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CDFI Industry Analysis
Summary Report

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Key Findings

- CDFIs have been "stepping into the breach" to address lending-related needs during the recession—and have paid a financial price for doing so.
- CDFI portfolio performance has been mixed, but only for a minority of organizations is it an issue that significantly affects overall financial performance.
- Significant scale effects exist in all sectors of the CDFI industry.
- Operating expenses play the driving role in determining whether CDFIs achieve self-sufficiency.
- CDFIs, particularly CDFI Loan Funds, face numerous barriers preventing them from using and leveraging capital more effectively.

Background

The Carsey Institute, under contract to NeighborWorks® America and the U.S. Department of Treasury's Community Development Financial Institutions (CDFI) Fund, conducted a detailed analysis of a large sample of community development financial institutions (CDFIs) on issues of capitalization, liquidity and portfolio, and risk management by CDFIs from 2005 to 2010. This work is part of the CDFI Fund's Capacity Building Initiative. The purpose of the report is to explore issues of capitalization, liquidity, and portfolio and risk management by CDFIs. This study involved a large sample of CDFIs. However, at least for CDFI Loan Funds, it was a selected analysis. It is important to note that the analysis is not necessarily representative of all CDFI Loan Funds;[2] but it is representative of CDFI Banks, CDFI Credit Unions and CDFI Bank Holding companies, as information obtained is from all institutions with CDFI certification.

CDFIs fill a market gap by supplying financial products and services tailored to the needs of underserved communities and are targeted to promote community development. CDFIs may take the form of loan funds, credit unions, banks, holding companies, and venture funds within the finance/insurance/real estate industry sector. As of November 30, 2010, there were approximately 907 certified CDFIs in operation in the United States, including 572 nonprofit loan funds, 197 credit unions, 72 CDFI banks, 41 bank holding companies, and 25 venture funds.

There is a distinction between a CDFI and the CDFI Fund. The CDFI Fund provides certification to CDFIs that meet the six statutory and regulatory criteria of the CDFI Fund.[3]

Industry Overview

The research focused on the following questions:

1. What capitalization and liquidity issues do CDFIs face?
2. What portfolio health and risk-management issues do they face?
3. What factors affect CDFI self-sufficiency?
4. How have CDFIs been affected by the recession of 2008-2009?
5. Given that CDFIs vary greatly along a spectrum of types, sizes, financial products, etc., how are the various players affected by the issues?
6. How do these issues impact CDFIs versus traditional financial entities that share similar characteristics (e.g., CDFI banks vs. traditional banks of a similar size)?

To explore these questions, data from multiple sources was compiled and analyzed, including:

1. Financial reports submitted to regulators by CDFI banks and credit unions, and their traditional counterparts, in 2005-2010.
2. Data submitted by nonprofit CDFI Loan Funds to the CDFI Fund when applying to the CDFI Program, including audited financial statements, self-reported financial and loan portfolio metrics, and detailed business plans. Generally these applications yielded data from the year ending in 2009.
3. Data from 80 CDFI senior executives surveyed in 2011.
4. Community Investment Impact System (CIIS) data compiled by the CDFI Fund from a limited number of CDFIs in 2005-2009.
5. Interviews with 13 industry stakeholders, which were used to organize the research and to present preliminary research findings for further discussion.

Table 1 provides a breakdown of the groups studied.

Table 1: Breakdown of study groups

	Number in Industry	CDFIs in industry	CDFIs examined in this study
Loan funds	?	572	282
Credit unions	7,503	~197[4]	197
Banks	6,838	~72	72
Bank holding companies	3,984	~46	41
Venture funds	462[5]	25	-

Caveats and Limitations

All of the themes and findings raised in these reports should be treated as working hypotheses supported by existing data, but that may merit additional data gathering and research. The analysis is limited by a number of factors.

1. The institutional CDFI certification was not "time stamped." In the case of CDFI Loan Funds, each organization is a certified CDFI for all reporting years. The same cannot be said for banks, holding companies, and credit unions. For these institutions, the CDFI Fund's published listing of 907 certified CDFIs as of November 30, 2010 was referenced. Data from 2005-2010 are included for any bank, bank holding company, or credit union that is listed as a certified CDFI whether or not it was a certified CDFI during this period.
2. For CDFI Loan Funds, self-reported CDFI application data on organizational financials and loan portfolio performance was used. This data is somewhat dated, and because loan funds are not regulated, there are no standards beyond the guidance provided by application instructions. Audited financial information was used for the loan funds studied in more detail, but even here auditors for the selected CDFIs used vastly different reporting practices. This limitation is so significant that it is included as one of the main findings of this research.
3. Uniform Bank Performance Reports (UBPR) data sets are used for bank analyses. The data sets are somewhat aggregated by definition.
4. Venture fund information is not included. The researchers were unable to locate public sources of data for CDFI venture capital firms.
5. The analysis focuses largely on financial metrics as opposed to social metrics. However, if a CDFI fails to achieve an attractive "business return," it does not necessarily mean that it fell short of important "mission returns."
6. This study did not attempt to address a range of issues which affect the field and were often raised in interviews. For example, the mission impacts of CDFIs are worthy of a more exhaustive study than was conducted here. Additionally, many interviewees cited the difficulty of attracting and retaining staff members with financial industry knowledge and experience.

Primary Findings

The five key findings of the report are as follows:

Finding 1: CDFIs have been "stepping into the breach" to address lending-related needs during the recession—and have paid a financial price for doing so.

CDFIs have expanded their assets and their loan portfolios since the market peak in 2005, as the economic crisis has made it harder to access traditional credit markets.

1. Among loan funds in this sample, median assets doubled and loan portfolios increased 76 percent. The median CDFI loan fund deployment ratio grew 3.1 percent annually from 2006 to 2009.
2. CDFI credit union portfolios grew faster than their traditional counterparts from 2005 through 2010. The median CDFI credit union portfolio grew 47 percent from 2005 to 2010, compared with 29 percent growth for non-CDFI credit unions. Assets grew by 38 percent, compared with 47 percent for non-CDFI credit unions. In an apparent response to the mortgage credit crisis, CDFI credit unions also appear to be shifting their portfolio composition, in particular by increasing their focus on first mortgages—from 18 percent of loans in 2005 to 26 percent of loans in 2010.
3. CDFI banks saw median assets grow at an annualized rate of 7.9 percent from 2006 to 2010, while the assets of corresponding traditional banks grew at an annualized rate of 0.63 percent. CDFI banks saw their median loan portfolios grow 33 percent over the same period, versus 27 percent for the comparison group.[6]

Further analysis of selected CDFI business plans confirms that CDFIs are willing to take risks and serve customers with financial products that traditional capital markets are unlikely to provide. As described in their business plans, business lending CDFIs are making start-up loans, micro-enterprise loans, and providing gap financing, or focusing their lending on minority and/or low-income borrowers in distressed areas. CDFIs that focus on mortgages and other housing-related loans are focusing their products on traditionally underserved populations such as low-income and minority households, and providing low-cost products including home purchase loans, foreclosure prevention loans, emergency loans for seniors, and energy efficiency loans. Real estate development CDFIs are lending to developers serving low- and very-low-income populations, not only for development of affordable housing but also for community facilities, retail outlets and charter schools, among other projects.

In short, true to their mission, CDFIs appear to be "stepping into the breach" to attempt to close gaps faced by constituents who cannot access traditional market capital.

At the same time, CDFIs appear to have paid a financial price for their actions during the recession:

1. CDFI credit unions have experienced declining earnings and rising delinquency rates, and they have higher delinquency rates than the credit union industry as a whole.
   - Net income has declined every year from 2008 to 2010; return on assets declined every year from 2006 to 2010; and net interest margin declined every year from 2005 to 2010. For non-CDFI credit unions, net income has also been declining since 2006. Return on assets (ROA) for non-CDFI credit unions has declined every year since 2005. Net interest margin for non-CDFI credit unions has remained relatively flat (4.5 percent in 2005 compared to 4.58 percent in 2010).
   - Delinquent loans as a percentage of total loans have risen every year between 2005 and 2010, rising from 1.5 percent to 2.9 percent. This performance diverges from the industry as a whole, which saw an improvement in 2010, with delinquencies dropping from 1.3 percent of total loans to 1.0 percent between 2009 and 2010.
   - Charge-offs have followed a similar trend. Median charge-offs to average loans for CDFI credit unions rose between 2005 and 2009. They then declined slightly in 2010. However, at 0.93 percent, the 2010 level remains about 53 percent higher than the 2005 level of 0.61 percent. The credit union industry as a whole, meanwhile, saw median charge-offs to average loans increase 57 percent during the same period, from 0.54 percent to 0.89 percent. Note however, that the absolute difference between CDFI credit unions and non-CDFI credit unions, 2005-2010, for this metric is 0.032 (0.32 percent) higher for CDFI credit unions.
2. Median net income for CDFI banks, which equaled median net income for corresponding traditional banks in 2006, dropped sharply in the recession. As of 2010, median net income for CDFI banks was 63 percent of that of traditional banks. Net loss to average total loans and leases grew from 0.13 percent in 2005 to 0.88 percent in 2009 before falling back to 0.82 percent in 2010.

Finding 2: CDFI portfolio performance has been mixed, but only for a minority of organizations is it an issue that significantly affects overall financial performance.

Data on CDFI Loan Fund loan performance are limited in that there are no comprehensive CDFI industry-specific, loan-level databases providing details on the risk characteristics of loans at time of origination and their subsequent performance. The data obtained provide a mixed picture, with some segments of the industry appearing to outperform market benchmarks, while other segments experience high delinquencies and charge-offs.

