: Data on the mean rate spread and volume of manufactured housing loans were not reported in 2003. Sources: Home Mortgage Disclosure Act public datasets for 2003, 2006, 2009, 2012, and 2015.*



A basic comparison of means across states and years suggests that AIANs' market experiences have been relatively unaffected by geography and national economic conditions. On average, and by comparison to non-Native home mortgage borrowers, AIAN borrowers seeking mortgages for properties on or near Indian Lands:

- Request lower loan amounts
- Have been denied home mortgage loans at higher rates
- Have been denied loans because of poor credit histories more frequently
- Are offered loans at higher interest rates
- Purchase more mobile homes
- Have focused their borrowing more on home improvement than on new home purchases or loan refinancing

Regarding the last point, interview evidence suggests that home improvement loans may be easier to acquire because they tend to be for amounts lower than home purchase or home construction loans. On trust land, it also tends to be easier to leverage structures than unimproved leaseholds. On some tribal lands, the former HUD Mutual Help Program has created significant homeownership, but many of these houses also are in dire need of repair, making home improvement but not refinance or home purchase loans desirable. In other words, there are many reasons for the greater proportion of home improvement loans, all of which point to unequal market access for Native Community members.

These snapshot findings do not control for covariates, a project beyond the scope of this Data Review. However, research by Parker (2011) confirms general expectations.<sup>15</sup> Using a similar subset of HMDA-generated data, Parker tests a multivariate model of loan application outcomes that controls for applicant income, applicant gender, loan purpose, reservation economic conditions, and other variables. The results show that, other things equal, applicants from counties that contain reservation land are more likely than residents of counties without reservations to be denied mortgage credit and that within reservation-containing counties, American Indians are even more likely than Caucasians to experience denials.

His analysis also begins to tease out the impact of trust land on mortgage market experiences. While Parker is unable to associate a specific land status (trust or fee simple) with each mortgage application, his results show a small but positive correlation between loan originations to AIAN borrowers and the estimated proportion of reservation land held in fee simple. Building on the previous section's conclusion (and anticipating the next section's), these findings underscore the need for a detailed investigation of mortgage lending on trust land, especially one that accounts for the

<sup>15</sup> | To be clear, we note that Parker (2011) is intended to explore the relationship between state jurisdiction over Indian Lands as provided by Public Law 83-280 (PL 280) and access to credit, and while we have concerns about the conclusions he draws related to PL 280, coefficients on certain of his control variables are relevant to the discussion here.

influences of strengthened tribal institutions, the emerging roles of NGOs such as Native CDFIs, and innovations in tribal law (variables absent from Parker's and others' analyses).

### *Predatory Mortgage Lending*

Before 2006, public HMDA datasets did not include information on interest rates, which made it difficult to assess whether American Indians, Alaska Natives, and Native Hawaiians were systematically subject to unfairly high rates. The inclusion of interest rate information in post-2006 HMDA increased the opportunities for research.

By definition, subprime loans are higher-interest rate loans offered to borrowers whose poor credit ratings or higher probability of default disqualify them for ordinary loans. While subprime loans are not inherently unfair (the higher interest rates are necessary to cover lenders' additional risk), they nonetheless create an opportunity for bias and predation.



Photo credit: Native Nations Institute (2016)

The data in Exhibit 8 suggest that concerns about predatory lending to American Indians are worthy of further exploration. In the majority of the years and states examined, the average rate spread (a measure of the difference between the annual percentage interest rate on a loan and the prime interest rate) is higher for American Indians and Alaska Natives living on and near Indian lands than for the general population. Future research must be able to address borrower characteristics (and hence, lender risk) in order to provide a clearer answer to the question.

### *A Snapshot of Mortgage Lending in Native Hawaiian Communities*

Because it was not possible from available data to create a snapshot for Native Hawaiians parallel to the AIAN snapshot (that is, one that focuses on mortgage applications from Native Hawaiians for properties on or near Hawaiian Home Lands), we focus instead on the borrowing experience of Native Hawaiians living in Hawaii generally (Exhibit 9).

## Exhibit 9. Mortgage Loan Applications by Native Hawaiians Compared to All Applications from Hawaii (2006, 2009, 2012, & 2015)

*As compared to all applicants in the state, Native Hawaiian applicants living in Hawaii:*



*requested lower loan amounts.*



*had a higher loan denial rate.*



*were more often denied because of a poor credit history.*



*were offered loans with a higher mean rate spread.*



*applied for proportionately more manufactured housing loans.*



*applied for proportionately more home improvement loans.*



Sources: Home Mortgage Disclosure Act public datasets for Hawaii for 2006, 2009, 2012, and 2015.



Photo credit: John Rae (2016)

These data present a similar story to the AIAN data. Compared to other residents of the state, Native Hawaiians tend to request lower loan amounts, apply for more home improvement loans, have their mortgage applications denied more often, and are offered mortgages at higher rates of interest than the general population. As an additional point of comparison, median family income among Native Hawaiians was 88 percent of the statewide median in 2014 (OHA 2015).

### Summary

An analysis of information generated through Home Mortgage Disclosure Act mandates suggests that American Indian, Alaska Native, and Native Hawaiian borrowers living in Native Communities have been less able to access conventional home mortgages than their non-Native counterparts. Indicative research suggests that these negative market experiences may prevail even when other relevant factors are held equal among Native and non-Native borrowers. Detailed analysis of the driving factors behind AIANs' access to residential mortgage loans would be a useful next step for both policymakers and advocates.

## HUD-GUARANTEED HOME MORTGAGES

Section 184 of the Housing and Community Development Act of 1992 authorizes the U.S. Department of Housing and Urban Development (HUD) Indian Home Loan Guarantee Program (Section 184 IHLGP).<sup>16</sup> Loans that participating banks make through the Section 184 IHLGP are backed with a 100 percent guarantee from HUD's Office of Native American Programs. As the Office of the Comptroller

of the Currency (OCC) notes, "by guaranteeing home loans, the program encourages lenders to underwrite mortgages in Indian country" (OCC 2014, 1).

### Advantages of IHLGP Loans

Section 184 IHLGP loans are available to enrolled members of federally recognized tribes and to Tribally Designated Housing Entities, and offer a variety of advantages for borrowers.<sup>17</sup> The loans feature manual underwriting (which increases the likelihood that borrowers with non-traditional credit histories will qualify), low down payments (1.25 percent on loans less than \$50,000, 2.25 percent on loans more than \$50,000), a fixed interest rate, and modest mortgage-related costs (a one-time 1.5 percent loan guarantee fee<sup>18</sup> and, beginning in fiscal year 2015, a 0.15 percent annual loan guarantee premium<sup>19</sup>). They have no maximum income limits and can be used to purchase, refinance, build, or rehabilitate a home. Properties may be located anywhere in the geographical formula service area associated with a tribe's Indian Housing Block Grant.

### Impact of the IHLGP

The Section 184 IHLGP has been a remarkably successful means of increasing access to capital and building the assets of American Indians and Alaska Natives. From its inception in the mid-1990s through March 2016, the IHLGP had guaranteed more than 33,280 loans and provided access to nearly \$5.46 billion for American Indian and Alaska Native housing (HUD 2016a). Fewer than 1000 loans were issued through 2000; nearly all IHLGP activity has occurred from 2001 onward. The uptick in the issuance of Section 184-guaranteed loans was particularly pronounced from 2005 onward. As Exhibits 10 and 11 indicate, the program continued to attract qualified borrowers throughout the recession in the late 2000s.

17 | "Tribally Designated Housing Entity" is a HUD term for the unit a tribe designates to administer its housing programs. A TDHE may be a tribal government department, a tribal housing authority, or a nonprofit corporation.

18 | Prior to April 4, 2014, this fee had been one percent.

19 | The loan guarantee premium is levied only on the remaining loan balance and only until the unpaid principal balance, excluding the upfront loan guarantee fee, reaches either 78 percent of the initial sales price or 78 percent of appraised value, whichever is lower. Limited appropriations are a key reason HUD has begun charging loan guarantee premiums. Demand for loan guarantees is high; any hope of meeting that demand depends on leveraging additional resources into new loan guarantee commitments. Borrower-derived sources of funds (the premium plus the upfront fee) are HUD's only option for raising such revenue.

16 | The US Department of Agriculture also offers a home mortgage guarantee program—and direct loans—to qualified American Indian clients through its "Section 502" program. While data on these programs were not available for this report, they constitute an important area for future research.

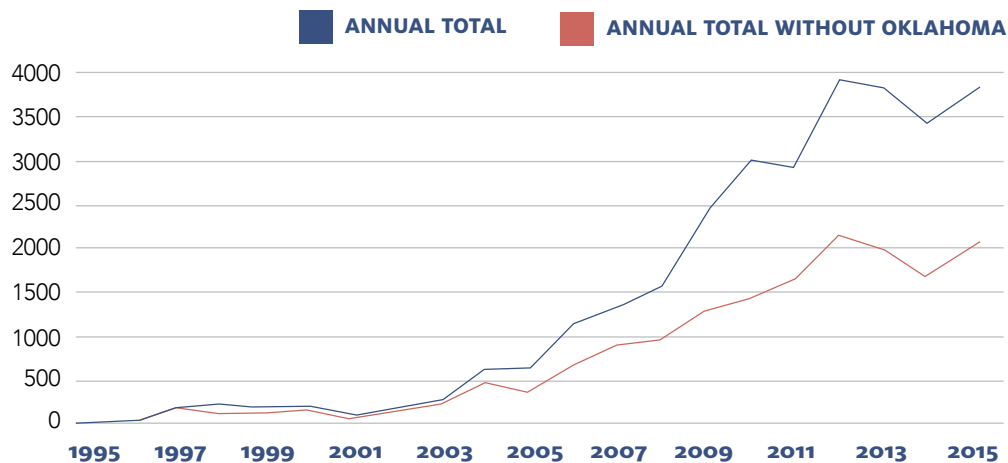
### Other Trends

Exhibits 10 and 11 also make evident two striking facts about the Section 184 IHLGP:

- From the mid-2000s onward, approximately half of all Section 184 IHLGP activity has been in Oklahoma.
- The bulk of Section 184 IHLGP activity has been on fee simple rather than trust land.

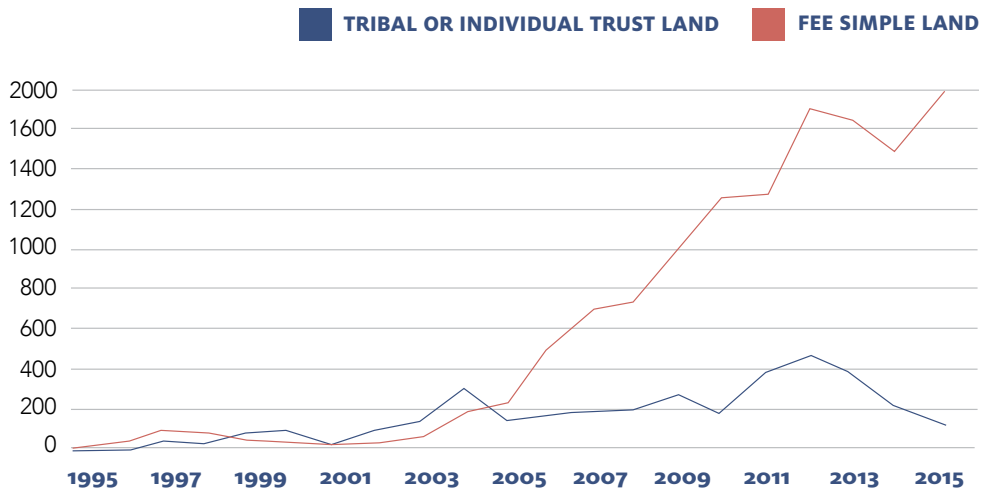
Certainly, these findings are related. Because of the state's unique history, there is little reservation land—and therefore little tribal trust land—in Oklahoma. Except for the Osage Nation, which does have a reservation, federally recognized tribes that share the state's geography have “jurisdictional areas,” in which individual allotments and fee simple parcels are intermixed. As a result, numerous Section 184-guaranteed home purchases by citizens of Oklahoma-based tribes involve fee simple land.

