The CDFI Data Project

Providing Capital, Building Communities, Creating Impact

Community
Development
Financial
Institutions

Fiscal Year 2003

Third Edition

A Publication of the CDFI Data Project

This report is a product of the CDFI Data Project (CDP)—an industry collaborative that produces data about Community Development Financial Institutions (CDFIs). **The goal of the CDP is to ensure access to and use of data to improve practice and attract resources to the CDFI field**. *CDFIs: Providing Capital, Building Community, Creating Impact* analyzes fiscal year 2003 data collected through the CDP from 477 CDFIs.

A Publication of the CDFI Data Project

Written by the CDP Publication Committee:

- Aspen Institute
- Community Development Venture Capital Alliance
- National Federation of Community Development Credit Unions
- National Community Capital Association
- National Community Investment Fund

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Table of Contents

I. Executive Summary 2

II. The CDFI Industry Overview 6

III. Community Development Banks 21

IV. Community Development Credit Unions 26

V. Community Development Loan Funds 31

VI. Community Development Venture Capital Funds 35

VII. Microenterprise Financing 42

Appendix A: Methodology 47

Appendix B: Glossary of Terms 48

Appendix C: The CDFI Data Project 50

Executive Summary

The fiscal year (FY) 2003 data on the Community Development Financial Institution (CDFI) industry demonstrate that the CDFI industry continues to grow and change, while retaining its focus on strong financing performance and increasing impact in low-income communities throughout the United States. This study, which includes data from 477 CDFIs in FY 2003, one of the largest data sets ever collected on the CDFI industry, demonstrates that:

CDFIs are producing a wide range of positive social impacts in low-income communities in the form of new high-quality jobs, affordable housing units, community facilities, and financial services to low-income people. In FY 2003, CDFIs achieved the following:

- Provided $4.1 billion in financing
- Financed and assisted 9,211 businesses that created or maintained 32,030 jobs
- Facilitated the construction or renovation of 44,689 units of affordable housing
- Built or renovated 768 community facilities in economically disadvantaged communities
- Provided 9,285 alternatives to payday loans and helped 9,234 low-income individuals open their first bank account[1]

CDFIs serve niche markets in economically disadvantaged communities throughout the United States that are not adequately served by conventional financial markets. CDFI customers were 52% female, 59% minority, and 69% low income, all much higher proportions than in mainstream financial institutions. These customers typically are those who have been turned down by conventional financial institutions because they do not have sufficient collateral or do not have sufficient capacity and resources to borrow from banks.

CDFIs finance transactions in low-income communities in a prudent and effective way. CDFIs are adept at managing risks through a combination of solid capital structures and loan loss reserves, close monitoring of portfolios, and technical assistance, as needed. In 2003, CDFIs had a net charge-off ratio of 0.7%, which rivals the net charge-off ratio of 0.78%[2] for all financial institutions. Delinquency ratios are also relatively low. Banks and loan funds had delinquency rates greater than 90 days of 1.6% and 3.5%, respectively, and credit unions, which measure delinquency by a different metric, had a delinquency rate greater than 60 days of 1.7%.

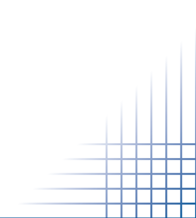
CDFIs continue to grow and change in response to changes in the market. The 477 CDFIs in this study held $13.1 billion in assets and $8.4 billion in financing outstanding. For CDFIs for which we have four years of data (263 CDFIs), financing outstanding grew at a compound annual growth rate (CAGR) of 18%. CDFIs are growing at a time of decreasing subsidy available to CDFIs from government sources and financial institutions.

Market Changes, Challenges, and Innovations

The CDFI industry is changing rapidly as a result of changes in economic and demographic trends in the communities CDFIs serve as well as shifts in public and private funding sources. CDFIs have responded with new strategies, new products, and new ways of doing business. They are making these transformations while maintaining strong loan and investment portfolios that create substantial impact in low-income communities across the United States. A few of the key ***challenges*** facing the industry include the following:

- **Subsidy**: The CDFI industry is facing a decline in subsidy from both private and public sources. Funding for the CDFI Fund, the Small Business Administration (SBA), and other key federal programs that support CDFIs has declined during the Bush administration, and the president's FY 2006 budget proposal includes substantial decreases to and consolidation of these programs and other programs that support community development finance. At the same time, several foundations that have supported CDFIs for years are moving on, while other foundations have reduced their support.
- **Banking Industry Changes**: The banking industry continues to go through regulatory and operational changes that impact banks' activity with CDFIs and CDFI customers. The Community Reinvestment Act (CRA), which places responsibilities on depository institutions to lend to, invest in, and serve all of the communities in which they receive deposits from customers, is under attack. The four federal agencies that regulate banks and thrifts have recently proposed changes that would, in particular, diminish the importance of bank investments in CRA evaluations and likely result in a decline in such regulatory-motivated investments in CDFIs. Also, bank consolidation continues at a rapid pace, resulting in fewer and fewer banks to partner with CDFIs and few branches operating in low-income neighborhoods, decreasing financial services for low-income customers in these markets. Because bank investments have been a key component of CDFI growth during the past decade, these changes in the banking industry pose challenges for the CDFI industry.
- **Access to Credit**: CDFIs work to address issues of poverty and access to credit in economically disadvantaged communities. In low-income communities, more and more customers are obtaining financial services from predatory lenders that are charging exorbitant rates and fees and draining wealth from their low-income clients. According to the Center for Responsible Lending, a research and policy organization, borrowers lose an estimated $9.1 billion per year due to predatory lending. In addition, although the economy is unlikely to expand in the next few years at the same rate as in the past, the gap between the rich and the poor is likely to increase. There remain at least 12 million households, and possibly many more, that are unbanked, and check-cashing and other high-cost financial companies are increasingly the choice of low-income households.

[1]The 9,285 payday loan alternatives and 9,234 unbanked customers are based on the community development credit unions (CDCUs) that responded to the survey; the National Federation of Community Development Credit Unions estimated this figure to be 21,416 for payday loan alternatives and 74,300 new accounts to unbanked customers in FY 2003 for the entire universe of CDCUs.
[2]Source: Federal Deposit Insurance Corporation, December 2003



The CDFI industry is ***developing solutions*** that focus on scale, efficiency, sustainability, and access to capital markets to address these and other challenges in their markets. The changes taking place are both at the system level, with new industry products and ways of doing business, and at the individual CDFI level, to improve their efficiency and delivery of services. Some examples of the innovations taking place in the industry include the following:

- **CDFIs are increasing earned income to improve self-sufficiency** and rely less on grant subsidy. CDFIs are generating higher fees by providing loan servicing, packaging, and underwriting for third parties and increasing fees and fee-based consulting services.
- **CDFIs are being smart about use of subsidy**. Subsidy is essential for the industry to fund research and development of new products, as well as CDFI core technical assistance programs to increase the capacity of their borrowers. As subsidy declines, CDFIs are working to dissect their business models to understand where subsidy is needed and use subsidy only when it is essential.
- **CDFIs are developing partnerships to work more efficiently together**. These partnerships include mergers among CDFIs, loan participations, and staff sharing.
- **CDFIs are integrating more with capital markets** by using more conventional financial products than ever before. Some examples include loan sales, interest rate swaps, and lines of credit, which help CDFIs manage liquidity and capital.
- **CDFIs are reevaluating their business models** to determine which tasks can be disaggregated, outsourced, or consolidated to provide for a more efficient delivery system and reduce operating costs.
- **CDFIs are making good business decisions that will lead to a more sustainable business model**. These decisions may include reevaluating the provision of technical assistance, laying off staff due to outsourcing, and saying no to grant dollars that will divert the CDFI's attention from its core strategy.

CDFIs in our sample had more than $8 billion of financing outstanding in low-income communities throughout the United States; they have proven that investing in low-income communities can be profitable, prudent, and successful, and are changing and innovating to ensure that they are permanent and growing resources for their clients and in their communities. See Figure 1 for a summary of key FY 2003 statistics.