The very limited data available on delinquencies and charge-offs for CDFI Loan Funds are mostly positive. Some representative highlights include the following:

1. In 2009, CDFI Loan Funds that were dedicated exclusively to home financing reported a median portfolio at risk (i.e., 90+ day delinquency) of 2 percent, up from 0.9 percent in 2008. By comparison, the Mortgage Bankers Association National Delinquency Survey statistics for the fourth quarter of 2009 show overall 90+ day delinquencies at 9.7 percent and subprime delinquencies at 30.1 percent. The CDFIs are outperforming traditional portfolios even though their products are targeted to higher-risk borrowers than those served by the market as a whole. This evidence emerged from the analysis of loan funds in the full report, which examined nine home financing CDFI business plans.
2. Similarly, CDFI Loan Funds engaged solely in business lending had a median charge-off rate in 2009 of 1.3 percent. This compares with charge-off rates in 2009 of 1.5 percent for the overall SBA 7a program and 1.5 percent for the overall SBA 504 program.[7] On the other hand, these CDFI Loan Funds saw higher charge-off rates in 2008 than these SBA benchmarks (3.1 percent versus 1.7 percent for SBA 7(a) and 1.1 percent for SBA 504).
3. Loan funds engaged solely in real estate development lending had a median portfolio at risk of 1.6 percent in 2009, up from 1.4 percent in 2008. Charge-offs were 2 percent in 2009, up from 0.6 percent in 2008 (see Table 2). No commonly used benchmark is available here, but it is evident that at least the median-performing loan funds are not at great risk of shutting their doors due to poor loan performance.

Table 2: 2008-2009 metrics for CDFI Loan Funds engaged solely in real estate lending

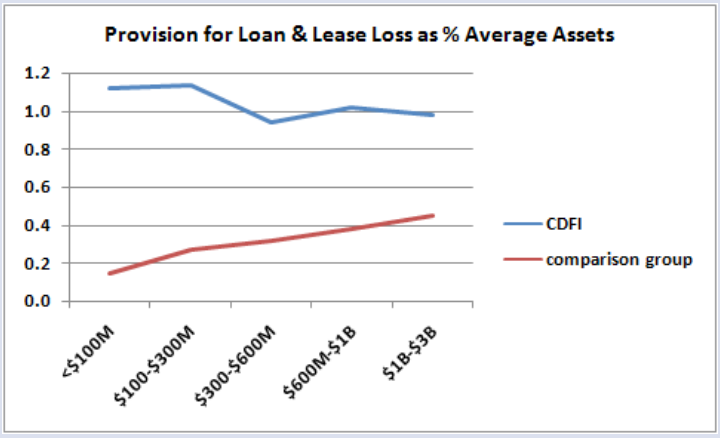
CDFI Loan Funds engaged solely in real estate lending	2008	2009
Median portfolio at risk	1.4%	1.6%
Charge-offs	0.6%	2.0%

For a minority of CDFI loan funds, however, loan losses have affected financial sustainability. Among real estate and home financing loan funds in this study, 27 percent of portfolios showed risk greater than 7 percent, which is the CDFI Fund's Minimum Prudent Standard (MPS). Among business loan funds, 26 percent of their portfolios exceeded the MPS of 10 percent at risk. Among all the loan funds in this study, 11 percent reported portfolios at risk greater than the CDFI Fund's "overall" MPS of 15 percent. In the full report, loan funds with higher charge-off rates are clustered in the low self-sufficiency grouping. These losses are affecting business lending loan funds and funds with multiple business lines, and suggest that loan performance is having an impact on overall sustainability.

Data on credit unions indicate that CDFI credit unions have been experiencing greater risk in their loan portfolios than traditional credit unions. As of 2010, CDFI credit unions had more than double the rate of delinquent loans as a percentage of total assets as the overall credit union industry: 2.9 percent compared with 1.0 percent. Charge-offs to average loans were only slightly higher, at 0.93 percent for CDFIs versus 0.89 percent for non-CDFIs. On the other hand, from 2010 data, it is also quite clear that most CDFI credit unions have excellent portfolio quality (see Chart 1).

For real estate loans, 64 percent of CDFI credit unions have 60-day delinquencies of less than one percent; for business loans, 77 percent of CDFI credit unions have 60-day delinquencies of less than one percent.

Chart 1: Provision for loan and lease loss as a percentage of average assets—CDFI credit unions versus all credit unions



Nor do many credit unions suffer from very poor portfolio quality:

1. Of all credit unions, 5 percent have real estate loan portfolios that exceed the CDFI Fund MPS of 7 percent at-risk.
2. For CDFI credit unions,[8] 11 percent of exceed this MPS.
3. Only about 9 percent of credit unions have business loan portfolios at risk greater than the CDFI Fund MPS of 10 percent.
4. For CDFI credit unions, this percentage is 7 percent.

CDFI banks also appear to have consistently higher loan-loss expenses than corresponding traditional banks. On the other hand, this difference appears to diminish for larger asset sizes, and no adjustments are made for the likelihood that the CDFI banks are lending to riskier borrowers.

For real estate loans:

1. 52 percent of all banks have 30-89 day delinquency rates of less than 1 percent.
2. 13 percent of CDFI banks have 30-89 day delinquency rates of less than 1 percent.
3. 11 percent of all CDFI banks[9] have real estate loan portfolios that exceed the CDFI Fund MPS of 7 percent at risk. For all banks, this percentage is 1.7 percent.

For business loans:

1. 69 percent of all banks have 30-89 day delinquency rates of less than 1 percent.
2. 56 percent of CDFI banks have 30-89 day delinquency rates of less than 1 percent.
3. 7 percent of all CDFI banks have commercial loan portfolios that exceed the CDFI Fund MPS of 7 percent. For all banks, this percentage is 3.7 percent.

Finding 3: Significant scale effects exist in all sectors of the CDFI industry.

The analyses strongly support a finding that CDFIs with larger assets are much more likely to achieve high self-sufficiency ratios than institutions with smaller assets. There is a powerful scale effect among loan funds, as well as among CDFI banks and credit unions.

Among CDFI Loan Funds, the results show that larger funds outperform smaller ones along a range of factors that may result in greater self-sufficiency:

1. drastically lower combined interest and operating expense ratios
2. more leverage on their balance sheets
3. generally higher deployment ratios
4. substantially lower levels of charge-offs as organizations progress from $1 million in assets and up

At the same time, larger loan funds are able to achieve greater self-sufficiency despite operating at lower margins (smaller pricing mark-ups) than smaller funds, as can be seen in Tables 3 and 4, showing three-year averages.

Table 3: Financial metrics by CDFI Loan Fund asset size

Asset size[10]	% of applicants	Self-sufficiency ratio	Leverage ratio[11]	Combined interest / operating expense ratio	Margin[12]
<$500k	10.3	0.107	-0.574	8.16	-1.640
$500k-$1M	8.2	0.232	2.522	14.19	-0.651
$1M-$5M	23.1	0.385	1.599	1.24	-0.348
$5M-$10M	13.1	0.540	2.258	0.382	-0.210
$10M-$50M	25.2	0.623	2.538	0.421	-0.137
$50M-$100M	6.8	0.903	3.304	0.264	-0.094
>$100M	13.5	0.848	8.138	0.079	-0.033

Table 4: Financial metrics by CDFI Loan Fund asset size (cont.)

Asset size	Mean deployment ratio[13]	Mean charge-off ratio[14]
<$500k	0.23	0.00%
$500k-$1M	0.54	0.00%
$1M-$5M	0.68	0.52%
$5M-$10M	0.71	0.40%
$10M-$50M	0.82	0.38%
$50M-$100M	0.92	0.18%
>$100M	0.86	0.06%

Similarly, among CDFI credit unions, larger credit unions have stronger net income performance while charging lower interest rates and fees on their loans, in large part by keeping non-interest expenses low (see Table 5).

Table 5: Financial metrics by CDFI Credit Union asset size

2010 numbers	<$10 M	$10M-$25M	$10M-$25M	$50M-$75M	$75M-$100M	$100M-$200M	$200M-$400M	>$400M
Loan interest	8.46%	7.50%	7.70%	6.73%	7.02%	7.14%	6.16%	5.77%
Gross yield	9.05%	8.21%	8.28%	7.30%	7.64%	7.82%	6.81%	6.31%
Cost of funds	1.55%	1.64%	1.67%	1.74%	1.48%	1.91%	1.76%	2.36%
Net yield with provision	5.12%	5.12%	5.07%	4.33%	5.25%	4.84%	3.72%	2.82%
Non-interest income	3.84%	3.11%	3.12%	3.08%	2.82%	3.46%	2.25%	1.63%
Non-interest expense	10.21%	8.59%	7.70%	7.17%	7.22%	7.42%	5.84%	3.38%
Net income	-1.25%	-0.37%	0.49%	0.23%	0.85%	0.87%	0.14%	1.07%

Economies of scale are also found in the CDFI banking sector, although these scale effects are more pronounced in traditional banks (see Table 6).

Table 6: CDFI Credit Union earnings and profitability by asset size

CDFI earnings and profitability (2005-2010)	<$100M	$100-$300M	$300-$600M	$600M-$1B	$1B-$3B
Percent of average assets:					
Interest income	6.20	6.03	5.91	6.17	6.01
- Interest expense	2.20	2.07	2.22	2.38	2.12
Net interest income	4.01	3.91	3.86	3.85	3.82
+ Noninterest income	0.86	0.85	1.08	0.72	1.18
- Noninterest expense	3.65	3.06	3.02	2.64	3.14
- Provision: loan & lease losses	1.12	1.14	0.94	1.02	0.98
Pretax operating income	0.45	0.59	0.89	0.93	1.37
Net income	0.41	0.39	0.64	0.59	0.81

Finding 4: Operating expenses play the driving role in determining whether CDFIs achieve self-sufficiency.