**Exhibit 10. Number of Section 184 IHLGP-guaranteed loans issued, by fiscal year**



Sources: HUD (2015b, 2016b).

**Exhibit 11. Number of Section 184 IHLGP loans issued outside Oklahoma, by fiscal year and type**



Sources: HUD (2015b, 2016b).

Yet as Exhibit 11 underscores, purchases in Oklahoma are only part of the story. While non-Oklahoma Section 184 IHLGP lending activity on trust lands tracked lending activity on fee simple lands in the program's early years, Section 184 IHLGP lending on fee lands increased at a much faster pace from 2005 onward. This result is somewhat unexpected, given that one of the Section 184 IHLGP's purposes is to address the unique status of Indian lands by providing lenders with legal assurances that the value of the property purchased can be reclaimed if the borrower defaults.

Without further research, it is difficult to know why lending on fee simple land is outpacing lending on trust land. Possible explanations include (but are not limited to) the ease of lending on fee simple parcels; ongoing misperceptions in the banking sector about the types of trust land and the risks of lending on trust land; limited incentives for mainstream banks to learn about trust land lending because the market is comparatively small; a lack of knowledge among borrowers that they may seek Section 184 IHLGP loans on trust lands; the lack of homes to purchase on trust land; preferences against homeownership on the reservation; larger numbers of qualified borrowers seeking fee-land mortgages; borrower fears that reservation housing markets are too underdeveloped to support a later home sale; and limited tribal institutional development.<sup>20</sup>

### *Hawaii*

The Section 184A Native Hawaiian Housing Loan Guarantee Program supports housing purchases on Hawaiian Home Lands. While developed later and serving a much narrower market than the Section 184 IHLGP, the Hawaiian Program secured 468 mortgages on Hawaiian homelands in the period 2008 to 2015; the cumulative value of these loan guarantees is \$114.95 million (HUD 2016b).

### *Summary*

The Section 184 and 184A loan guarantee programs have been a success, together guaranteeing more than 33,500 loans and supporting the flow of \$5.5 billion in mortgage finance for members of American Indian, Alaska Native, and Native Hawaiian communities. Despite this progress, it remains essential for HUD and tribes to develop new mechanisms and new incentives to spur lending on trust lands. Without concerted efforts to change the practices and attitudes that forestall lending on trust lands (efforts that should include research, policy innovation, and lender education, among others), tribes' and tribal citizens' equity in trust lands will remain underutilized.

20 | For example, trust-land housing markets might benefit if more tribes contracted Land Title Records Office (LTRO) functions from the Bureau of Indian Affairs (Edwards, Morris, and Red Thunder 2009) or if more took over tribal land leasing functions under the provisions of the Helping Expedite and Advance Responsible Tribal Home Ownership Act of 2012 (HEARTH Act). Tribal LTROs may be able to clear titles more quickly than the Bureau does, which helps capital flow by preventing loan offers from expiring before a Title Status Report is complete. Tribal control of lease management might facilitate greater use of leasehold mortgages or other alternative forms of collateral.



# 2 Native Business Owners' Access to Capital and Credit

## **NATIVE BUSINESS OWNERS' SOURCES OF CAPITAL**

Every five years, the Census Bureau conducts the Survey of Business Owners and Self-Employed Persons (SBO); U.S. businesses that generate at least \$1,000 in receipts are included in its survey pool. Data from the 2002, 2007, and 2012 SBOs offer insight into the characteristics of businesses owned by American Indians and Alaska Natives (AIANs) and by Native Hawaiians and Pacific Islanders (NHPIs).<sup>21</sup> Especially useful for this Data Review, the SBO data provide information on the sources and amounts of business startup and expansion financing.

Several caveats regarding these data are in order. First, business owners' participation in the survey is voluntary, which means that the data represent neither a complete enumeration of all businesses in the United States nor a scientifically designed statistical sample. Second, this analysis includes firms both with paid employees and with no paid employees, which varies from some other Census Bureau economic surveys. Third, racial and ethnic categorizations are self-reported, which creates an inexact match to the definition of Native Communities used in this Data Review.<sup>22</sup>

### *Sources of Startup Capital*

Exhibits 12 and 13 summarize the reported sources of startup capital for AIAN- and NHPI-owned businesses in 2002, 2007, and 2012. (Because respondents identified multiple sources of capital, the combined percentages for each year total more than 100 percent.) The exhibits show that:

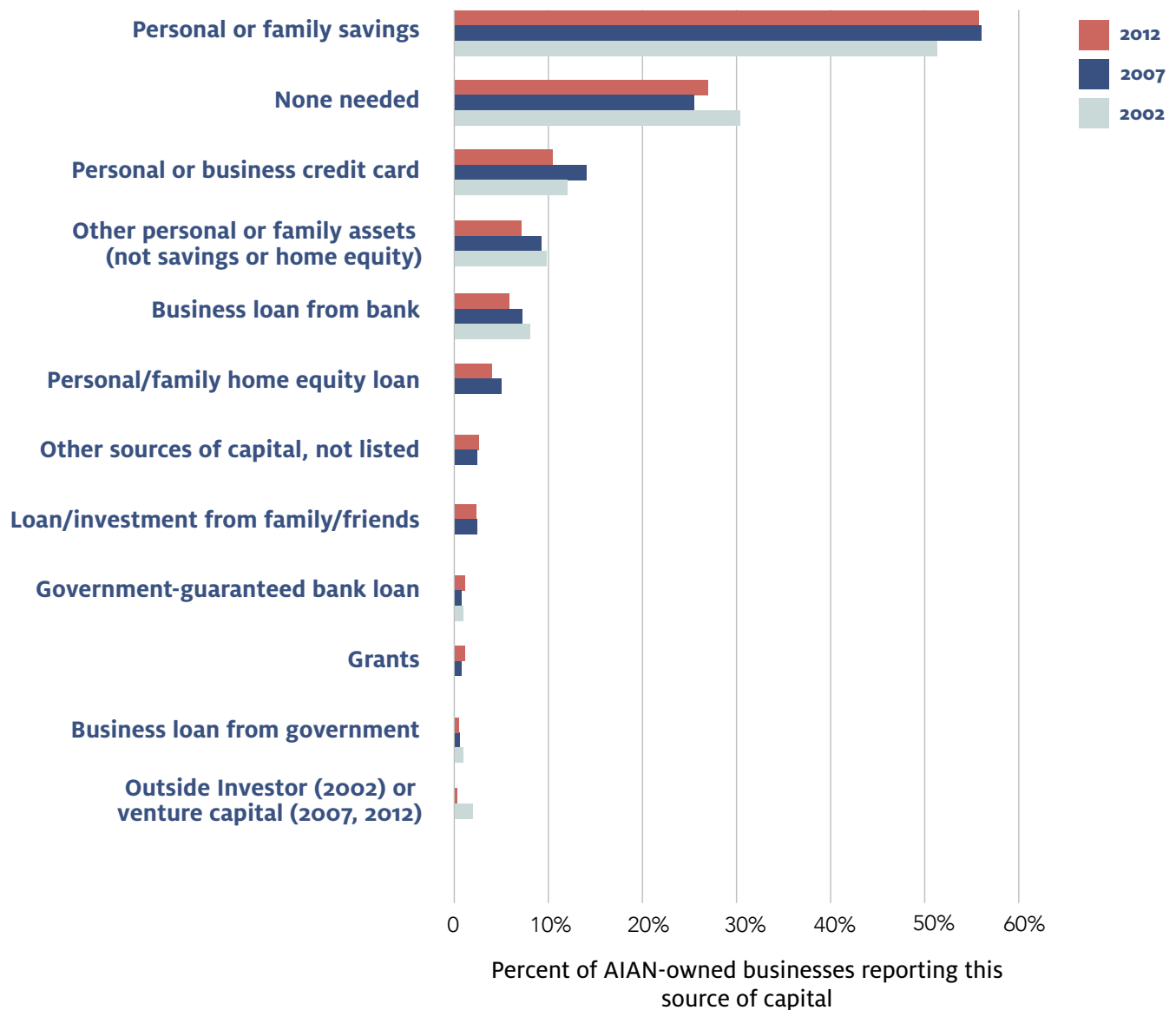
- In all three years evaluated, nearly two-thirds of AIAN-owned and NHPI-owned businesses were started using personal/family savings or other personal/family assets. These results are similar to national averages: in 2012, 63.5 percent of AIANs, 61.9 percent of NHPIs and 63.2 percent of all respondents (regardless of race) reported using personal/family savings or other personal/family assets for business startup.
- Few AIAN and NHPI businesses were started using bank financing. In 2012, for example, only 5.6 percent of AIAN business owners and 3.6 percent of NHPI business owners reported using formal bank financing as source of startup capital. By comparison, 7.5 percent of all business owners reported doing so. While not large, these differences correspond with key informants' anecdotal impressions that AIANs and NHPIs have more difficulty financing their startup businesses with loans from traditional lenders than non-Natives do.
- Ten to 15 percent of AIAN and NHPI business owners consistently report using credit cards to finance business startup. Depending on the year and subpopulation, this is three to five percentage points higher than is typical in the

<sup>21</sup> | Data from the Survey of Business Owners and Self-Employed Persons data for 2002, 2007, and 2012 are available on the U.S. Census Bureau portal <http://www.census.gov/programs-surveys/sbo/data/tables.html>.

<sup>22</sup> | See, for example, Census Bureau (2016).

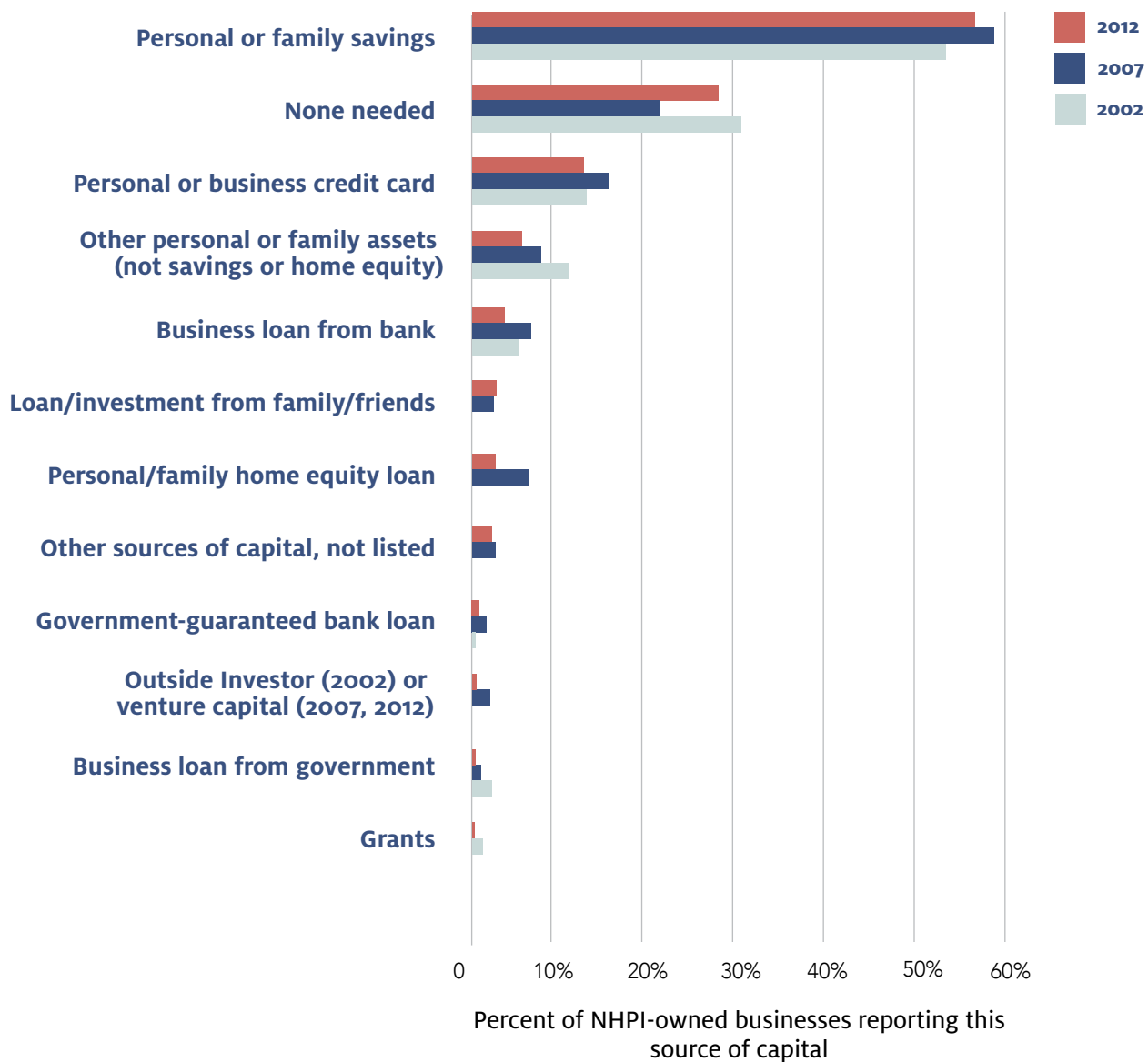
mainstream. Again, a possible explanation is that AIAN and NHPI business owners have more difficulty accessing lower-cost capital standard bank loans than do other entrepreneurs.