Figure 1 Summary of FY 2003 CDFI Data

	All	Bank	Credit Union	Loan Fund	Venture Capital
Number of CDFIs	477	32	265	159	21
Total assets	$13,130,624,455	$5,696,108,790	$4,002,019,546	$3,242,342,456	$190,153,663
Average assets	$27,643,420	$178,003,400	$15,101,961	$20,392,091	$10,008,088
Total FTEs	6,151	2,219	1,587	2,265	80
	n=316	n=32	n=116	n=151	n=17
Total direct financing outstanding	$8,359,819,344	$3,500,541,169	$2,831,726,421	$1,923,383,943	$104,143,662
Average direct financing outstanding	$17,939,526	$109,391,912	$10,685,760	$12,822,560	$5,785,759
% of direct financing outstanding ($)	n=293	n=17	n=116	n=142	n=18
Business	19%	33%	3%	16%	98%
Community service	8%	14%	0%	11%	1%
Consumer	23%	8%	64%	0%	0%
Housing	44%	34%	29%	67%	0%
Micro	1%	0%	1%	3%	1%
Other	5%	11%	3%	2%	1%
% of direct financing outstanding (#)	n=291	n=16	n=116	n=141	n=18
Business	3%	15%	0%	13%	69%
Community service	1%	2%	0%	5%	2%
Consumer	75%	47%	88%	1%	0%
Housing	12%	19%	6%	54%	0%
Micro	4%	1%	1%	27%	28%
Other	6%	16%	6%	0%	0%
Net charge-off ratio	0.7%	0.3%	0.8%	1.0%	NA
Delinquency rate > 90 days	NA	1.6%	NA	3.5%	NA
Delinquency rate > 2 months	NA	NA	1.7%	NA	NA
Total capital [a]	$12,346,891,241	$5,484,704,000	$3,967,071,321	$2,577,098,304	$318,017,616
Average capital	$26,048,294	$171,397,000	$14,970,080	$16,519,861	$15,143,696
% of debt capital from: [b] [c]	n=276	n=15	n=116	n=137	n=8
Banks, thrifts, and credit unions	12%	1%	2%	47%	26%
Corporations	8%	19%	1%	2%	2%
Federal government	3%	1%	0%	9%	23%
Foundations	4%	0%	0%	15%	43%
Individuals	59%	63%	89%	3%	0%
National intermediaries	1%	0%	1%	3%	2%
Nondepository financial institutions	2%	0%	0%	7%	3%
Other	4%	1%	5%	5%	0%
Religious institutions	2%	1%	1%	5%	0%
State government	6%	12%	1%	5%	1%

Notes:
(a) Total capital for VC funds includes capital committed (and not drawn down).
(b) Debt capital includes borrowed funds, EQ2, secondary capital; shares, and deposits; debt capital breakout does not include credit union borrowings.
(c) One outlier is excluded from debt capital breakouts for loan funds.

The CDFI Industry Overview

CDFIs are specialized financial institutions whose core purpose is to provide financial products and services to people and communities underserved by traditional financial markets. Currently, approximately 1,000 CDFIs operate in low-wealth communities in all 50 states, the District of Columbia, and Puerto Rico. CDFIs provide affordable banking services to individuals and help finance small businesses, affordable housing, and community services that, in turn, help stabilize neighborhoods and alleviate poverty. In addition, CDFIs provide credit counseling to consumers and technical assistance to small business owners and housing developers to help them use their financing effectively.

CDFI customers include a range of individuals and organizations:

- **Small business owners** who bring quality employment opportunities and needed services to economically disadvantaged communities
- **Affordable housing developers** who construct and rehabilitate homes that are affordable to low-income families
- **Community service providers** that provide childcare, health-care, education, training, arts, and social services in underserved communities
- **Individuals** who require affordable banking services, including basic checking and savings accounts, responsible alternatives to predatory financial companies, and mortgages and other kinds of loans

Why Are CDFIs Needed?

A growing gap exists between the financial services available to the economic mainstream and those offered to low-income people and communities. CDFIs help bridge that gap by bringing capital and financial services to these underserved people and communities, affording them access to capital to start and expand businesses, build and purchase homes, and develop needed community facilities.

As mainstream lenders have increasingly consolidated, grown in size, and streamlined their operations, their connections to local communities have diminished. Millions of families today either have no relationship with mainstream lenders or depend on fringe financial institutions. This exacerbates long-standing difficulties that low-income families, and the nonprofit institutions that serve them, have had in accessing credit and financial services.

In the absence of these conventional financial service providers, high-cost check-cashing services and payday lenders have moved into low-income communities. They prey on unsophisticated borrowers, draining wealth from these distressed neighborhoods and contributing to the growing economic inequality in the United States. Payday lenders offer quick cash but charge exorbitant interest rates. Check-cashing companies are increasingly becoming the financial service institutions of choice for low-income people, creating a dual system for delivery of financial services. CDFIs offer responsible alternatives to these predatory lenders, providing necessary products and services at a fraction of the cost to consumers.

Mainstream financial institutions also do not sufficiently meet the capital needs of nonprofit institutions that provide critical community services in economically disadvantaged communities and of small businesses that employ people and provide services in low-income communities. These organizations often do not have enough collateral to meet conventional banking standards or do not have the capacity and resources to borrow from banks. CDFIs are able to use their flexible capital products, coupled with critical technical assistance, to serve these markets and at the same time manage their risks.