To the extent that the CDFI industry could define a common business model, it might be described as follows: CDFIs provide loans that traditional capital markets are unlikely to provide (because they are smaller or more affordably priced, for instance) to borrowers who are unlikely to be served by traditional markets (because they are perceived to be, or in fact are, riskier or are systemically underserved), and yet the CDFIs show strong portfolio performance by providing high-touch "development services" to educate and counsel the borrower. The downside of this business model is that operating costs are driven up because CDFIs market, underwrite, and originate smaller loans, and provide more intensive services. Caution should be used in trying to identify a common business model. For instance, depositories such as banks and credit unions are typically self-sufficient and often emphasize the importance of savings for their individual customers. This is significantly different from the operations of loan funds.

As a cost driver for CDFI Loan Funds, operating expense is by far the largest component of an organization's expenses, dwarfing both cost of capital and loan loss expense. It thus represents a key determinant of organizational sustainability. The deeper analysis provides the most visible demonstration of this theme. For 21 of the 34 loan funds studied, operating expenses (as opposed to loan loss and interest expense) make up more than 70 percent of total expenses. For only three of the loan funds studied do operating expenses make up less than 50 percent of total expenses, and two of these three funds report that an affiliate performs some operating functions for them at no charge. Furthermore, regardless of business focus or asset size of the loan fund studied, organizations falling into the high self-sufficiency group have substantially lower operating expenses as a percentage of overall assets, than organizations falling into the low self-sufficiency group. With only one exception, operating expenses for high self-sufficiency groups were approximately 10 percent of assets or less. Only three of the 17 low self-sufficiency groups had operating expenses of 10 percent of assets or less, and seven had operating expenses of greater than 20 percent of assets.

Indeed, as alluded to in Finding 3, a major reason why larger CDFI Loan Funds may be more likely to have high self-sufficiency ratios is that they have drastically lower levels of operating expense per dollar of assets managed. Given the results obtained from the "deep dive" analysis, it is safe to assume that operating expense is the main component of the combined interest and operating expense ratio that was calculated for all loan funds. This ratio is significantly lower for large loan funds. Across all loan funds, a strong statistical correlation ($r = 0.75$) exists between the interest/operating expense ratio and organizational self-sufficiency.

There is some evidence that organizations with smaller operating expense ratios may have less intensive development services or may receive development services or other services from an affiliated organization, thus reducing their expenses. In particular, organizations receiving free services from an affiliate had staff expenses that composed 26 percent of total expenses on average, while the expenses of those that did not report free services composed 42 percent of total expenses.

Even among CDFI credit unions and banks, there is a similar dynamic, in which operating expense is consistently a much more powerful driver of profitability than loan performance or cost of capital. For example, among the largest CDFI banks ($1 billion to $3 billion in assets), non-interest expense runs at 3.14 percent of assets. This compares with interest expense at 2.12 percent and loan and lease losses at 0.98 percent. This dynamic is as strong or stronger among the smallest CDFI banks (under $100 million in assets), where non-interest expense is on average 3.65 percent of assets and interest expense are only 2.2 percent, and loan and lease losses provisions count for 1.12 percent of assets.

The factors driving CDFI operating expenses are clearly complex, but the bottom line is that more efficient delivery mechanisms may be critical for CDFIs' survival. These mechanisms could include greater use of technology, more collaboration between organizations, and expanding overall assets so that fixed expenses are spread over a much larger asset base. Perhaps a larger challenge for the field is that portfolio performance is directly tied to providing the very same services that are driving up the operating costs. The challenge therefore resides not simply in improving efficiency, but may be a core component of the basic business model.

Finding 5: CDFIs, particularly CDFI Loan Funds, face numerous barriers preventing them from using and leveraging capital more effectively.

There are four interrelated findings from the study:

- CDFI Loan Funds are generally not well leveraged, possibly reflecting the cost of debt as well as terms of financing available to them.
- CDFI Loan Funds struggle to perform the asset transformation function[15] and thus may need more help in meeting market needs for longer-term financing.
- Large amounts of un-deployed capital in the industry, if strategically redeployed, could accelerate the realization of heretofore unrealized potential in the industry.
- Inadequate data itself may present a barrier to CDFI capitalization.

CDFI Loan Funds are generally not well leveraged, possibly reflecting the cost of debt available to them.
Particularly among loan funds, a large number of CDFIs have very little leverage (i.e., they fund themselves mainly through net assets, not debt). The median CDFI loan fund in 2009 was leveraged at just $1.10 in liabilities for every $1 in net assets. About 8 percent of loan funds had no liabilities whatsoever. Banks and credit unions are typically leveraged at a rate of 10:1 or more.

It is important to distinguish between organizations that simply fail to efficiently employ their assets and organizations that make a reasoned decision to maintain relatively low leverage because they are too small to take advantage of the law of large numbers. The challenge for CDFI Loan Funds is that the overall number of loans is relatively small, so a significant loss in any loan can have a disproportionate effect on portfolio performance. That tends to result in loan loss reserves that are larger than necessary given performance history, and this tends to limit leverage.

On the cost side, for example, the overall blended cost of funds for a large loan fund approaches 4 percent in an environment in which banks can borrow long or short-term at a much lower rate, e.g. at 0.25 percent for short-term borrowing. The question to be asked, in light of the positive portfolio performance reported here, is why it is so difficult to access the Federal Reserve Bank or even the Federal Home Loan Bank. Although CDFIs are eligible to become members of the Federal Home Loan Bank, few are able to meet the collateral requirements. Such access would dramatically reduce the cost of funds, and thus increase profitability for loan funds. This issue will be addressed in more detail in the policy recommendations.

In many instances, as loan funds have grown, their cost of funds has grown. Growth in loan funds requires access to bank debt or lines of credit, and these tend to be higher than funds from individuals or religious institutions.

It is also possible that the difference in the cost of loan capital is related to the original source of CDFI funds. Organizations that grew out of the CAP agencies of the 1960s and 1970s often had government funds that, at some point, were converted to organizational equity. These CDFIs tend to have lower debt costs because they are funded through organizational equity. Other CDFIs require investment through institutions such as banks and insurance companies in order to grow.

The median CDFI bank, meanwhile, is leveraged at $9.20 for every $1 in net assets in 2010, and the median CDFI credit union is at $9.91.

One reason why CDFI Loan Funds use little leverage may be that their "equity" (net assets) is free, whereas their cost of debt can be surprisingly high. Their incentives are thus diametrically opposed to those of the typical for-profit corporation, which seeks to maximize debt because its cost of debt is generally lower than its cost of equity. The 31 loan funds selected for deeper analysis that reported having debt (notes payable and lines of credit) on their audited balance sheets, had a median cost of debt (interest expense/debt) of 2.7 percent. Moreover, seven of these funds had debt costing 4 percent or more annually, and seven more had debt costing between 3 and 4 percent. This compares to banks, which may have an overall cost of funds of less than 1 percent.

Unfortunately, more comprehensive data on the interest expense and cost of debt of CDFI Loan Funds are not readily available, but a limited set of data is available through the CDFI Fund's CIIS data. The 122 loan funds for which data were available in 2009 showed an interest expense (as a percentage of total loans outstanding) of 2.7 percent. By comparison, CDFI credit unions had interest expense/loans outstanding of 2.2 percent, and CDFI banks had interest expense/loans outstanding of 0.3 percent. This data, notwithstanding limitations, certainly suggest that loan funds may have a capital cost disadvantage to other CDFIs and financial institutions. Such a cost disadvantage makes intuitive sense as well. Analysis from the "deep dive" and survey data confirm that banks are the leading source of debt capital for CDFI Loan Funds. It is reasonable to expect that most banks pass along this capital to CDFIs at some markup over their cost of capital. Unfortunately, the result, as described by one loan fund executive director, is that "our below market money these days is basically above market."

It is worth noting that for a handful of CDFI Loan Funds, particularly some large and sophisticated funds, leverage is an important part of their business model. As seen in the table below, about 16 percent of CDFI Loan Funds are leveraged at 4:1 or more (see Table 7, Charts 2 and 3).

Table 7: CDFI Loan Fund leverage

Leverage	% CDFIs	Leverage	% CDFIs
< 1:1	48.2%[16]	>1:1	51.7%
<2:1	65.1%	>2:1	34.9%
<3:1	79.3%	>3:1	20.7%
<4:1	84.1%	>4:1	15.9%
<5:1	87.1%	>5:1	12.9%
<6:1	90.5%	>6:1	9.5%
<7:1	93.1%	>7:1	6.9%
<8:1	94.0%	>8:1	6.0%

Chart 2: CDFI Loan Fund leverage (1)

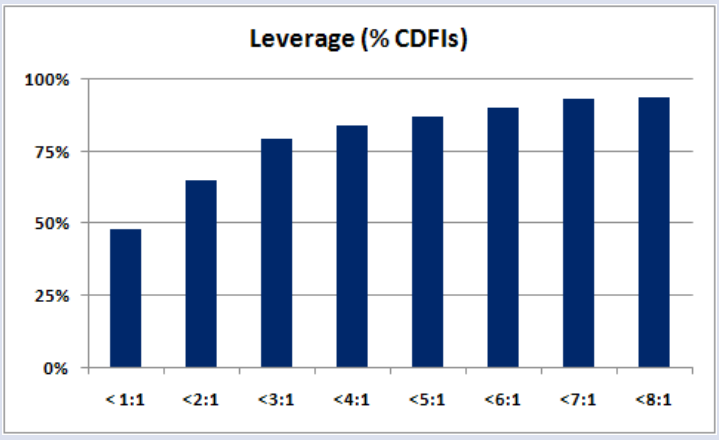
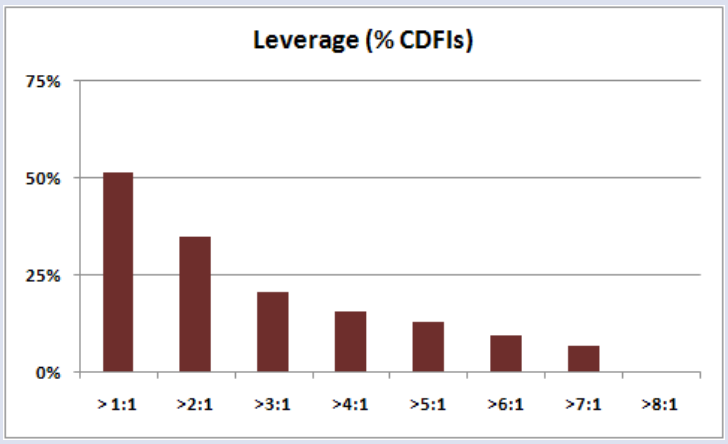


Chart 3: CDFI Loan Fund leverage (2)



Moreover, most loan fund managers, whether their organization is leveraged or not, appear to view getting more equity, not raising more debt, as the central capitalization challenge of their work. For survey respondents, obtaining additional equity was considered one of the most critical components for their organization's success. As one loan fund director put it, "the answer to everything is equity." Notwithstanding these perceptions, the results suggest that access to debt at a cost that CDFIs can support is a very significant challenge for the CDFI Loan Fund sector, one that does not appear to be shared by CDFI credit unions and banks.