## Exhibit 12. Sources of Startup Capital for AIAN-Owned Businesses (2002, 2007 & 2012)



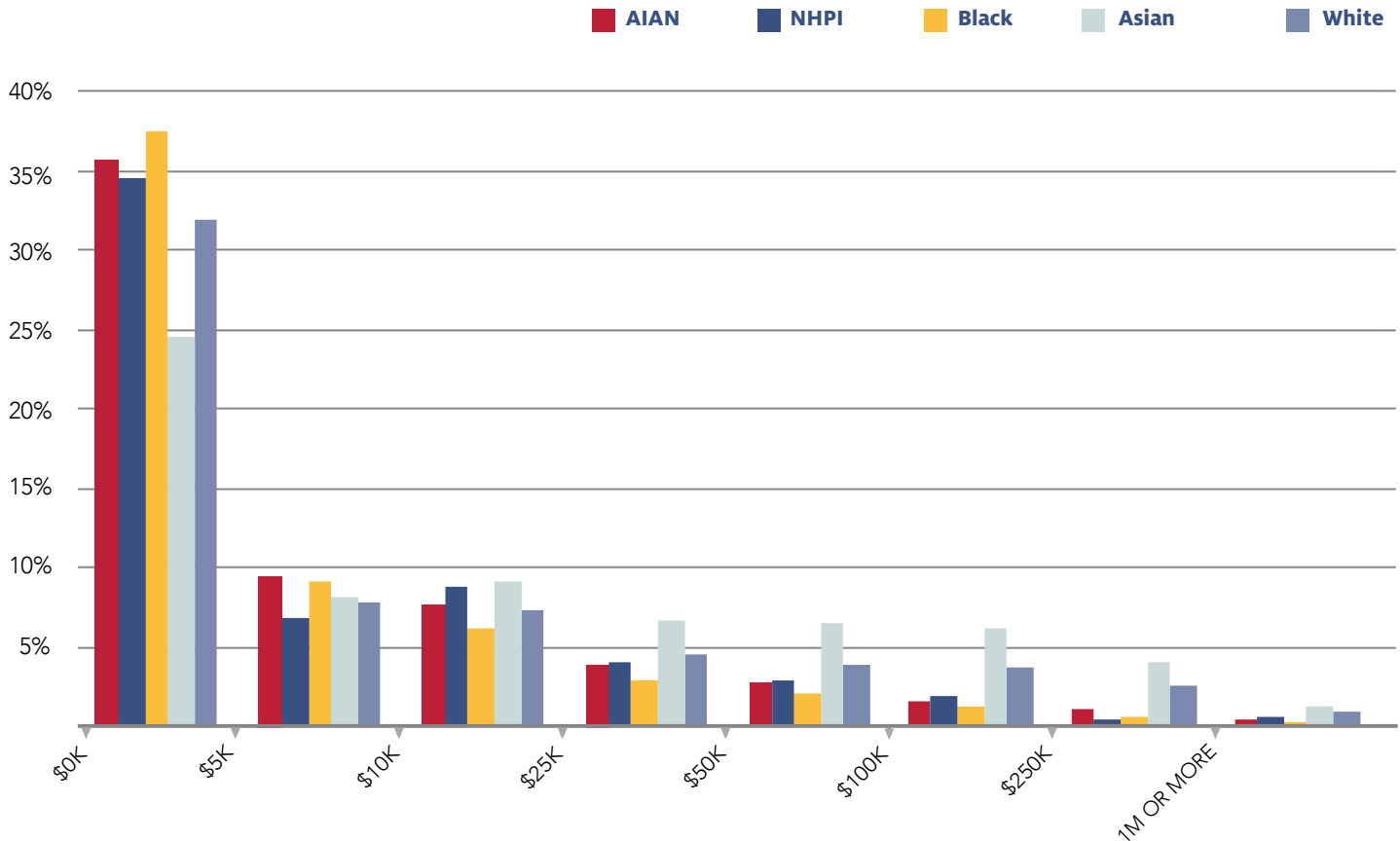
*Note: The Census Bureau included somewhat different response categories in 2007 than in 2002, which limits data comparability across years. Thus, the lack of a 2002 data point in the chart above means that the source was not queried in the 2002 survey, not that capital from that source was unavailable. Sources: Census Bureau (2006a, 2014a, 2015).*

## Exhibit 13. Sources of Startup Capital for NHPI-Owned Businesses (2002, 2007 &amp; 2012)



*Note: The Census Bureau included somewhat different response categories in 2007 than in 2002, which limits data comparability across years. Thus, the lack of a 2002 data point in the chart above means that the source was not queried in the 2002 survey, not that capital from that source was unavailable. Sources: Census Bureau (2006b, 2014c, 2015).*

## Exhibit 14. Reported Startup Capital Amounts by Race of Business Owner (2012)



*Note: SBO treats “Hispanic” as an ethnicity as opposed to a race, so Hispanic-owned businesses are excluded from this table. Technically, it is possible to report Hispanic ethnicity concurrent with membership in any of the racial categories listed in the chart. Sources: Census Bureau (2014b, 2015).*

### Amounts of Startup Capital

The SBO data also provide information on the size of startup capital investments. Exhibit 14 breaks the 2012 data out by racial group.

Among business owners who reported startup capital amounts, African Americans, AIANs, and NHPIs report the lowest levels of startup finance. More than 34 percent of AIAN, NHPI, African American business owners who participated in the survey reported that they started their businesses with \$5,000 or less.

Comparing business sectors with apparently low capital requirements<sup>23</sup> to those with the largest number of AIAN and NHPI firms, there is substantial overlap. On the

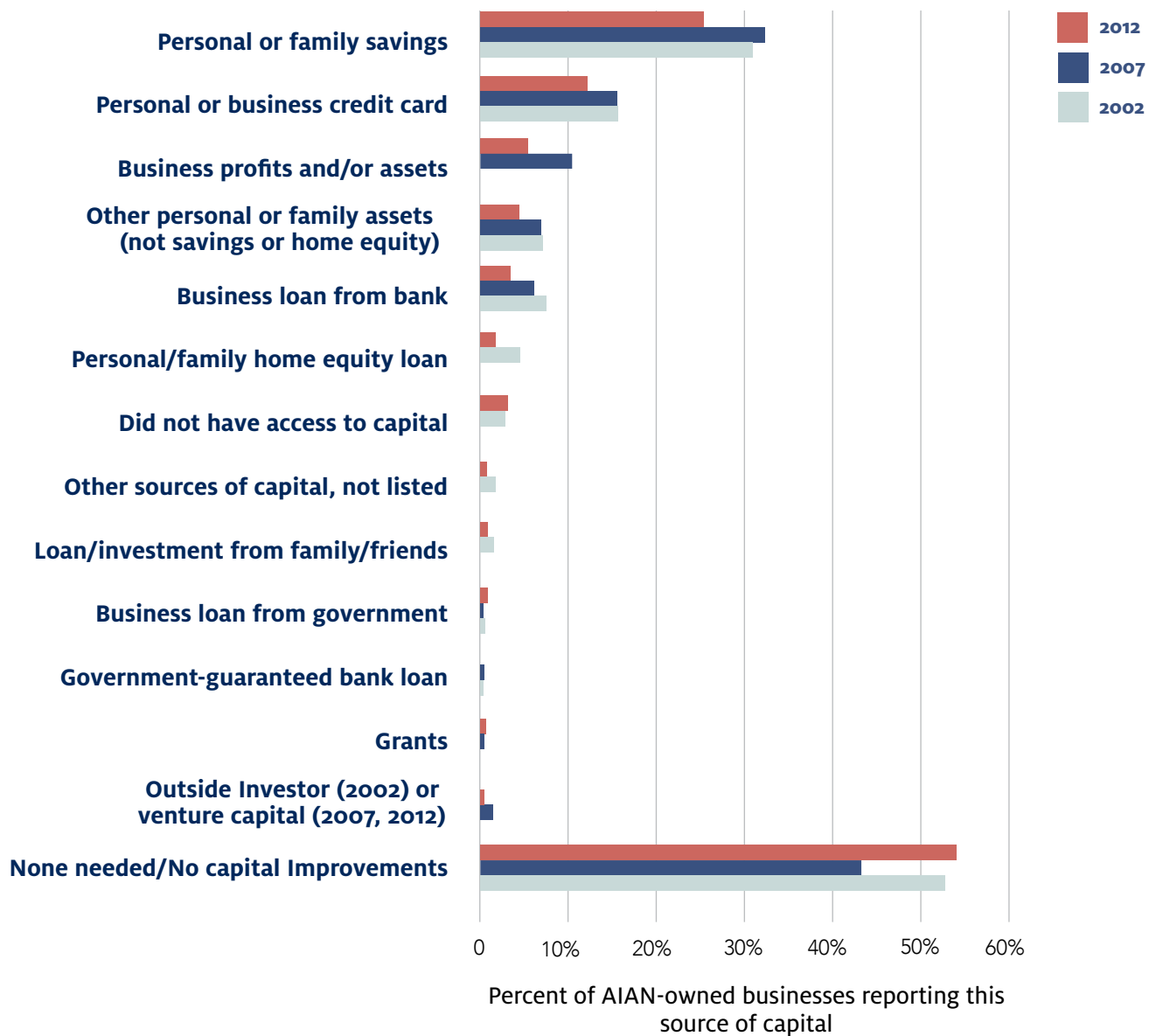
one hand, AIAN and NHPI entrepreneurs may choose, without constraint, to engage in sectors that require less startup funding. On the other hand, AIAN and NHPI entrepreneurs may be engaged in these sectors because they find it difficult or undesirable to access capital. Additional information is necessary to determine which of these explanations, or some other reason entirely, accounts for the distribution of AIAN and NHPI firms.

### Sources of Expansion Capital

Businesses also may face financial constraints when they seek to expand operations. Exhibits 15 and 16 show the sources of business expansion financing reported by AIAN- and NHPI-owned firms in 2002, 2007, and 2012.