CDFI Loan Funds struggle to perform the asset transformation function and thus may need more help to meet market needs for longer-term financing.

Another issue affecting loan fund leverage levels is that generally, loan funds do not appear to have access to long-term debt. Of the 34 loan funds studied in the deep dive, only four had a term of 10 or more years remaining on most of their debt. By comparison, 17 loan funds had less than 5 percent of their debt with 10 years or more remaining on it, and three loan funds had no debt at all.

On-balance-sheet CDFI loan products appear largely oriented toward shorter-term products, particularly for business loan funds, real estate loan funds, and multi-line loan funds. Longer-term products appear largely to be either sold to secondary market players (for example, using SBA 504 funding or selling loans to banks or intermediaries) or are funded by net assets. (A good example of the latter is grant funds that home financing CDFIs take in to then make long-term deferred loans to help homebuyers.) For home financing CDFIs in particular, the collapse of Neighborhood Housing Services of America has made the secondary market route more difficult. In the deeper analysis, several loan funds were noted to attempt to meet long-term capital needs by providing balloon loans (for example, multi-family real estate mortgages with 20 year amortization and a seven year maturity) and seeking to help the borrower switch to conventional credit at the time of the balloon payment.

What appear to be absent from the CDFI Loan Fund business model are strategies by which the organization funds longer-term assets using shorter-term debt. In other words, unlike banks and credit unions, many CDFIs have no role in asset transformation. Only 17 percent of CDFI Loan Fund survey respondents said they borrow short and lend long. The study results suggest, albeit not conclusively, that some mechanisms may be needed to help CDFI Loan Funds originate longer-term loan products, whether by enabling these CDFIs to borrow long-term debt, or by helping them hedge the asset-liability management risk stemming from borrowing short and lending long.

Potential exists to more effectively use large amounts of undeployed capital in the industry.
Of the 282 CDFI Loan Funds studied, the 112 organizations that were leveraged at less than $1 of debt per $1 of net assets had over $350 million in aggregate cash. About $53 million of this cash was held by loan funds with less than $10 million in assets, and $297 million held by loan funds with more than $10 million in assets. Given that there are about twice as many CDFI Loan Funds (572) than the 282 in this study, there might be over $700 million in cash at under-leveraged loan funds across the entire sector. The availability of this cash raises the question of whether inter-CDFI transactions could somehow be facilitated to improve liquidity for those CDFIs that need it, while providing a better return for the investing CDFIs than they receive at the bank.

Inadequate data and non-standardized auditing practices may present a barrier to CDFI capitalization.
In developing this report, the research team encountered significant data limitations at every turn. These limitations are substantial enough to be a significant barrier to CDFI capitalization, especially for CDFI Loan Funds, but also, to some degree, for other types of CDFIs. The limitations include:

1. Very little product-specific portfolio performance information is available for loan funds. To understand how business loans made by CDFI Loan Funds are performing, currently the only option available is to select those loan funds that are exclusively making business loans and compare their results to loan performance of all organizations.
2. Loan level data are not available for the CDFI industry, short of compiling and harmonizing datasets from individual organizations. This information barrier may be the most harmful in its impact on CDFI access to capital markets, since it is currently simply impossible to make the most routine analyses that are normally conducted with other classes of loan assets. It is not possible, for example, to create a breakdown of default rates or prepayment speeds for a given class of CDFI loans, or even to provide a breakdown of borrower credit scores. What is ironic about this is that CDFI managers feel they are swamped with reporting requirements, which they routinely fulfill. It is difficult to reconcile how CDFIs can be doing so much reporting yet have so little to show for it.
3. Standards and formats for audited financials vary. For example, some loan fund audits made no distinction between restricted and unrestricted cash; others did not report delinquency levels in the loan portfolio; some did not identify the amount of the Loan Loss Reserve and simply stated net loans receivable; and others failed to discount the principal amount of deferred loans to reflect the diminished value of the cash flows attached to these loans. On the other hand, some audits did all of these things, thus making it very hard to make comparisons.
4. Uniformity in underlying business models is lacking, so a given financial ratio cannot be compared across organizations. Just to cite one example, some loan funds make deferred loans as well as amortizing loans, and include the amount of outstanding deferred loans in their delinquency calculations. This provides an overly optimistic view of the organization's ability to manage its loan portfolio compared to another organization with a portfolio of only amortizing loans. The presence of such widely varying "stories" behind each financial report makes it difficult for analysts to quickly evaluate organizations, which in turn may reduce the ability of these organizations to access capital markets. However, the need for systematic reporting does not justify the imposition of consistent business models across the industry. For CDFIs, the most reliable means of adding value lies in their ability to respond to market need and varying sources of debt and equity capital. That flexibility should not be lost in the name of consistency.

Policy Recommendations

Urban and rural areas served by CDFIs often lack access to credit and capital. The reasons for this stem from the higher information and transaction costs faced by financial institutions and investors in serving underserved urban and rural areas (on both the equity and debt side). Lack of access also stems from the more limited deal flows, limited supporting infrastructure, and in rural areas, the difficulty of providing oversight over long distances. Furthermore, CDFI investments are often characterized by the small scale of individual transactions and the perception of a high degree of risk. Finally, CDFIs are typically small, vertically integrated institutions that are totally self-contained, doing everything from underwriting, originating, and servicing loans.

In order to serve more people, access more funds, and have greater impact, CDFIs will need to change the way they operate. CDFIs could operate as national or regional networks rather than as individual, unaffiliated lenders. Although many CDFIs identify with a particular form of CDFI (e.g., loan fund, credit union, or micro-enterprise lender) and often belong to a trade association, these affiliations are of limited use when addressing operational issues related to growth, efficiency, and scale. New models of networked community development lenders are necessary if CDFIs are to access the capital necessary to improve their local economies. Building sophisticated infrastructure would enhance the growth of the CDFI field. This idea has been raised before—for example, Kirsten Moy's *New Pathways to Scale*.[17] One of the major impediments to developing sophisticated operating platforms is the initial cost, which is typically beyond the capability of any CDFI or group of CDFIs.

Policy Recommendation 1

Create Networks, Build Infrastructure, Attract Resources and Build Scale

For the past 30 years, thousands of nonprofit community development organizations (CDOs) and CDFIs have demonstrated effective strategies for addressing poverty and underdevelopment in the United States. These organizations have developed a variety of successful community programs, all designed to improve the quality of life in their local communities.

Despite this important work and, in many cases, impressive results, these organizations generally have been unable to scale up their operations—that is, to make a meaningful and sustainable impact by serving a larger percentage of those in need. The case for organizations working in a broad range of antipoverty program areas, including community development finance, micro-enterprise, workforce development, affordable housing, individual development accounts, youth initiatives, early child care services, social services, and low-income tax preparation. In short, the need for scale in the nonprofit community development and community development finance world has long overshadowed the individual achievements of these organizations. The result is high levels of frustration among practitioners *and* funders, as well as within the low-income communities they serve.

What Does Scale Mean?

For community development, scale means:

1. providing services to a large number of low-income people
2. providing services to a significant percentage of those in need
3. being able to leverage size to improve results
4. having enough capital to develop new products and services
5. getting beyond year-to-year funding concerns
6. capturing enough market share to influence for-profit providers, and
7. being significant enough to have a voice with legislators and regulators

The concept of scale is also shorthand for the related goals of scope, sustainability, and impact. To scale up a product or service, organizations must move well beyond marginal hand-to-mouth and year-to-year community development efforts. Serving more people (scope), being able to maintain operations over time (sustainability), and making a real difference in communities (impact)—taken together—are all components of successfully achieving scale.

Why Scale Matters

Larger organizations have many advantages, and the data collected for this study reinforce this point. First, larger CDFIs often have critical capacities that smaller CDFIs do not have. For example, large organizations have access to capital, market research, the ability to develop and test new products and services, and the infrastructure to deliver products and services efficiently and with consistent quality. These capacities allow larger organizations to effectively carry out their missions. Perhaps most importantly, once at scale, larger CDFIs can afford to attract and retain higher quality staff, including experienced specialists.

Larger CDFIs are also better able to leverage both the public and private sectors. Simply stated, they have more clout. To public officials and policymakers, scale communicates a constituency. In the case presented here, scale could give CDFIs a voice in shaping public policies. Similarly, large CDFIs have a greater ability to influence mainstream practices, persuading for-profit players to serve the underserved, go down-market, or develop more affordable products. A large customer base can attract private-sector partners who may be more willing to reduce fees or tailor products and services in return for access to greater volume. To attract Wall Street and other investors who think in terms of millions of dollars, organizations must be able to put that kind of money to work and have the organizational capacity to inspire investor confidence.

Finally, scale matters because it is in play everywhere—shaping our economy and our society. Small businesses often fail because they cannot compete with organizations of scale. In the retail sector, for example, giant retailers control suppliers. In their attempt to reduce costs, these retailers drive wages and benefits lower and push jobs off-shore.

Developing models for scale in the community finance sector can create an antidote to inefficiency, strengthen small organizations, and develop the blueprint that will promote thriving models of community development finance in urban and rural areas while maintaining the mission objectives of CDFIs.

Policy Recommendation 2

Promote the Availability of Longer Term Capital

The availability of long-term debt and equity capital for CDFIs, particularly loan funds, is one of the major structural issues facing the industry. The lack of long-term debt financing forces CDFIs to "hoard cash," pushing down leverage and giving the appearance that many underleveraged CDFIs are not lending as much as they could, thus neglecting demand among its targeted consumers. It is not a reluctance to borrow that pushes leverage down, it is the lack of long-term debt and equity or near-equity funding that is undermining the capital structure of many CDFIs.[18]

In addition, the lack of long-term capital distorts the CDFIs' product suite by default. Demand for longer-term consumer debt products is either not being met at all, or is being met by providing mismatches of assets and liabilities. Many CDFIs simply do not lend long, and the demand for long-term debt is either ignored or fit into the available product mix, which typically is a shorter-term debt product.

The CDFI Bond Guarantee Program, which will be able to offer long-term, fixed-rate debt financing, at terms just slightly above comparable Treasury securities may help address the issue of access to long-term, fixed-rate debt. Another possible source of this type of capital will be collaborations among CDFIs.

Policy Recommendation 3

Promote Streamlined Access to Industry Data

Consistent with policies that promote scale creation, is a policy that promotes the availability of transparent industry data from which managers can make informed decisions. Data are available for banks and credit unions, but not for loan funds or venture funds. Why not require applicants to the CDFI Fund or recipients of CDFI funding to provide uniform, consistent and accurate financial and performance data on their portfolio and operations? Bank and credit union quarterly reports can be provided using Financial Performance Reports FPR and Uniform Bank Performance Report UBPR data and call reports. Yet information for 60 percent of the industry (CDFI Loan Funds) is not available. Any understanding of the industry, and therefore any sensible planning, is severely handicapped by this lack of data.

The Carsey Institute supports any policies that will promote increased data transparency, timely (quarterly) reporting, and uniform reporting requirements.

In place of some of the current documentation required by the CDFI Fund, the Fund could consider creating a standardized quarterly report, similar to the call reports submitted by banks and credit unions, and require all CDFIs to submit them (or at least all CDFIs over a certain asset amount.) The Fund could make these reports public (like the Federal Deposit Insurance Corporation and the National Credit Union Administration do), which would be a great service to the industry. A quarterly call report that includes the impact data now required in the Fund's Institutional Level Report (ILR), would collect data more efficiently and would create standardized data from a universal data pool year after year. That report would accurately represent the industry and would provide meaningful data for research purposes. In addition, the CDFI Fund might consider assembling a group of CDFIs to meet with the Financial Accounting Standards Board (FASB) to establish a common set of industry reporting standards.

Policy Recommendation 4

Promote and Document Innovation

Every CDFI is slightly different, no matter what the institutional type. High performers have similar characteristics and operations. Many CDFIs are mission-bending, throwing out the capital net year after year, often linking programs and products to services. But it is often difficult to determine whether new programs are the result of innovation, or of copying other programs, or the result of "writing to the grant."

There are major, if unintended consequences for having no knowledge bank or other online resource for systematically cataloging or analyzing best practices. These information gaps stifle innovation and cause replication of ineffective approaches to capital deployment. Adequate data collection and performance metrics may diminish this consequence, but an institutional approach to promoting innovation, documenting the innovation and disseminating the results is critical in reducing overall inefficiencies within the field.

Policy Recommendation 5

Promote Education and Training

CDFIs need ongoing education and training on familiar issues: market definition, asset design, cash flow management, standardization of documentation, portfolio analysis, interest rate spreads, etc. Some need basic help with loan policies and procedures while many others need capitalization assistance and definition of that assistance.

Conclusion

The analysis suggests that the CDFI "story" is largely accurate. That story is that CDFIs are institutions that have learned to effectively manage the "risk" that discourages conventional financial institutions from serving low- and moderate-income individuals and communities. The data analysis suggests that CDFIs have succeeded in lending to and investing in individuals and communities not served by conventional financial institutions, while maintaining loan performance standards generally equivalent to those of the conventional financial sector. However, it is also true that the costs of serving these individuals and communities is somewhat higher because good performance is, in part, due to the additional technical and training services provided by most CDFIs. But some additional costs incurred by CDFIs could be mitigated if CDFIs, as a group, undertook certain changes in their operating procedures. Support for building CDFI "infrastructure," as described in this report could enhance the efficiency, productivity and impact of CDFIs. This report also suggests the need for additional research to address some of the ongoing issues faced by CDFIs including, but not limited to access to long-term capital, creating capacity for transformational activities, understanding of market failure/inefficiencies, and analysis of workforce development and retention issues for CDFIs.

Appendix: Summary Statistics

Industry Overview

Table 8: Breakdown of industry

	Number in Industry	CDFIs in industry	CDFIS examined
Loan funds	?	572	282
Credit unions	7,503	~197[19]	197
Banks	6,838	~72	72
Bank holding companies	3,984	~46	41
Venture funds	462[20]	25	-

CDFI Loan Funds

Data for CDFI Loan Funds were obtained from 2010 CDFI Program applications.[21] The applications contained usable information on 282 loan funds. The loan funds reported data for three of the fiscal years from 2005 to 2009, depending on their fiscal year convention. Asset sizes are shown in Table 9.

Table 9: CDFI Loan Funds by asset size

Asset size	% of applicants
<$500k	10.3%
$500k-$1M	8.2%
$1M-$5M	23.1%
$5M-$10M	13.1%
$10M-$50M	25.2%
$50M-$100M	6.0%
>$100M	13.5%

1. These funds grew at a rapid rate from 2006 to 2009.The net asset ratio grew slightly. With this growth came increased deployment of capital and at the same time a declining self-sufficiency ratio and operating liquidity.
2. More than half of all loan funds are engaged in multiple lines of business.
3. Leverage is significantly different by line of business, as is margin and loan yield. Median loan fund leverage is 1.1.
4. Larger funds are more leveraged and smaller funds are less leveraged. The smallest funds have the largest portfolio-at-risk ratios.
5. The median deployment ratio grew at an annual rate of 1.8 percent from 2006 to 2009.
6. The median self-sufficiency ratio declined at an annual rate of 6.6 percent from 2006 to 2009.

7. The median operating liquidity ratio declined at an annual rate of 1.4 percent from 2006 to 2009.
8. Charge-offs reached 3.1 percent in 2008. However, delinquencies declined in 2008 only to rise again in 2009 to 4.5 percent.
9. Business lenders had the highest delinquency and loan loss ratio in 2009 and real estate development lenders the highest charge-off and deployment ratio, but also the highest net income (all as medians) (see Tables 10 to 15).
10. Most loan funds do not have a definable or recognizable portfolio risk management system. Those that do generally outperform the others, but this may be a function of asset size.
11. Generally, size matters. As asset size gets larger, there tends to be less volatility in financial indicators, whether year to year, region to region, or line of business to line of business. Operational self-sufficiency[22] and combined interest and operating expense ratios[23] increase as asset classes become larger.

Table 10: CDFI Loan Fund leverage by asset size and line of business

Median leverage	2006	2007	2008	2009
All CDFI Loan Funds	1.249	1.228	1.209	1.101
<$500k	0.399	0.554	0.406	0.174
$500k-$1M	0.549	0.922	1.326	0.980
$1M-$5M	1.034	1.092	1.038	2.749
$5M-$10M	1.137	1.258	1.200	1.004
$10M-$50M	1.461	1.333	1.287	1.116
$50M-$100M	1.383	1.388	1.812	6.828
>$100M	4.994	4.145	5.396	2.228
Business lending	1.560	1.194	1.299	0.790
Home financing	0.624	1.088	0.989	1.256
Real estate development	0.782	1.454	1.852	2.634
Multiple business lines	1.273	1.172	1.129	1.064

Table 11: CDFI Loan Fund net asset growth by asset size and line of business

Medians	2006-2007	2007-2008	2008-2009
Net asset growth			
All CDFI Loan Funds	0.0655	0.0311	0.040
<$500k	0.143	0.071	0.077
$500k-$1M	0.020	-0.075	-0.003
$1M-$5M	0.035	0.032	0.045
$5M-$10M	0.042	0.045	-0.001
$10M-$50M	0.089	0.043	0.043
$50M-$100M	0.075	0.124	0.068
>$100M	0.206	-0.123	0.042
Business lending	0.076	0.011	-0.018
Home financing	0.072	0.064	0.049
Real estate development	0.009	0.056	-0.028
Multiple business lines	0.066	0.034	0.062

Table 12: CDFI Loan Fund portfolio at risk by asset size[24]

	2005	2006	2007	2008	2009
<$500k	0.0488	0.0508	0.0850	0.1209	0.3436
$500k-$1M	0.0933	0.0668	0.0870	0.0967	0.0544
$1M-$5M	0.0529	0.0600	0.0658	0.0612	0.0296
$5M-$10M	0.0938	0.0547	0.0382	0.0335	0.0499
$10M-$50M	0.0642	0.0382	0.0523	0.0585	0.0444
$50M-$100M	0.0332	0.0164	0.0164	0.0202	0.0187
>$100M	0.0249	0.0305	0.0352	0.0224	0.0378

Table 13: CDFI Loan Fund portfolio at risk by line of business[25]

	2005	2006	2007	2008	2009
Business lending	0.0508	0.0428	0.0417	0.0403	0.045
Home financing	0.0518	0.0264	0.0186	0.0296	0.040
Real estate development	0.0657	0.0168	0.0229	0.0310	0.018
Multiple	0.0374	0.0370	0.0440	0.0363	0.042

Table 14: CDFI Loan Fund policies and procedures

	Yes	No	In development	Unclear	N/A
Loan policies and procedures (n=282)	85.1%	1.8%	1.8%	10.7%	0.7%

Table 15: CDFI Loan Fund portfolio management systems

	Yes	No	Unclear
Portfolio management system (n=269)	84.8%	2.6%	12.6%

Risk Management

Eighty-three organizations stated that they had a risk management system. This report does not verify the quality of the systems, just the fact that they were reported. The systems are shown in Table 16.