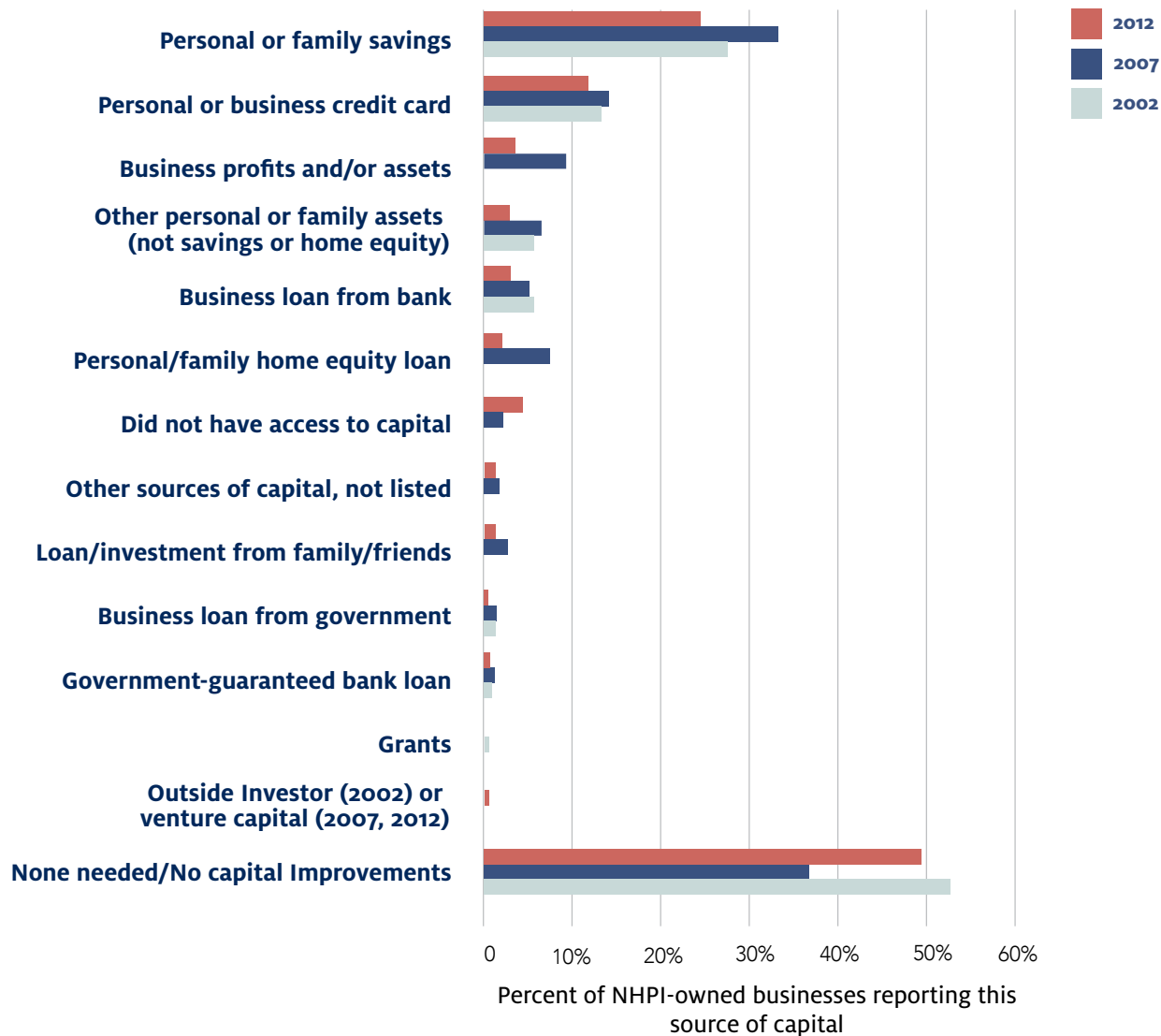
<sup>23</sup> | Those sectors in which the largest proportions of business owners reported low levels of startup resources in 2012.

## Exhibit 15. Sources of Expansion Capital for AIAN-Owned Businesses (2002, 2007 &amp; 2012)



*Note: The 2007 survey included somewhat different response categories than the 2002 and 2012 surveys, which limits data comparability across years. Thus, the lack of a 2002 data point in the chart above means that source was not queried the 2002 survey, not that capital from this source was unavailable. Sources: Census Bureau (2006a, 2014a, 2015).*

## Exhibit 16. Sources of Expansion Capital for NHPI-Owned Businesses (2002, 2007 &amp; 2012)



*The 2007 survey included somewhat different response categories than the 2007 and 2012 surveys, which limits data comparability across years. Thus, the lack of a 2002 data point in the chart above means that source was not queried the 2002 survey, not that capital from this source was unavailable. Sources: Census Bureau (2006b, 2014c, 2015).*

Across all years and similar to the finding for business startups, AIAN and NHPI firms relied on personal savings more than any other source of capital for business expansion (excluding the category “None needed”). While the 2002 survey did not query the use of business profits for expansion, profits were clearly another important type of “savings” used for AIAN and NHPI business expansion in 2007—although markedly less so in 2012. These findings are comparable to the findings among business owners overall.

Even AIAN and NHPI businesses that are growing are not particularly likely to use formal bank loans to finance growth and less likely to do so than their non-Native counterparts. For example, in 2012, more than three times as many AIAN business owners reported using personal credit cards as a source of finance for business expansion than reported using bank loans (12.1 percent versus 3.5 percent). By contrast, the 2012 multiple is only 1.8 in the mainstream (8.2 percent of all business owners used credit cards to finance expansion and 4.5 percent reported using a bank loan).



## Summary

On average, American Indian, Alaska Native, Native Hawaiian, and Pacific Islander business owners report lower levels of startup funding than do most non-Native business owners. In the years 2002, 2007, and 2012, AIAN and NHPI business owners were more likely to use personal savings for business startup and business expansion than any other kind of capital—a finding that also holds true among all business owners, regardless of race. However, AIAN and NHPI business owners are less likely than business owners overall to obtain business loans from banks (whether for business start up or business expansion) and more likely to use credit cards as a source of finance.

## SMALL BUSINESS ADMINISTRATION LOANS

The Small Business Administration (SBA) promotes capital access for small businesses in the United States through its 7(a) and 504 loan guarantee programs, which facilitate lending to small businesses by reducing financial institution risk. The 7(a) program supports lending for business startup or expansion, and the 504 program supports lending for the purchase or renovation of major fixed assets, such as land, buildings, and other facilities.<sup>24</sup> Generally, SBA loan guarantees are approved only when other means of business financing are not available, which maximizes the resultant capital flow to business owners.

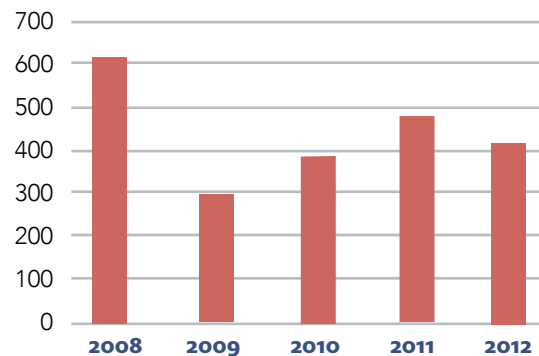
American Indian-, Alaska Native-, and Native Hawaiian-owned small businesses are eligible alongside other small businesses for SBA loan guarantees, and numerous Native-owned firms have benefited from their eligibility. Because SBA data collection protocols make it possible to separate Native-owned firms from the overall pool of borrowers, it also is possible to track Native firms' program participation.<sup>25</sup>

### The Total Number of SBA-Guaranteed Loans

From 2008 to 2012, the total number of SBA-guaranteed loans extended to Native American-owned businesses through the SBA 7(a) and 504 programs fluctuated significantly, reaching a high of 624 in 2008 and a low of 295 in 2009 (Exhibit 17).

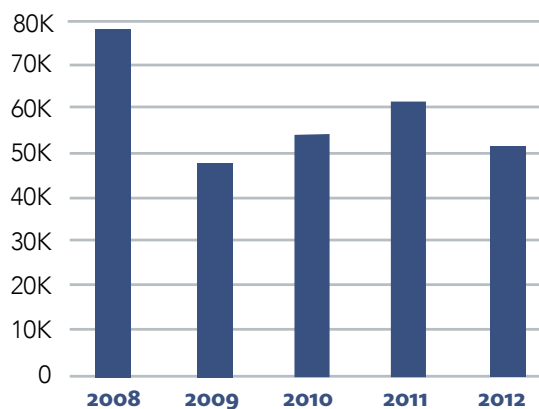
SBA-guaranteed lending to all small businesses in the United States followed a similar pattern (Exhibit 18). There was a large number of approved loans in 2008, a steep drop in the number of approved loans in 2009 that correlated with the U.S. financial crisis, and a partial recovery in lending volume immediately following the recession.

**Exhibit 17. Number of SBA Program 7(a) and Program 504 Loans Approved for American Indian Businesses, by fiscal year**



Sources: SBA Loan Guarantee Programs 7(a) and 504, fiscal years 2008-2012.

**Exhibit 18. Number of SBA Program 7(a) and Program 504 Loans Approved for all U.S. Businesses, by fiscal year**



Sources: SBA Loan Guarantee Programs 7(a) and 504, fiscal years 2008-2012.

<sup>24</sup> | Specific information on these Small Business Administration programs is available at <http://www.sba.gov/loanprograms>, accessed June 19, 2014.

<sup>25</sup> | Statistics cited in this chapter are based on a special tabulation provided by the SBA for this Data Review.



Photo credit: Banc First

Yet the most striking aspect of Exhibits 17 and 18 is not their similarity but the disparity they reveal. From 2008 to 2012, the number of SBA-guaranteed loans to Native-owned businesses constituted less than one percent of the total number of SBA-guaranteed loans; annual proportions ranged from 0.62 to 0.82 percent. By contrast, American Indians, Alaska Natives, and Native Hawaiians account for approximately 2.1 percent of the total U.S. population (Norris et al. 2012, Hixson et al. 2012), which suggests that the SBA-guaranteed loan programs are underutilized by Native business owners.

#### *The Total Value of SBA-Guaranteed Loans*

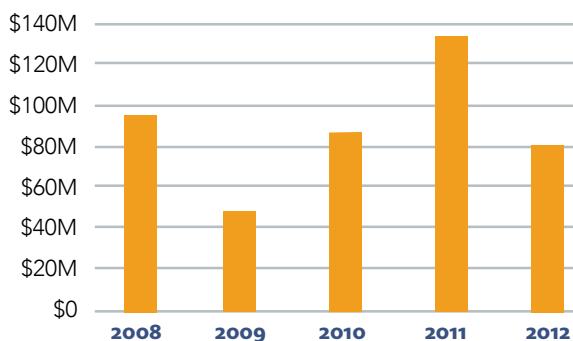
From 2008 to 2012, the total value of loans to Native American-owned businesses guaranteed through the

SBA 7(a) and 504 programs ranged from \$47 million in 2009 to \$133 million in 2011 (Exhibit 19). In total, SBA guarantees supported the flow of \$496.7 million in loan financing to Native-owned businesses over the five-year period. These loans represented 0.51 percent of the \$98.3 billion that the SBA 7(a) and 504 programs guaranteed, which is further evidence of Native business owners' disproportionately low participation.<sup>26</sup>

#### *Summary*

The Small Business Administration's loan guarantee programs are useful but underutilized tools for increasing the amount of capital available to American Indian, Alaska Native, and Native Hawaiian-owned businesses.

**Exhibit 19. Total Value of Loans to Native-Owned Businesses Guaranteed through SBA Programs 7(a) and 504, by fiscal year**



Sources: SBA Loan Guarantee Programs 7(a) and 504, fiscal years 2008-2012

<sup>26</sup> | A more revealing exercise would be to consider the percentage of Native American-owned businesses in the universe of SBA guaranteed loan-eligible businesses and query whether the actual percentage of Native American-owned businesses that receive SBA-guaranteed loans is "appropriate" based on their proportionate representation among eligible businesses. Disparity would be evident if the fraction of Native-owned businesses receiving loans (among all loans awarded) was less than the fraction eligible for loans (among all businesses eligible). As the SBA itself notes, however, "SBA generally does not specify what businesses are eligible," so this comparison is not possible (SBA no date, para. 2).

# 3 Native Communities' and Tribal Governments' Access to Capital and Credit

## NATIVE COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS

The Community Development Financial Institutions Fund (CDFI Fund) is an agency of the U.S. Department of the Treasury established by the Riegle Community Development and Regulatory Improvement Act of 1994. The agency's mission is "to expand economic opportunity for underserved people and communities by supporting the growth and capacity of a national network of community development lenders, investors, and financial service providers" (CDFI Fund 2017, para. 2).

To achieve its mission, the CDFI Fund administers several programs designed to build the capacity of Community Development Financial Institutions (CDFIs)—specialized financial institutions dedicated to increasing access to credit, capital, and other financial services in low-income communities. Through programs such as the Community Development Financial Institutions Program (CDFI Program) and the Native American CDFI Assistance Program (NACA Program), the CDFI Fund provides financial and technical assistance to CDFI loan funds, banks, credit unions, and venture capital funds throughout the nation.



Photo credit: Seven Sisters Community Development Group

### *Native CDFI Basics*

A CDFI is considered a Native Community Development Financial Institution (Native CDFI) if it focuses at least 50 percent of its business activities on American Indians, Alaska Natives, or Native Hawaiians. Native CDFIs often operate within reservation boundaries or other Native Community boundaries, and often are managed and staffed by tribal citizens. The development services (financial education, credit repair, homebuyer education, and business coaching, for example) and loan products (consumer, business, and housing loans, for example) they offer are similar to those offered by mainstream CDFIs, although their educational approaches, teaching materials, contract language, and even collateral may reflect culture- or community-specific needs. Because the Native Community setting can influence both the speed at which a CDFI can

become organized and the rate at which development services can prepare clients to become borrowers, some Native CDFIs experience longer startup periods than mainstream CDFIs.

Native Community-focused organizations have been eligible for CDFI Fund support since the CDFI Fund's inception in 1994. Native Community-specific programming has been a priority for the CDFI Fund since 2001, when findings from the NALS highlighted the extreme and often unique challenges to improving access to capital and credit in Native Communities, and the CDFI Fund determined that programs targeting Native Communities were necessary. Today, the NACA Program, a CDFI Fund program created specifically to help establish and expand Native CDFIs, has two components: Financial Assistance (FA) awards and Technical Assistance (TA) grants.

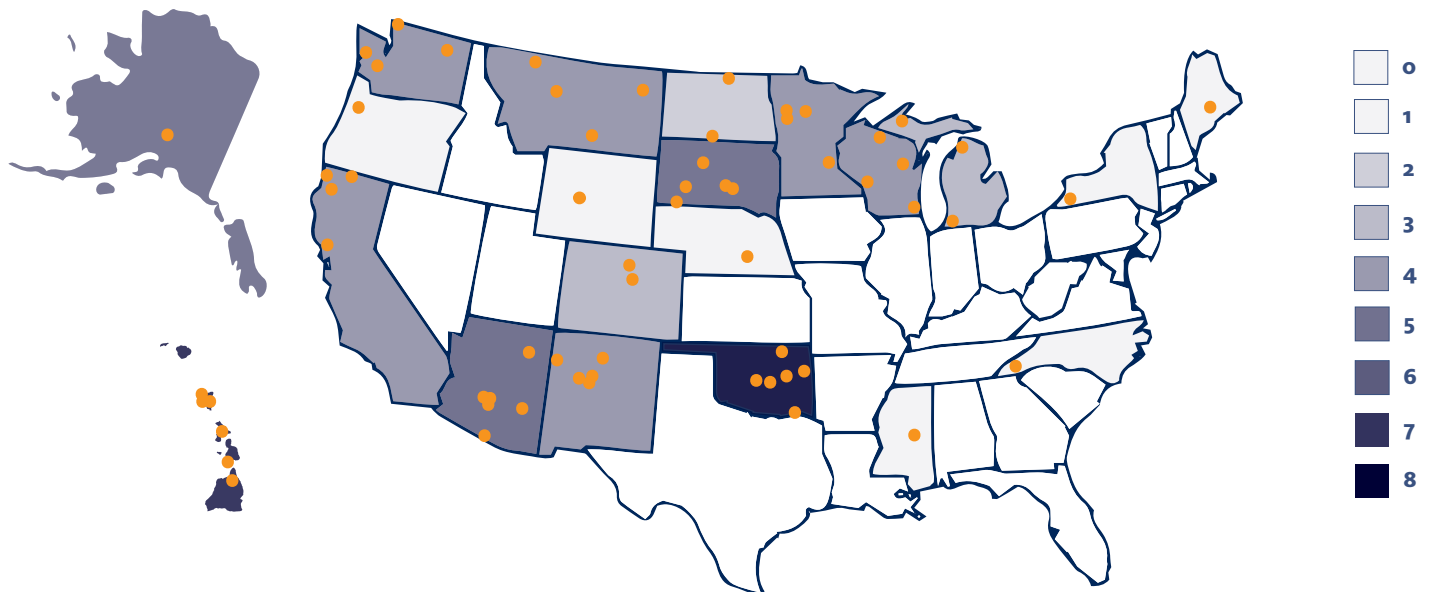
- FA awards provide grants, loans, deposits, and equity investments to certified Native CDFIs.<sup>27</sup> While the number of awards and their maximum

value can vary from year to year depending on the availability of funding, in recent years the CDFI Fund has made FA awards of up to \$750,000. Native CDFIs that receive an FA award must match it with non-federal funds, although Congress has sometimes waived the requirement.<sup>28</sup>

- TA grants are available to help both certified Native CDFIs and non-certified organizations seeking certification increase their capacity. Again, grants are subject to the availability of funds, but TA grants of up to \$150,000 have been typical.

Exhibit 20 shows the distribution of certified Native CDFIs operating in 2016. The group includes loan funds, credit unions, banks and thrifts, and depository institution holding companies.

## Exhibit 20. Locations of Certified Native CDFIs (2016)



Source: CDFI Fund (2016).

27 | Certification is a designation conferred by the CDFI Fund. Native community-serving organizations must show that they are a legal entity at the time of the application, have a primary mission of promoting Native community development, are a financing entity (lender), primarily serve the Native community market, provide development services as well as financial services, and are accountable to their target market(s).

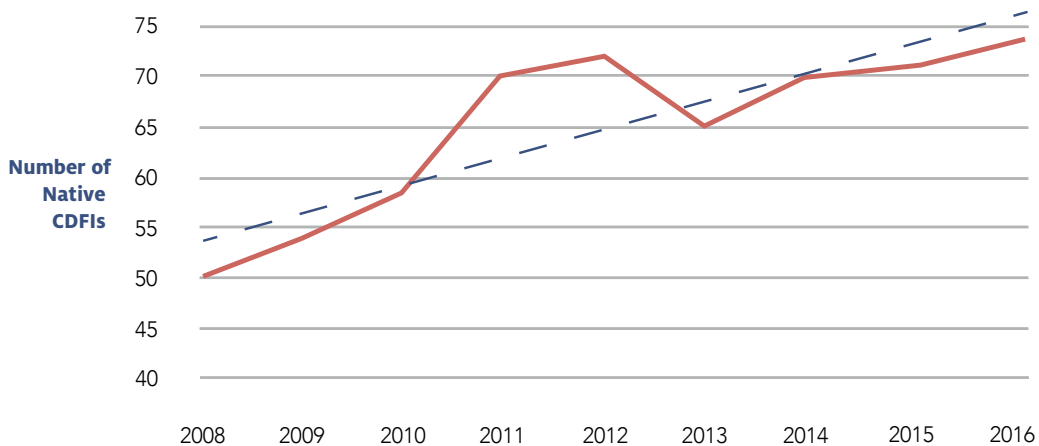
28 | For example, Congress waived the in fiscal years 2009-2013 and 2015.

### Growth of the Native CDFI Industry

Creation of the Native Initiatives program within the CDFI Fund was an important turning point for the Native CDFI sector. CDFI Fund investments have fueled both the supply of Native CDFIs (by providing technical assistance, management training, operating capital, and loan fund capital) and demand for CDFI services (by training Native CDFI staff to offer development services and then funding these service offerings), and helped generate considerable sector growth since 2001.

By September 30, 2016, the CDFI Fund recognized 74 certified Native CDFIs, compared to 14 in 2001, the first year of the NACA Program (CDFI Fund 2009 & 2016).<sup>29</sup> In early 2013, the CDFI Fund announced that any certified CDFI whose original or most recent certification was at least three years old would have to apply for recertification. While this policy is intended to ensure that CDFIs continue to meet the standards for certification, when first introduced, it led to a short-term downward revision in the number of certified CDFIs (Wascalus 2014). As Exhibit 21 shows, the Native CDFI sector's strong growth is evident even when taking this reset into account.

**Exhibit 21. Recent Growth in the Native CDFI Sector**



*Note: Vertical axis does not start at zero. Source: CDFI Fund.*

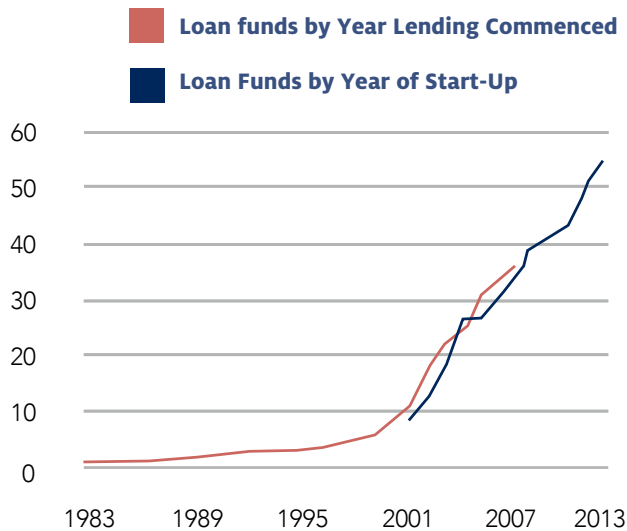
29 | Some sources alternatively cite 16 Native CDFIs in 2001.





Photo credit: Seven Sisters Community Development Group

## Exhibit 22. Number of Native Loan Funds, by year



Sources: Dewees and Sarkozy-Banoczy (2008) and Kokodoko (2015).

Exhibit 22 highlights the change in the sector's growth rate. It combines data from Dewees and Sarkozy-Banoczy (2008), who report the start date of lending for 36 active in 2007, and Kokodoko (2015), who reports the number of certified Native loan funds in the overall group of certified Native CDFIs. After 2001, the number of Native CDFI loan funds has grown at a much faster pace.

### Native CDFI Activities

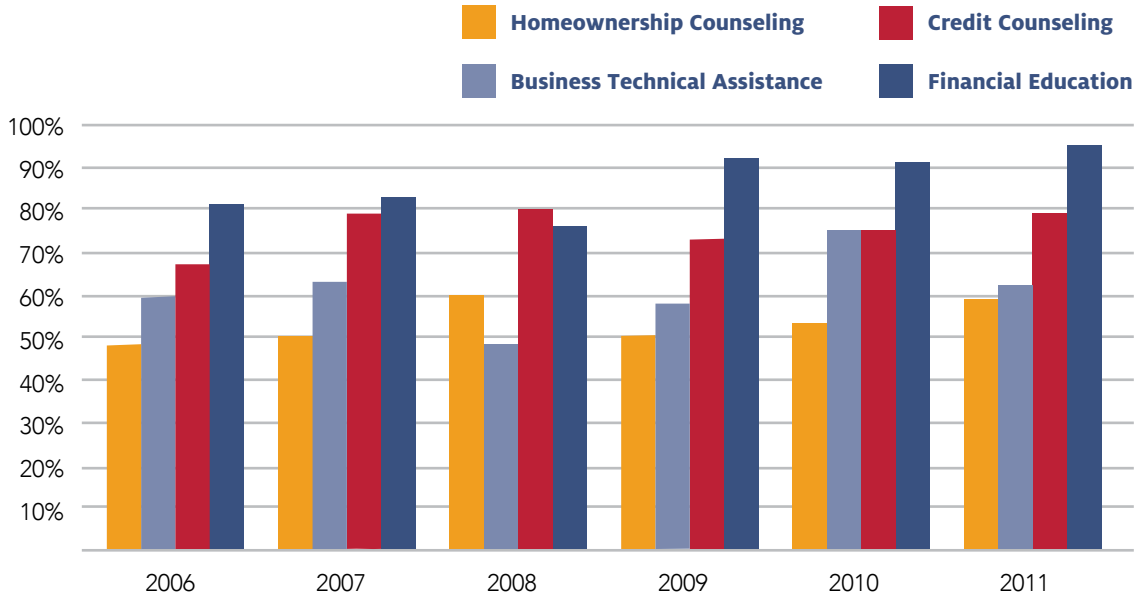
The CDFI Fund annually collects data from certified Native CDFIs concerning their activities and operations, and detailed information for the years 2003 to 2011 was available for this Data Review. While these data are partial, they nonetheless provide important insight into the ways that Native CDFIs increase capital and credit access for Native Community members.<sup>30</sup>

Most Native CDFIs are heavily engaged in the delivery of development services. As Exhibit 23 shows, financial education and credit counseling are the most common development services that Native CDFIs offer—in five

30 | Not all program participants reported data, and not all reported data were usable. In any one year, between eight and 15 Native CDFIs (not always the same ones) reported loan origination data, 24-32 reported on their development services offerings, and 24-33 responded to questions about credit reporting. These low respondent numbers suggest that conclusions should be drawn with caution as the range of potential error is large.