Table 16: CDFI Loan Fund risk management systems

RMS type	Freq	%	Cum
Categories	1	1.20	1.20
Classification	3	3.61	4.82
Committee	1	1.20	6.02
Database	2	2.41	8.43
Factors	14	16.87	25.30
Grades	2	2.41	27.71
Grid	2	2.41	30.12
Letter	1	1.20	31.33
Matrix	4	4.82	36.14
Multi-point	4	4.82	40.96
Narrative	1	1.20	42.17
Numeric	25	30.12	72.29
Proprietary	1	1.20	73.49
Scorecard	3	3.61	77.11
Scoring	1	1.20	78.31
Software	1	1.20	79.52
Staff	3	3.61	83.13
Tier	4	4.82	87.95
Unclear	7	8.43	96.39
Web based	1	1.20	97.59
Weighted	2	2.41	100.00
Total	83	100	

Chart 4: CDFI Loan Fund portfolio at risk/portfolio by asset size

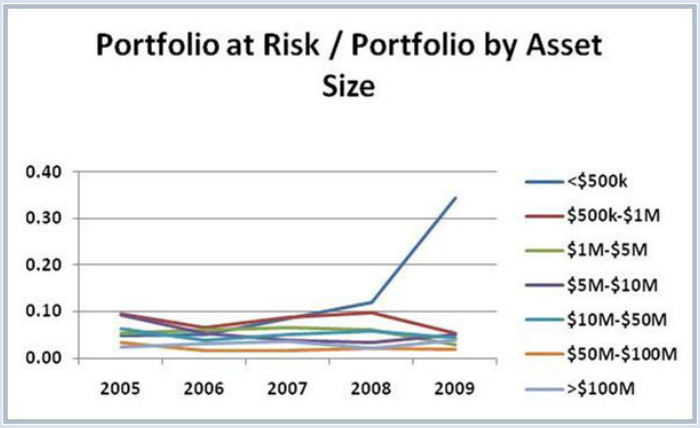


Chart 5: CDFI Loan Fund charge off /portfolio by line of business

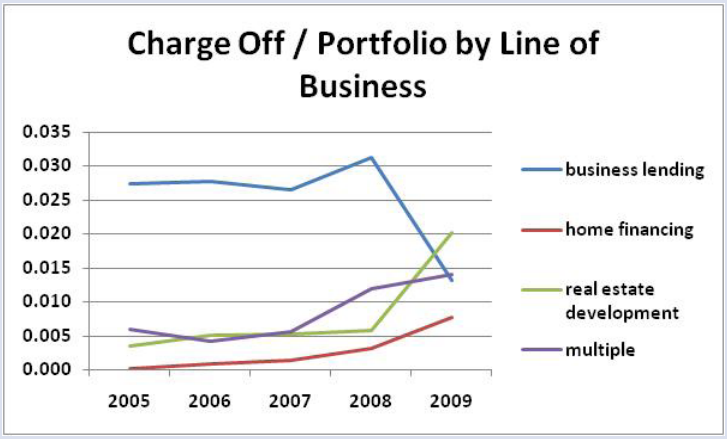


Chart 6: CDFI Loan Fund median summaries

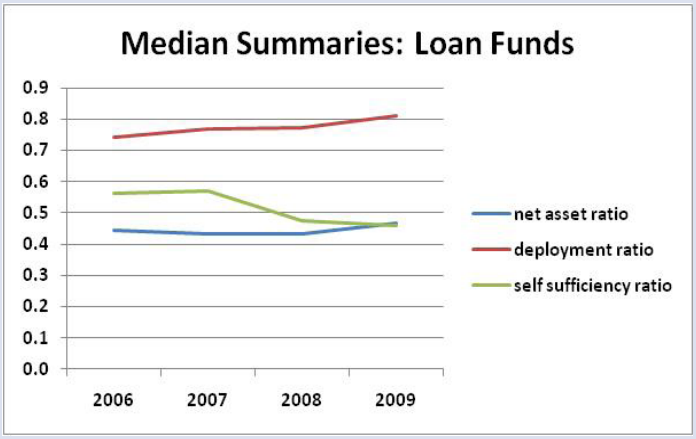
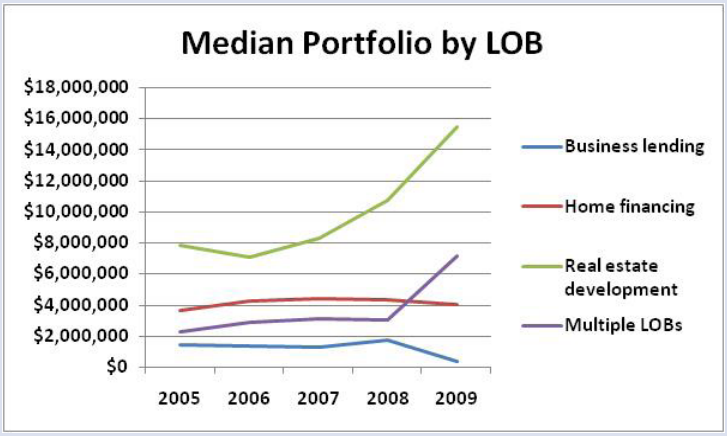


Chart 7: CDFI Loan Fund median portfolio size by line of business



CDFI Credit Unions

Data for credit unions were obtained from Financial Performance Report and Call Reports from the National Credit Union Association (see Table 17). Total CDFI credit union assets in 2010 were $9.6 billion. This is 1 percent of the credit union industry.

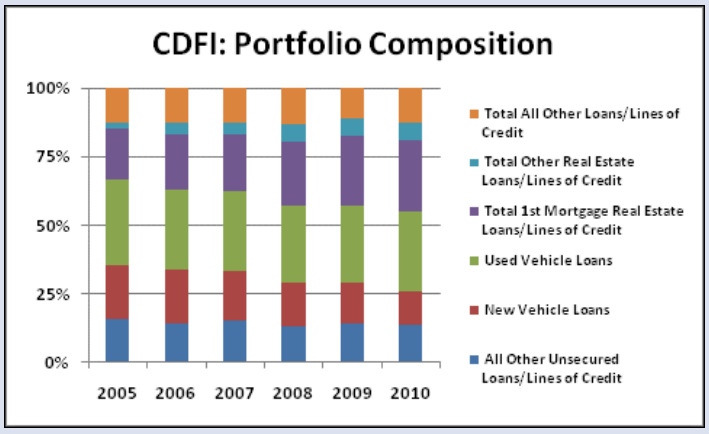
Table 17: CDFI Credit Unions by asset size

Asset size as of 2010	#	%
<$100M	161	81.7
$100M-$200M	10	5.1
$200M-$400M	11	5.6
>$400M	15	7.6
Total	197	100

Eighty-two percent of CDFI credit unions have assets of less than $100 million. CDFI credit unions had a higher total loans/total assets ratio than the industry in each of the six review years. 2010 levels of net income are 12 percent of 2005 levels. 2010 ROA was 0.34 percent.

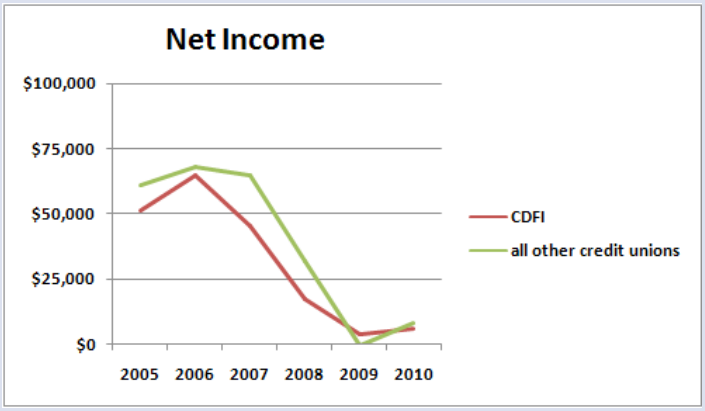
1. In several areas, CDFI credit unions outperformed the industry during the study period. Using 2010 as a comparison year, these areas included net worth to total assets, gross income to average assets, yield on loans, yield on investments, net margin and net interest margin over assets. In addition, CDFI credit unions showed stronger net worth growth, loan growth, asset growth, and membership growth (see Chart 8).

Chart 8: CDFI Credit Union portfolio composition



2. CDFI credit unions generally were more top heavy, that is, they had more employees per member. However, their employee expense was less.
3. The recession affected CDFI credit unions to a greater extent than the industry. In many areas—such as delinquent loans to total assets, delinquent loans to net worth, ROA, loan yield, net margin to assets—the entire industry bounced back in 2010, but CDFI credit unions did not (see Chart 9).

Chart 9: CDFI Credit Union net income



4. The portfolio mix of CDFI credit unions changed during the study period, with first mortgages increasing as a percentage of the portfolio and new car loans decreasing. CDFI credit unions in general have fewer unsecured lines of credit than traditional credit unions.
5. Delinquent loans to total loans continued to rise. The CDFI six-year ratio was 1.74 times the industry average. Yet, CDFI credit unions saw a median loan portfolio increase of 47 percent from 2005 to 2010. In 2010, delinquent loans/total assets were double the industry rate. Table 18 shows median portfolio delinquencies and median provision for loss.