## Exhibit 23. Native CDFI Development Services



*Note: The number of Native CDFIs reporting on development service activities ranges from 24 to 32.*

*Sources: CDFI Fund Institution Level Reports 2006-2011.*

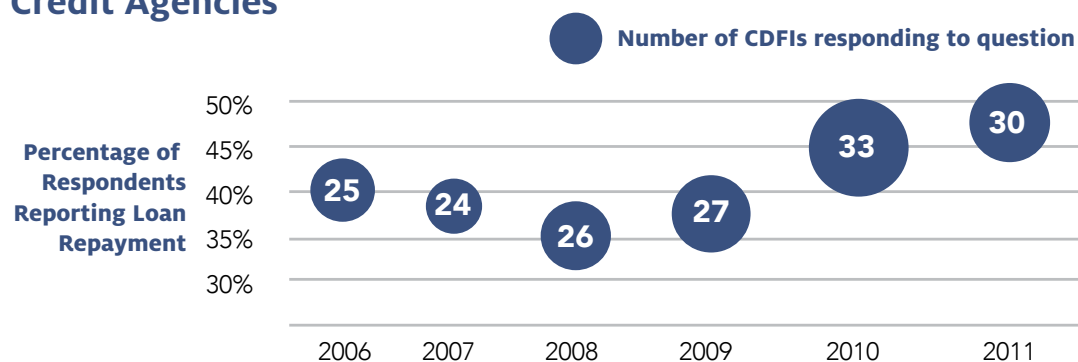
of the six years evaluated at least 70 percent of reporting Native CDFIs provided programming in these areas. Homeownership counseling and business TA are not far behind—half or more of the reporting Native CDFIs offered these services over the years 2006 to 2011. Approximately 40 percent of the reporting Native CDFIs offered housing TA in each year evaluated, but not more than 25 percent (and usually fewer) offered real estate TA.

Of course, Native CDFIs' core activity is lending. For the period 2004 to 2012, Native CDFIs that received NACA awards made over 15,000 loans totaling \$365 million (Nolan 2014), indicating an average loan size of \$24,300. More detailed loan origination information for the period 2003 to 2011 shows average annual loan values ranging from \$30,200 in 2007 to \$13,700 in 2011. In other words, loans made by Native CDFIs are relatively small.

While these values likely reflect Native CDFIs' limited loan capital (more below), they also reflect Native CDFIs' customer bases. Market studies—and the development services summary above—attest that most Native CDFIs serve customers with significant but lower-value capital and credit needs. In response, Native CDFIs may offer smaller loans, such as credit-builder and “get-out-of-debt” loans, which are intentionally designed as steppingstones in the process of building client financial capability and assets.<sup>31</sup>

<sup>31</sup> | These products help borrowers consolidate debt obligations, escape recurrent borrowing from predatory lenders, access lower interest rates, and establish or repair credit, combining lending with education so that clients are better able to manage their finances and future credit needs.

## Exhibit 24. Native CDFIs that Report Loan Repayment to Credit Agencies



Sources: CDFI Fund Institution Level Reports 2006-2011.

Exhibit 24 demonstrates that a growing number of Native CDFIs also participate in another kind of steppingstone activity—reporting loan repayment information to credit bureaus. Even though this is not a cost-free activity for Native CDFIs, they pursue credit reporting to help clients translate successful borrowing from a Native CDFI into other kinds of capital and credit access.

### Challenges for Native CDFIs

The Native CDFI sector's growth, development, and success at helping local economies grow is partly responsible for the challenges Native CDFIs currently face: increased demand for Native CDFIs' services and products strains many Native CDFIs' operating and loan capital budgets. Yet Native CDFIs' primary financial challenge arises from the inescapable fact that their business model is costly, and they must somehow cover those costs.

On the operating costs side, most Native CDFIs need capital to fund ongoing administrative expenses, which range from the cost of keeping the lights on and paying core staff to expenses for the kinds of responsive and high-touch development services that change Native clients' access to capital. Especially because they have high fixed costs relative to their sizes,<sup>32</sup> it is not yet feasible for most Native CDFIs to adequately fund their operations through proceeds from lending or other fee-based activities.

The Native CDFI sector's median self-sufficiency ratio—which measures the fraction of an organization's expenses that can be covered through earned income—underscores this point. From 2001 to 2012, the sector's median self-sufficiency ratio rose above 30 percent only in 2006 and reached a low of 16 percent in 2010 (Kokodoko 2015). The median ratio reached 30 percent again in 2012, and still may be inching upward, but in general, over the 12-year period studied, no more than half of Native CDFIs generated annual earnings sufficient to cover one-third their operating costs.

On the loan capital side, few Native CDFIs have the capacity to make more and larger loans, even though they want to. For example, the CDFI Fund data indicate that only a fraction of Native CDFIs can serve borrowers whose financing needs significantly exceed current average loan amounts. Of 37 Native CDFIs reporting loan value information to the CDFI Fund's Institution Level Report database for the period 2003 to 2011, only

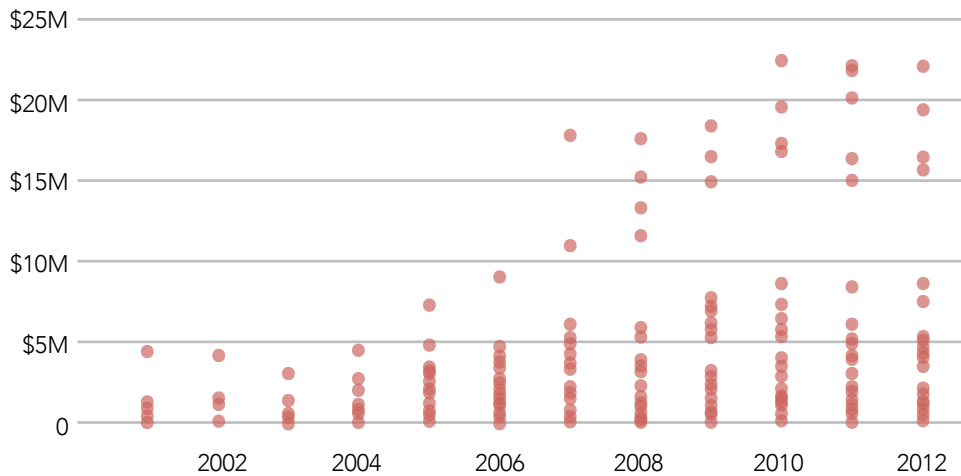
32 | See Kokodoko (2015), Figure 9, which shows that, on average, Native CDFIs' expenses rise only slightly as their asset bases increase.

six reported an average loan value (in inflation-adjusted 2011 dollars) of more than \$100,000 in any given year, and only three of those six reported an average loan value of more than \$1 million. Key informants suggest that these Native CDFIs are making larger loans on- and off-reservation, engaging actively with more mature and expanding businesses, and even providing commercial lines of credit—and that more Native CDFIs would like to develop such lines of business.

Findings from First Nations Oweesta Corporation’s 2012 market study are even more explicit: “Despite substantial asset growth, certified Native CDFIs are still unable to address financing demand in their communities. Nearly 48 percent of respondents indicated that they had insufficient loan capital to satisfy financing demand in their target markets” (Oweesta 2013, 6). Corresponding quantitative data from the survey show that lending capital needs—among respondents only—rose from \$4.9 million in 2009, to \$7.7 million in 2011, to a projected \$14.6 million for 2012.

Native CDFIs’ total asset values provide additional evidence of capacity constraints. Data from certified CDFI loan funds show that the bulk of Native CDFIs have operated and continue to operate with less than \$5 million in total assets (Exhibit 25). In fact, half of the CDFIs in the sample had less than \$2 million in total assets in 2012.

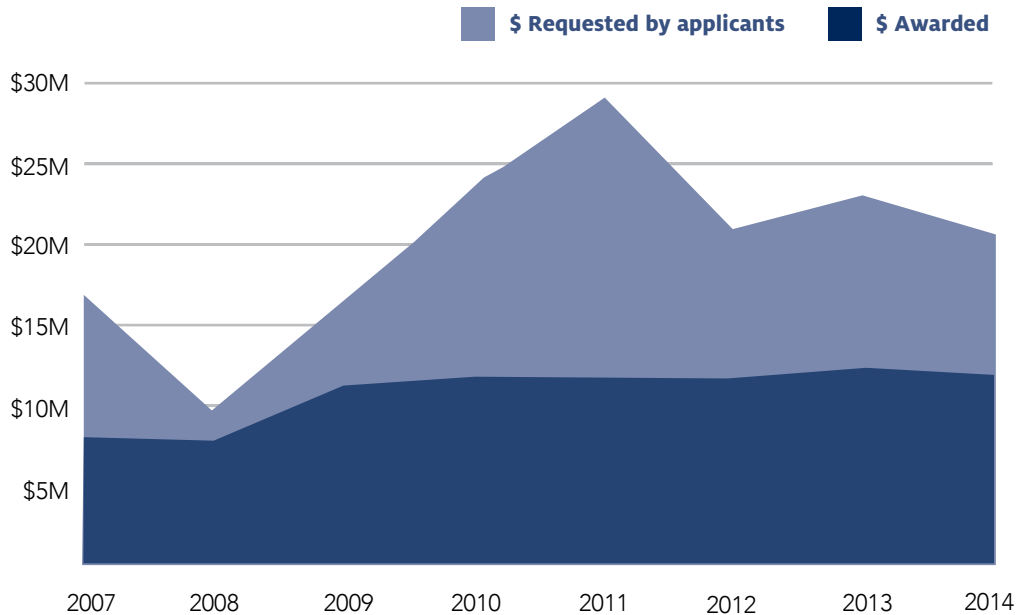
### Exhibit 25. Annual Total Asset Value for Certified Native CDFI Loan Funds



*Note: Coastal Villages Community Development Fund LLC is excluded for scale purposes. Sources: Internal Revenue Service Form 990, as collected by the Federal Reserve Bank of Minneapolis, and Kokodoko (2012).*

These operating and loan capital needs spill over into demand for CDFI Fund awards and grants. Exhibit 26 compares the amount of FA awards and TA grants requested by Native CDFIs and the amount awarded by the CDFI Fund. In every year from 2008 to 2014 (even in 2009, when the American Recovery and Reinvestment Act provided additional funding for Native CDFIs), more TA and FA were requested each year than was available for awards.

## Exhibit 26. CDFI Fund NACA Awards



Source: CDFI Fund.

Ultimately, the core challenge for the Native CDFI industry is greater capitalization. This was a need in 2001, and remains one today. By contrast to 2001, however, the current need is not just for more finance but for access to even more diverse forms of capital. CDFI Fund awards and tribal government support have been—and will be—key to the sector’s growth and development,<sup>33</sup> but substantial new capital is needed to fuel a new level of growth. Given that most Native CDFIs lend from equity capital, one option is the greater use of debt capital, from sources ranging from the federal government to private foundations, other tribes, and mainstream CDFIs (Oweesta 2013).<sup>34</sup> Importantly, with greater capitalization, Native CDFIs not only would be able to lend more but also would be able to generate more revenue from lending and to spread fixed costs over a larger base, which increases their self-sufficiency.

### Summary

Since 2001, the number of Native Community Development Financial Institutions has grown fivefold. As a result, Native Community residents, businesses, and even governments have greater access to capital and credit. For Native Community members, this occurs not only through direct lending but also through the provision of services that can assist Native community members in budgeting, saving, and developing positive credit histories that are more attractive to other lenders. Nonetheless, the demand for credit and capital remains high and will continue to increase as Native Community economies grow.

33 | Thirty of 39 Native CDFIs responding to Oweesta’s 2012 market survey indicated that the CDFI support was a “primary source” of operating funds, where primary was defined as an amount covering 20 percent or more of the organization’s annual operating costs. Forty-seven percent of responding CDFIs reported that tribal governments provided part of their initial loan capital; 38 percent reported that federal programs had. Multiple responses were allowed on both survey questions (Oweesta 2013).

34 | In fact, making the shift toward increased use of debt capital is an industry-wide challenge (Swack et al. 2012).

## NEW MARKETS TAX CREDIT PROGRAM

The New Markets Tax Credit Program (NMTC Program) was authorized by Congress in 2000 to increase business activity in low-income communities and is administered by the Community Development Financial Institutions Fund (CDFI Fund).<sup>35</sup>

### *How the Program Works*

The program attracts new investment by permitting individual and corporate investors to receive a federal income tax credit in exchange for making equity investments in specialized financial intermediaries called Community Development Entities (CDEs). Native CDFIs can qualify automatically as CDEs based on their CDFI certification.

Investors receive a tax credit equal to 39 percent of the total they invest in the CDE. A regulated portion of the credit is applied over seven consecutive years, and investors are not allowed to redeem their investments during that period. CDEs use the funds to finance for-profit or nonprofit businesses operating in low-income communities. These businesses, known as Qualified Active Low-Income Community Businesses (QALICBs), are enterprises that CDEs are well positioned to assess both in terms of their risks and their promise for helping local economic development take hold. A CDE may earn fees on NMTC closings and interest on its investments in QALICBs, which can provide earned income to further assist its community development mission.

### *Native Participation*

From 2004 to 2011, the CDFI Fund allocated more than \$30.5 billion in tax credits through the NMTC Program (Abravenel et al. 2013). Annual tax credit allocation authority ranged from \$2 billion to \$4 billion, except in 2008 and 2009, when additional funding from the American Recovery and Reinvestment Act made approximately \$5 billion available annually.

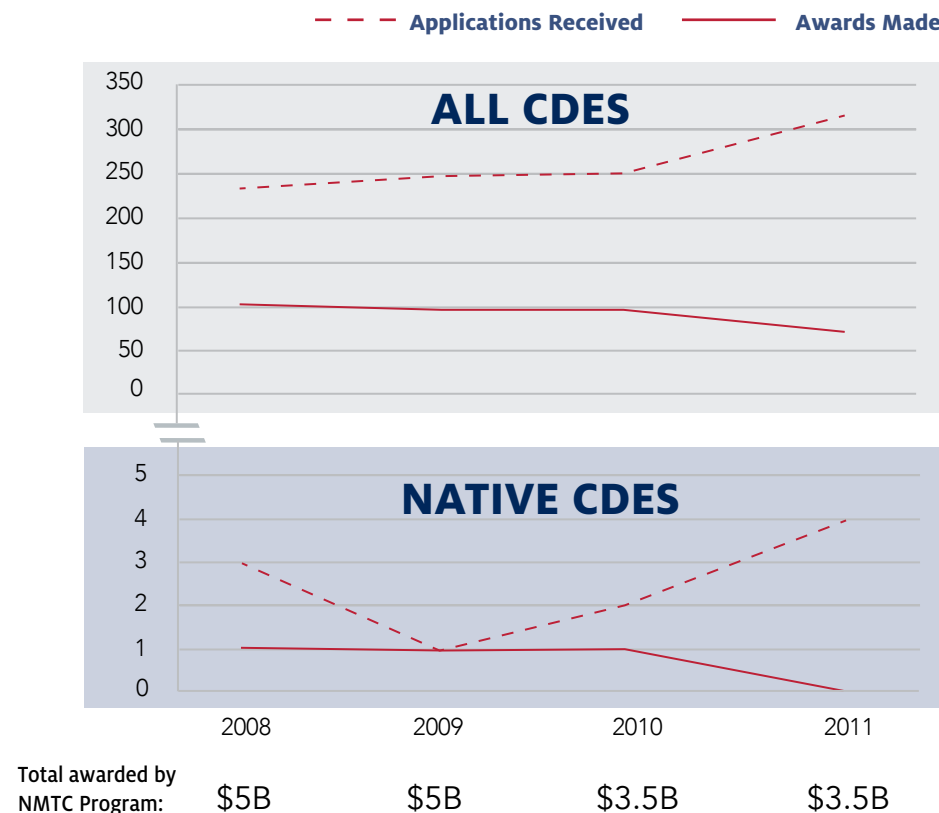
In the same period (2004 to 2011), CDFI Fund information made available for this Data Review shows that CDEs used the NMTC Program to finance 90 projects serving Native Communities in 15 states: Alaska, California, Hawaii, Maine, Minnesota, Mississippi, Montana, Nevada, New Mexico, North Dakota, Oregon, Oklahoma, South Dakota, Washington, and Wisconsin. These 90 projects constitute 2.6 percent of the approximately 3,500 QALICB projects that NMTC-financing has supported overall. This percentage exceeds the Alaska Native, American Indian, and Native Hawaiian proportion of the U.S. population (2.1 percent; Norris et al. 2012, Hixson et al. 2012)—which is appropriate, given that Native Americans and Native Communities are overrepresented among low-income populations.

Native CDEs have been less well represented in the pool of CDEs that have applied for and received awards. Between 2008 and 2011, the CDFI Fund received only 10 NMTC applications from seven Native-controlled CDEs. These ten constituted 0.95 percent

35 | For purposes of the NMTC program, low-income communities are census tracts where (A) the poverty rate is at least 20%; (B) the median family income does not exceed 80% of the area median family income; (C) the median family income does not exceed 85% of the area median family income provided the census tract is located in a high migration rural county; or (D) the census tract has a population of less than 2,000, is contained within a federally designated Empowerment Zone, and is contiguous to at least one other low-income community (as defined here) (CDFI Fund 2015).

of the total number of applications received during the period. Three applications from Native-controlled CDEs received awards, which together provided the recipients with \$128 million in NMTC allocation authority. Award percentages are even farther from parity: Native CDEs received 0.8 percent of the total number of NMTC awards made from 2008 to 2011 and 0.75 percent of the total tax credits awarded. Application success rates provide additional perspective. Native CDEs succeeded with 30 percent of their NMTC applications from 2008 to 2011, while non-Native CDEs succeeded with 35 percent. Exhibit 27 provides a snapshot of this NMTC award activity.

### Exhibit 27. New Markets Tax Credit Applications and Awards (2008-2011)



Source: CDFI Fund.

#### Summary

Although the NMTC Program has funded projects in Native communities at a rate proportional to the Native American population in the United States, the numbers of Native-controlled CDEs applying for and receiving awards through the New Market Tax Credit Program are small.

### NATIVE-OWNED DEPOSITORY INSTITUTIONS

Banks and other depository institutions are characterized as minority owned if 50 percent or more of their stock is owned by socially or economically disadvantaged groups. According to federal government guidelines, these groups include African Americans, Asian Americans, Hispanic Americans, and Native Americans (FDIC 2002).



### A Small but Growing Sector

Exhibit 28 lists the 18 Native-owned banks in the United States in 2016, up from nine counted by the NALS in 2001 (FDIC 2016, CDFI Fund 2001).<sup>36</sup> Their combined assets total more than \$2.67 billion (2016 dollars). Three of the 18 are national banks; the others are state-chartered entities. Ten are in Oklahoma, creating an extremely uneven distribution across Indian Country.

### Exhibit 28. Native American-Owned Depository Institutions, by year of founding

			<b>TOTAL ASSETS</b>
		<b>State-chartered bank; member of the Federal Reserve system</b>	
		<b>State-chartered bank; NOT a member of the Federal Reserve system</b>	
		<b>National Bank</b>	
1901	<b>ALLNATIONS BANK</b>	Calumet, OK	<b>\$49,906</b>
1901	<b>FIRSTBANK</b>	Antlers, OK	<b>\$314,627</b>
1902	<b>F&amp;M BANK</b>	Edmond, OK	<b>\$380,852</b>
1903	<b>BANK 2</b>	Oklahoma City, OK	<b>\$125,598</b>
1903	<b>PEOPLES BANK</b>	Westville, OK	<b>\$48,270</b>
1908	<b>BANK OF CHEROKEE COUNTY</b>	Hulbert, OK	<b>\$108,472</b>
1908	<b>WOODLANDS NATIONAL BANK</b>	Hinckley, MN	<b>\$178,504</b>
1931	<b>BANK OF COMMERCE</b>	Stilwell, OK	<b>\$87,123</b>
1934	<b>PINNACLE BANK</b>	Marshalltown, IA	<b>\$182,774</b>
1938	<b>OKLAHOMA STATE BANK</b>	Vinita, OK	<b>\$136,356</b>
1971	<b>LUMBEE GUARANTY BANK</b>	Pembroke, NC	<b>\$324,505</b>
1973	<b>FORT GIBSON STATE BANK</b>	Fort Gibson, OK	<b>\$65,525</b>
1984	<b>FIRST NATIONAL BANK &amp; TRUST COMPANY</b>	Shawnee, OK	<b>\$267,653</b>
1987	<b>NATIVE AMERICAN BANK NA</b>	Denver, CO	<b>\$83,328</b>
1995	<b>BAY BANK</b>	Green Bay, WI	<b>\$80,667</b>
1996	<b>PEOPLES BANK OF SENECA</b>	Seneca, MO	<b>\$153,778</b>
2006	<b>EAGLE BANK</b>	Polson, MT	<b>\$56,970</b>
2007	<b>TURTLE MOUNTAIN STATE BANK</b>	Belcourt, ND	<b>\$29,482</b>

Source: FDIC (2016).

There also is growing number of Native-controlled credit unions. The NALS identified seven in 2001, the 2016 list of certified Native CDFIs includes nine (CDFI Fund 2016), and there are still more Native-controlled credit unions outside the CDFI sector (National Credit Union Administration 2007, Creditunions.com 2012, Rapport 2013, Ghosh 2015).

36 | We do not know which banks were counted in the 2001 Native American Lending Study, so we do not know how many of these same banks were counted in 2016. The main point is that there has been sector growth. We also do not know why Oklahoma-based tribes dominate the Indian banking sector, although there are several possible explanations. For example, demonstration effects may increase the popularity of bank ownership, the economic prowess of Oklahoma tribes may increase the attractiveness of bank ownership, differences in land tenure between most Oklahoma-based tribes and other tribes may be an incentive for bank ownership, etc.



Photo credit: Seven Sisters Community Development Group

### *The Critical Role of Native-Owned Banks and Other Depository Institutions*

While most Native banks and other depository institutions do not serve Native Communities exclusively, they are an important factor in capital and credit access for the tribes and tribal citizens they serve. Individual consumers rely on them for depository services, business and housing lending, and financial education. Tribal governments rely on them to manage payrolls, process distribution payments, receive and hold inter-government transfers, invest assets, and provide lines of credit.

At first glance, these services are not much different from the services any bank might offer a Native Community. Yet often, other banks have not offered them, assuming instead that working in Native Communities is too risky (Woodrow 2011, Small 2012-2013). By contrast, Native-owned banks are committed to working in tribal settings, managing risk through an understanding of the ways that collateral, loan guarantees, credit profiles, and tribes' laws and regulations differ from the non-tribal setting. In turn, they bring more Native Communities and Native Community members into the financial mainstream with appropriate consumer banking services (for example, ATMs in tribal communities and direct deposit options for revenue distributions); auto, education, business, and home mortgage loan products that use guarantees or other Native-specific collateral; and specialty services and financing packages for tribal governments (Hartley 2004, Van Winkle 2006-2007, Loiselle 2009, First Nations Development Institute 2015).