Table 18: CDFI Credit Union delinquencies and provision for loss

Median $	2005	2006	2007	2008	2009	2010
Delinquencies						
CDFI credit unions		100,233	106,588	114,624	117,491	181,637
All other credit unions	79,053	78,254	87,460	72,321	120,402	113,803
Provision for losses						
CDFI credit unions	27,419	13,997	34,123	44,056	86,018	73,121
All other credit unions	24,916	21,186	23,000	36,000	51,132	45,000

6. CDFI credit unions had a lower cost of funds from 2005 to 2008. They pay their depositors less in the form of earnings on shares. In addition, for the six-year period, CDFI credit union fee income ratio was 31 percent higher than the industry. This shows up in net margin/average assets where CDFIs outperform the industry (see Tables 19 and 20).

Table 19: CDFI Credit Union median fee income

Median $	2005	2006	2007	2008	2009	2010
CDFI credit unions	77,683	95,528	99,704	130,158	125,445	132,337
All other credit unions	56,104	66,263	74,496	84,700	87,674	91,397

7. Between 2005 and 2010, the operating expense ratio of CDFI credit unions was 36 percent higher than the industry, and the ratio of net operating expenses to average assets was 27 percent higher for CDFI credit unions.

Table 20: CDFI Credit Union mean ROA

Mean ROA	2005-2010
<$100M	0.53
$100-$200M	1.37
$200-$400M	0.78
>$400M	0.93

8. CDFI credit unions have a higher ratio of total loans to total shares than the entire industry. The six-year average difference between the two groups in this ratio is 27 percent (higher for CDFI credit unions). Also, CDFI credit unions have a higher ratio of total loans to total assets than the entire industry. The six-year average difference between the two groups in this ratio is 8 percent (higher for CDFI credit unions).
9. Yet CDFI credit union members maintain a lower average share balance than industry standards. On average, this balance is 31 percent lower for CDFI credit unions. In 2010, the cash difference was $2,682 per share balance per person.
10. Size has an impact on CDFI credit unions,[26] although not always what one might expect (see Charts 10 and 11).
    a. Credit unions with smaller assets have a higher net yield, even accounting for losses and charge-offs.
    b. Smaller credit unions have higher non-interest income and higher non- interest expense.
    c. Smaller credit unions outperform their CDFI peers in most income categories.
    d. Their operating expenses as a percentage of their portfolio are higher.
    e. Their charge-offs are greater as a percentage of portfolios. Even so, their net yield is higher.
    f. Smaller credit unions have much higher office operations expense.

Chart 10: CDFI Credit Unions net worth/ total assets

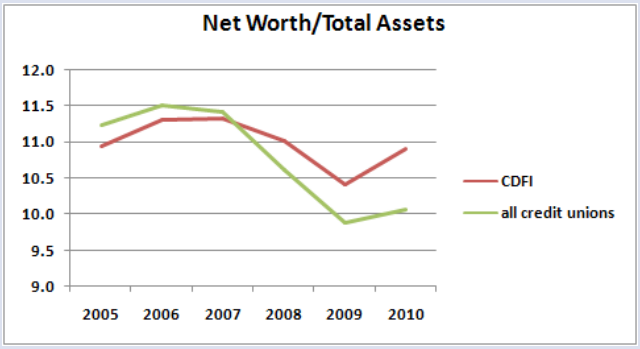
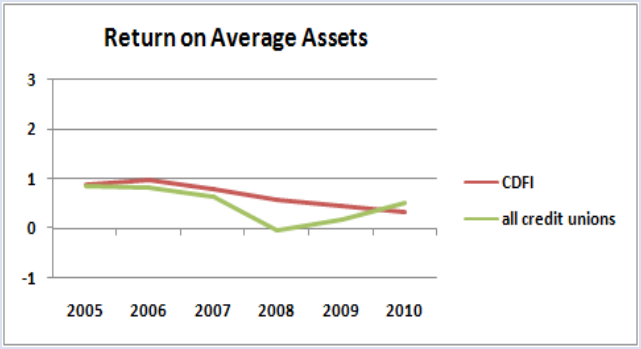


Chart 11: CDFI Credit Unions ROA



CDFI Banks

Data on banks comes from Uniform Bank Performance Reports. CDFI banks represent about 0.9 percent of the assets of the industry for banks greater than $10 billion in 2010 assets, and 0.2 percent of the total US banking industry. See Table 21 for a breakdown of CDFI Banks by asset size.

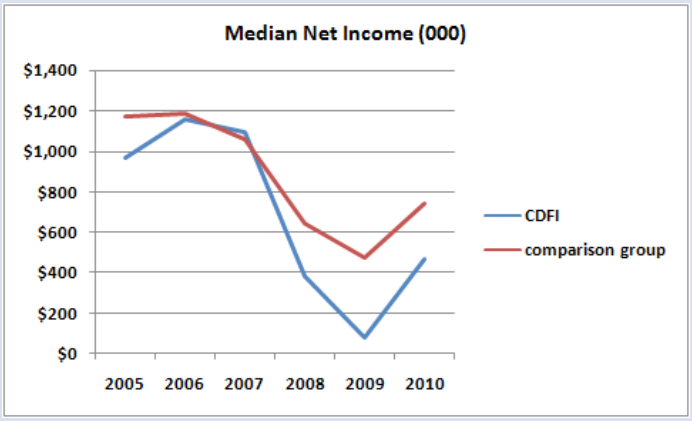
Table 21: CDFI Banks by asset size

Asset size as of 2010	#	%
<$100M	21	29.1
$100M-$300M	29	40.3
$300M-$600M	16	22.2
$600M-$1B	2	2.8
$1B-$3B	4	5.6
$3B-$10B	0	0.0
Total	**76**	**100**

CDFI banks differ from traditional banks in many respects. As a group, they underperform compared with other banks of similar asset levels in several areas, most importantly net income and operating expenses (as a percentage of assets). Yet CDFI banks earn more net interest income (see Chart 12).

1. Asset growth was positive in each year studied, although this growth slowed to 0.3 percent in 2009-2010.
2. The capital structure of CDFI banks is only slightly different from traditional banks, with less retained earnings held in equity. Similarly, there are differences in portfolio composition, with CDFIs holding more real estate and commercial and industrial loans. However, CDFI banks are not remarkably different from their non-CDFI counterparts.

Chart 12: CDFI Banks median net income



3. CDFI banks hold greater percentages of real estate loans in their portfolio: 78 percent compared with 72 percent for traditional banks.
4. CDFI banks hold a greater percentage of commercial and industrial loans.
5. CDFI banks outperform the industry in two key areas:
   a. net interest and non-interest income as a percentage of assets
   b. yield on loans
6. CDFI banks underperform in the following areas:
   a. higher interest expense
   b. higher non-interest expense
   c. lower pre-tax operating income
   d. lower net income
   e. greater provision for losses
   f. lower asset earnings
7. Two major operational differences between CDFI banks and the comparison group are interest income and non-interest expense (see Table 22).

Table 22: CDFI Banks financial metrics

Percent of assets	CDFI	Comparison group
Total interest income	6.19	5.74
Interest expense	2.17	2.08
Net interest income	3.95	3.74
Provision for loss	0.51	0.26
Net interest income less provision	3.44	3.48
Non-interest income	0.89	0.60
Non-interest expense	3.72	3.03
Non-interest income—non-interest expense	-2.83	-2.43
Net income	0.52	0.83

8. There is a size advantage within the CDFI industry, with larger banks outperforming smaller banks. The advantage also applies to the comparison group, i.e., other banks with assets greater than $10 billion, in which performance improves in direct relation to size. With CDFIs, performance drifts with size, but the drift generally corresponds to the comparison group (in terms of slope).
    a. Banks in the comparison group maintain their scale from one asset group to the next in terms of fixed costs, while CDFIs do not.
    b. While the industry shows declining yields on all loan products as the size of the bank increases, CDFI banks do not show this effect with individual, commercial and industrial and credit card loans.
    c. Smaller CDFIs earn more interest income.
    d. Net income as a percentage of average assets increases with size.
    e. Net loss to total loans and leases increases from low to high asset group.
    f. Earnings coverage increases from low to high asset group.
    g. Unlike the comparison group, the CDFI banks show a lower percentage of past due loans as assets increase.

CDFI Bank Holding Companies

Data on bank holding companies came from FR Y-9C and FR Y-9LP data. In 2010, CDFI holding companies represent less than 0.03 percent of the total assets of the industry—and this is shrinking in comparison with prior review years.

Assets rose 102 percent for the industry between 2005 and 2010, but only 37.5 percent for CDFI holding companies.

Table 23: CDFI Bank Holding Companies by asset size

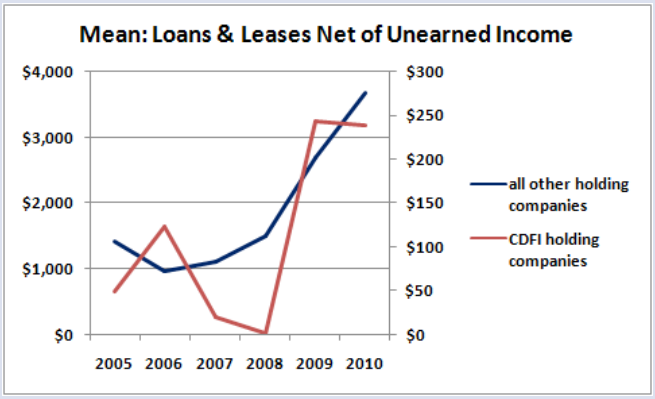
Asset size as of 2010	#	%
<$100M	40	93.0%
$100M-$200M	2	4.7%
$200M-$400M	1	2.3%
>$400M	-	-
Total	**43**	**100%**

CDFI holding companies represent a certain class of financial institution within the CDFI field. They own banks, but unlike traditional banks, many of them do not have deposits, hold a portfolio, or make loans. Their principal revenue sources are dividends, interest, management fees, and other fees. They grow their balance sheet through undistributed equity income in subsidiaries. In addition, they have the ability to shift performing and non-performing assets around, making analysis difficult.

When looking at CDFI holding company performance, the effects of the recession are evident, although interpretation is difficult. The underlying performance certainly has an impact on the balance sheet and income statement of the holding company, but the connection is not always direct (see Charts 13 to 15).

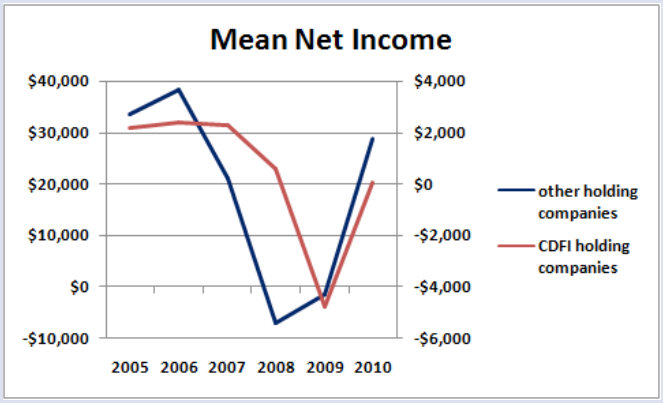
1. CDFI holding companies' fortunes declined far more than the comparison group in 2008 and 2009 and did not rebound as much as other holding companies did in 2010.

Chart 13: CDFI Bank Holding Companies mean loans and leases net of unearned income



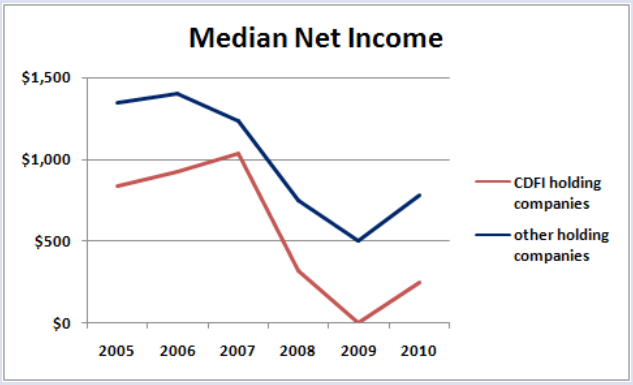
2. Median asset growth rate spiked in 2009 but declined in 2010, while for the industry the upward trend continued.
3. For the relatively few CDFI holding companies (three) with loans on their balance sheets, 2009 saw a marked rise in the dollar values of these loans.
4. Dollars in investments declined, but short-term borrowings skyrocketed in 2009 and 2010 for the few CDFI holding companies using this vehicle (five), unlike the rest of the industry.
5. Long-term borrowing skyrocketed also in 2009 for the 11 CDFI holding companies using this vehicle, reflecting an identical practice within the industry.

Chart 14: CDFI Bank Holding Companies mean net income



6. Equity composition has changed during the years reviewed. Preferred stock replaced retained earnings as the equity vehicle of choice in 2009 and 2010. This was not the industry practice, which showed a decline in preferred stock dollar values.
7. Retained earnings fell substantially in 2009 and 2010.
8. Median dividend income fell to zero in 2009 and 2010 and operating income plunged. Other expenses, which were always higher than the industry, climbed in 2005 through2007 and then began to decrease. However, CDFI median values are much higher than the industry. Median net income for CDFI holding companies fell to zero in 2009, and mean net income declined in 2007 through2009, with a slight rebound in 2010.

Chart 15: CDFI Bank Holding Companies median net income



ENDNOTES

1. The Industry Analysis was funded by th CDFI Fund, under Contract TPD-CDF-10-C-0003, Task Order 0002 and 0003. The curriculum and opinions expressed in these documents are those of the authors, who are solely responsible for the content, and do not reflect the opinions of the CDFI Fund or any other person, entity, or organization."

2. Although 282 CDFI Loan Funds were sampled, the outstanding question is: are the CDFI Loan Funds examined (as a result of their applying for 2010 funding to the CDFI Fund) different than those that did not apply? If one assumes that they are no different, then the results presented are representative of all CDFI Loan Funds, within the confidence levels and error margins discussed below. If, in fact, they are different, then the results may be representative of all CDFI Loan Funds. For CDFI Banks, CDFI Holding Companies and CDFI Credit Unions, a census was performed; in other words the data represents all of these CDFI institutions.

3. CDFI certification is a designation conferred by the CDFI Fund. An organization must be a legal entity and have a primary mission of promoting community development; serve principally an investment area or targeted population; be an insured depository institution, or make loans or development investments as its predominant business activity; provide development services (such as technical assistance or counseling) in conjunction with its financing activity; maintain accountability to its target market; and be a non-governmental entity and not be controlled by any governmental entities. CDFI certification is a requirement for accessing a Financial Assistance award from the CDFI Fund through the CDFI Program and the NACA Program, and certain benefits through the BEA Program.

4. The tilde (~) is an approximation. The CDFI list of certified CDFIs referenced in the body of the report lists more CDFIs than there is available information. Data were available on the number with the tilde. The difference between the CDFI list and the number with the tilde can be accounted for by non-reporting of those institutions comprising the discrepancy.

5. Frequently Asked Questions About Venture Capital, National Venture Capital Association. Available at http://www.nvca.org/index.php?Itemid=147&id=119&option=com_content&view=article.

6. Median loans and lease value.

7. See http://www.sba.gov/content/small-business-administration-sba-loan-program-performance.

8. The N value for all CDFI credit unions used throughout this report = 197. The N value for non CDFI credit unions is 7,503.

9. The N value for all CDFI banks used throughout this report = 72. The N value for non CDFI banks is 6,838.

10. In this table, each year's number is averaged, so there is one number per organization. The median number is then taken. The N value for all CDFI Loan Funds is 282.

11. Leverage ratio = total notes payable/net assets.

12. Margin ratio = loan yield ratio minus charge-off ratio – combined interest and operating expense ratio.

13. This number is the average of each year's median deployment ratio.

14. This number is the average of each year's median charge-off ratio.

15. For instance, a bank accepts deposits and "transforms" them into loans. A loan fund would similarly take net assets and or debt and transform them into loans to borrowers.

16. This equals the mean of the reporting years for each CDFI.

17. Kirsten Moy et al, New Pathways to Scale in Community Development Finance. Profitwise News and Views, December 2004. Available at http://www.aspeninstitute.org/publications/new-pathways-scale-community-development-finance-paper-published-profitwise-news-and-vi.

18. For a full discussion of this issue see Capital Markets, CDFIs and Organizational Credit Risk, by Charles Tansey, Michael Swack, Michael Tansey and Vicky Stein, the Carsey Institute, 2010. Available at http://www.carseyinstitute.unh.edu/docs/Swack_CapitalMarkets.pdf.

19. The tilde (~) in the table at the top of page three is an approximation. The CDFI list of certified CDFIs referenced in the body of the report lists more CDFIs than there is available information. Data were available on the number with the tilde. The difference between the CDFI list and the number with the tilde can be accounted for by non-reporting of those institutions comprising the discrepancy.

20. Frequently Asked Questions About Venture Capital, National Venture Capital Association. Available at http://www.nvca.org/index.php?Itemid=147&id=119&option=com_content&view=article.

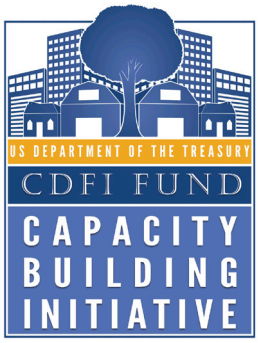
21. The CIIS data was reviewed early on. It could not be used due to insufficient CDFI sample size. This led to a request to look at 2010 CDFI Fund application data. From the application data, three years of financial data for 282 loan funds could be analyzed. This is a sufficient sample size to generalize to all loan funds if needed. If generalized to all CDFI loan funds, one assumes that the CDFIs that applied are similar to the CDFI Funds that did not apply, which may or may not be correct. With venture funds, no data was collected. There is no public source of venture fund performance data. On the other hand, CDFI banks and credit unions suffer from too much information, and one can make so many comparisons that distillation of the information is cumbersome as is any interpretation. However, in keeping with a liquidity capitalization and portfolio framework, this is what was attempted.

22. [Interest Payments from Financial Products + Fee Income from Financial Products, Financial Services, and other activities] divided by Total pre-tax Expenses.

23. [Total pre-tax Expenses - Net Write-Offs or Net Charge-Offs] divided by Total Gross Loans Receivables and/or Equity Investment Portfolio.

24. Sum of dollar value divided by sum of outstanding portfolio.

25. Sum of dollar value divided by sum of outstanding portfolio.



The CDFI Fund was created for the purpose of promoting economic revitalization and community development through investment in and assistance to community development financial institutions (CDFIs). The CDFI Fund was established by the Riegle Community Development and Regulatory Improvement Act of 1994, as a bipartisan initiative.

Since its creation in 1994, the CDFI Fund has awarded over $1.3 billion to CDFIs, community development organizations, and financial institutions through the CDFI Program, the Bank Enterprise Awards program, the Native American CDFI Assistance program, the Capital Magnet Fund, and the Financial Education and Counseling Pilot Program. In addition, the CDFI Fund has allocated $33 billion in tax credit authority to community development entities through the New Markets Tax Credit Program.

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