### *Tribal Bank Ownership as an Investment Opportunity*

When the Chickasaw Nation purchased Bank2, its leadership simply sought to include Native Community members as fully in banking services as non-Natives were involved (Hartley 2004). Through the development of appropriate products for Native Communities, the Native American proportion of Bank2's customer base grew from 10-15 percent in 2002 to approximately 35 percent by 2004, with a proportion of 50 percent projected for the future. Simultaneously, Bank2's asset base grew from a \$7.5 million in 2002 to \$63 million 31 months later. By 2015, its asset base exceeded \$100 million (Bank2 2015).

As this example demonstrates, owning a bank can be profitable, and a Native nation's investment can reflect a desire both "to do good and to do well." For example, the Meskwaki Nation purchased Pinnacle Bank in 2009—in part to improve capital access for the tribe and its citizens but also as a part of a strategy to diversify business activities, for which reason "the bank is actively marketing its minor's trust administration services to other tribes" (FNDI 2015, 19).

Like any business investment, however, bank ownership does not come with a guaranteed profit. If a tribe does not earn the return that it desires and ultimately disinvests, the opportunities to improve Native Communities' access to capital also may be lost. For example, faced with \$18 million in non-accrual loans and foreclosed real estate as a result of the late 2000s recession (an amount equal to 13 percent of the bank's total assets as compared to the industry norm of one percent), the Viejas Band of Kumeyaay Indians sold its share of Borrego Springs Bank in 2012. A larger banking group, attracted to Borrego Springs' strong record as an SBA lender and better able to manage the risk of mortgage defaults, consolidated the former tribal bank into its network (Allen 2012, Lamm 2013). While this banking group operates near many Native Communities, there is no guarantee that tribes and tribal citizens will have the same access to capital that they had under the Viejas Band's management (HPAIED 2002).

### *Summary*

Although Native-owned banks make up only a small portion of the nation's banking system, their numbers are growing. These institutions play a critical role in improving access to capital and credit in some Native

Communities and have been an important means of financial diversification for some Native nations. More generally, they point to the importance of community banking in underserved communities.

## TRIBAL TAX-EXEMPT BONDS

Authorized in the Indian Tribal Government Tax Status Act of 1983, tribal tax-exempt bonds are a relatively new funding source for tribal governments. In 1985, the Fond du Lac Band of Lake Superior Chippewa became the first tribe to issue a tribal tax-exempt bond, which it used to finance a clinic (Dorsey & Whitney 2015). As a point of comparison, U.S. states and municipalities have employed tax-exempt bonds for government finance since at least the 19th century. Interest income earned on these bonds is exempt from federal income taxes, which makes it possible for governments to borrow funds at lower interest rates.

Section 7871 of the Internal Revenue Code (IRC) provides the eligibility requirements for tribal tax-exempt bonds. In general, tribal tax-exempt bonds are restricted to financing “essential governmental functions” such as school construction or other public infrastructure development (IRS 2014). In addition:

- Tribal tax-exempt bonds can be used to finance manufacturing facilities provided that certain use, location, ownership, and employment requirements are satisfied.
- Up to \$2 billion in tax-exempt Tribal Economic Development Bonds can be issued to finance economic development projects used by tribal governments.
- Tribal governments are eligible to use certain other targeted tax-advantaged bond programs, such as new clean renewable energy bonds and qualified energy conservation bonds, under applicable bond volume caps (U.S. Code 26, §54C & §54D).

### Quick Facts<sup>37</sup>

Tribal tax-exempt bond issuances were less than one percent of all new U.S. tax-exempt bond issuances during the period 1987 to 2010. In fact, at their peak,

tribal bonds reached only 0.2 percent of all issuances over this period.

Overall, the total that tribal governments borrowed through bond financing was less than \$4 billion over the 23-year period, and only 90 of the 339 federally recognized tribal governments in the lower 48 states participated in this finance option.

The average weighted maturity of tribal bonds is seven years, slightly shorter than the state and local government average (7.25 years). Also, tribal governments tend to issue a larger proportion of bonds with floating interest rates than do states and localities (23 percent of recent tribal bond issuances versus four percent of all recent issuances).

The most commonly reported purpose for tribal bond financing is a general category of services denoted simply as “other.” Aside from this category, the reported uses for tribal tax-exempt bonds are distributed fairly evenly across the categories of transportation, utilities, safety, education, and environment. By contrast, the most commonly stated purpose for state or municipal bond revenues is education-related investments.

Regression analysis suggests that two somewhat contradictory factors are associated with a tribe’s decision to borrow using a tax-exempt bond: a tribe is more likely to borrow if it has economic resources and if its population has major economic needs. In Brashares’ and O’Keefe’s econometric model, the specific controls for these characteristics are a tribe’s participation in the gaming market, whether or not it earns royalties from resource extraction, the reservation poverty rate, and the reservation population’s relative participation in the Federal Supplemental Nutrition Assistance Program.

### Tribal Economic Development Bonds

Tribal Economic Development Bonds (TED Bonds) are a special type of tribal tax-exempt bonds established through the American Recovery and Reinvestment Act of 2009. Notably, the eligibility requirements for TED Bonds are comparable to those for state and local governments—tribes do not need to meet the restrictive essential governmental function standard and may use TED Bond financing for a broad range of economic development projects. Key remaining restrictions on

<sup>37</sup> | The reference for all information in the Quick Facts section is Brashares and O’Keefe (2013).

the use of TED Bonds are that projects must be located on tribal lands and the financing cannot be used for gaming facilities.

The statute creating TED Bonds provided the Treasury Department with \$2 billion in TED bonding authority for allocation to tribal governments. The IRS opted to distribute the authority in two segments (or tranches), the first of which was made available in 2009. There were 58 applications for the first \$1 billion bond issuance, and 76 for the second \$1 billion (U.S. Department of the Treasury 2011). Although the full \$2 billion authorization of TED Bonds was allocated to projects in this initial process, a majority of these bonds were not issued. In an attempt to further motivate uptake of TED bonding authority, the IRS announced a new process for allocating the volume cap in 2012, making it possible for at least some larger projects to be financed with TED Bonds. As of April 1, 2015, however, \$1,313,999,184 of the original \$2 billion authorization for TED bonds remained available and unissued (IRS 2015).

The reasons for this lack of uptake are not yet clear. On the one hand, fewer restrictions on bond use should have increased the attractiveness of bond financing to tribes. On the other hand, TED Bonds initially were made available at a time when very few investment projects of any sort were going forward inside or outside Native Communities. Moreover, for some tribes the capacity requirements for organizing a bond issue may have been a higher hurdle than expected, which in turn would have increased the return flow of bonding allocations to the Department of the Treasury. The long-run economic impact of TED Bond financing is not yet known. Nonetheless, TED Bonds have been an important financial innovation, particularly in their responsiveness to tribal concerns about the essential governmental functions rule and caps on borrowing.

### *Attempts to Improve the Usefulness of Tribal Bonds*

Originally, the essential governmental functions rule limited tribal governments to the same set of spending options open to state and local governments using tax-exempt bonds. Over time, however, changes in the scope of state and local government activities have created inequalities: the rule now prevents tribal governments from using tax-exempt bonds for purposes for which state and local governments *could* use such bonds. Responding to this difference, the Treasury Department issued an “Advance Notice of Proposed Rulemaking” in 2006 proposing to define the term “essential governmental function” for purposes of eligibility for tribal tax-exempt bonds as follows:

an activity will be considered an essential governmental function that is customarily performed by State and local governments if: (1) there are numerous State and local governments with general taxing powers that have been conducting the activity and financing it with tax-exempt governmental bonds, (2) State and local governments with general taxing powers have been conducting the activity and financing it with tax-exempt governmental bonds for many years, and (3) the activity is not a commercial or industrial activity (IRS 2006, 45474).

The advantage of this recommendation is that it would give tribal governments greater flexibility to finance needed economic development projects for tribal governmental use. At the date of writing, this proposed rule change had not yet been approved.

The Treasury Department also has undertaken other efforts to change the rule. In a 2011 report to Congress and subsequent budget proposals, the Treasury Department recommended that, for tax parity and fairness reasons, Congress adopt permanent tax-exempt bond financing eligibility requirements for tribal governments that are similar to the TED Bond program (notably removing the essential governmental function requirement) (U.S. Department of the Treasury 2011, 2015).

### *Summary*

The tribal tax-exempt bond market is a small segment of the municipal bond market. Yet as tribal economies and tribal government investment opportunities grow, there may be great potential for the expanded use of these bonds—especially TED Bonds (and similar instruments) that are exempt from the essential governmental functions test.

## **CONCLUSION**

Data from a variety of sources suggest that in the decade and a half following the release of the NALS, access to capital and credit in Native Communities has improved. Compared to 2001, Native individuals, Native-owned businesses, and tribal governments all have more financial options, and more funds are flowing to them.

For example:

- Access to banks and ATMs appears improved for many Native Community residents.
- The significant expansion of the Indian Home Loan Guarantee Program has increased homeownership among Native Community members.
- The number of Native CDFIs—institutions that provide capital and credit to some of the most distressed and under-served communities in Native America—has increased.
- The number of Native-owned banks has increased, and these institutions hold more than \$2.3 billion in assets.
- Additional bonding authority exists to benefit tribal governments, which can be used for a broader array of public sector investments than traditional tribal tax-exempt bonds.

Still more positive change may be on the horizon. AIAN per capita incomes are growing (Akee and Taylor 2014), Native Communities' financial infrastructure is broader and deeper than in 2001, and tribal governments are increasingly enacting laws and policies that support economic growth (Woodrow 2011). These changes will create new incentives for credit offerings and new options for capital access (although they also may increase the demand for finance).

That said, significant obstacles to access to capital and credit in Native Communities remain. The rise of online banking may offset the gains realized in access to brick-and-mortar banks. Native CDFIs wrestle with low capitalization, which reduces their capacity to offer development services and constrains the number and size of their loans. Limited innovation in tribal trust land collateralization—arising from undue risk





Photo credit: Jonathan Taylor (2016)

aversion, a lack of knowledge, or other factors—continues to challenge housing finance. Many tribes have yet to adopt leasing codes, leaving the possibilities created by the HEARTH unrealized. The generally slow process of gaining a Title Status Report reduces mortgage options on allotted lands. Native-owned banks are heavily concentrated in Oklahoma; some regions of the country have no Native-owned banks at all.

Moreover, several loan guarantee and economic development programs that benefit Native Communities have been underutilized, and it is unclear whether policy changes can encourage their use. For example, the Small Business Administration's loan guarantee program helps facilitate business lending in Indian Country and reduces risk for conventional lenders, but data indicate that less than one percent of all SBA loan guarantees have backed American Indian-owned businesses. While Tribal Economic Development Bonds have provided substantial new access to finance, issuances have lagged bonding allocations.

The current analysis also has identified several key gaps in knowledge concerning access to capital and credit in Native Communities. First, little is known about the types and value of individual-level asset holdings. In national surveys and datasets, members of the Native Community sub-population often are not represented in sufficient numbers to provide useful insights about the group overall. Targeted surveys are needed to fill the gap; one example is the recent implementation of the National Asset Scorecard and Communities of Color survey in Tulsa, Oklahoma, which included a relatively large sample of American Indians.

Second, the analysis here is limited to the observation of post-facto results. More experimental approaches, which would evaluate the design and implementation of capital and credit access programs for Native Americans, might increase the policy options for governments (both tribal and federal) and community-based organizations.

Finally, the research for this paper does not take into account recent legal settlements, which have significantly increased capital flows to some tribal citizens and tribal governments. One of these settlements, the Indian Land Trust settlement (from the case *Cobell v. Salazar*), also created new land ownership possibilities for tribal governments through land parcel consolidation. These changes have the potential to affect asset accumulation in many Native Communities, both immediately and over the long term.

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