CDFIs respond to market needs for affordable housing, small business development and job creation, the creation of community facilities, financial literacy, and consumer education. They also provide safe and fair mechanisms for low-income customers to do such simple things as opening a checking account and obtaining a mortgage.

CDFI activities fit into two broad categories. First, all CDFIs provide financial services, which include activities such as loans, equity investments, deposits, and consumer financial products. Second, virtually all CDFIs also provide nonfinancial services. For some organizations, these represent fairly modest complements to their larger financial service activities; for others, they represent the majority of the organization's work. These activities include entrepreneurial education, organizational development, homeownership counseling, savings programs, and financial literacy training.

The Four Sectors of the CDFI Industry

As with mainstream lenders, a variety of institutions have emerged to serve the broad range of needs in CDFI markets. Although sharing a common vision of expanding economic opportunity and improving the quality of life for low-income people and communities, different business models and legal structures define the four CDFI sectors: banks, credit unions, loan funds, and venture capital (VC) funds. Chapters III through VI provide a more in-depth analysis of each of the CDFI types.

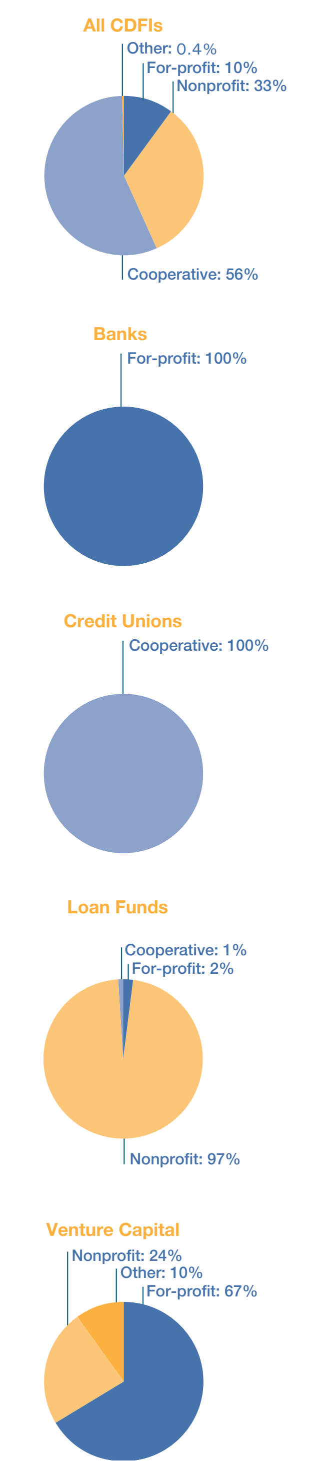
- **Community development banks** provide capital to rebuild economically distressed communities through targeted lending and investing. They are for-profit corporations with community representation on their boards of directors. Depending on their individual charters, banks are regulated by some combination of the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and state banking agencies. Their deposits are insured by the FDIC.
- **Community development credit unions (CDCUs)** promote ownership of assets and savings and provide affordable credit and retail financial services to low-income people, often with special outreach to minority communities. They are nonprofit financial cooperatives owned by their members. Credit unions are regulated by the National Credit Union Administration (NCUA), an independent federal agency, by state agencies, or both. In most institutions, deposits are also insured by the NCUA.
- **Community development loan funds (CDLFs)** provide financing and development services to businesses, organizations, and individuals in low-income communities. There are four main types of loan funds: microenterprise, small business, housing, and community service organizations. Each is defined by the client served, though many loan funds serve more than one type of client in a single institution. CDLFs tend to be nonprofit and governed by boards of directors with community representation.
- **Community development venture capital (CDVC) funds** provide equity and debt-with-equity-features for small and medium-sized businesses in distressed communities. They can be either for-profit or nonprofit and include community representation.

Within certain constraints, CDFIs choose the legal structure that maximizes value and resources for the people and communities they serve. The different corporate structures allow for different capitalization products, financing products, and regulations.

As demonstrated in Figure 2, community development banks are all for-profit entities and CDCUs are nonprofit cooperatives with members (and customers) as shareholders. Nearly all of the depositories—credit unions and banks—are regulated by state or federal agencies (or both) and use insured deposits and shares to capitalize their organizations.

The vast majority of CDLFs (97%) are nonprofit. The CDVC field is the most varied, with two-thirds structured as for-profits, 25% as nonprofits, and the remaining as quasi-government. The for-profit category includes limited liability companies (LLCs), limited partnerships (LPs), and C-corporations among their corporate structures. The loan funds and venture funds are unregulated institutions.

Figure 2
Legal Structures of CDFIs



Timeline of CDFIs

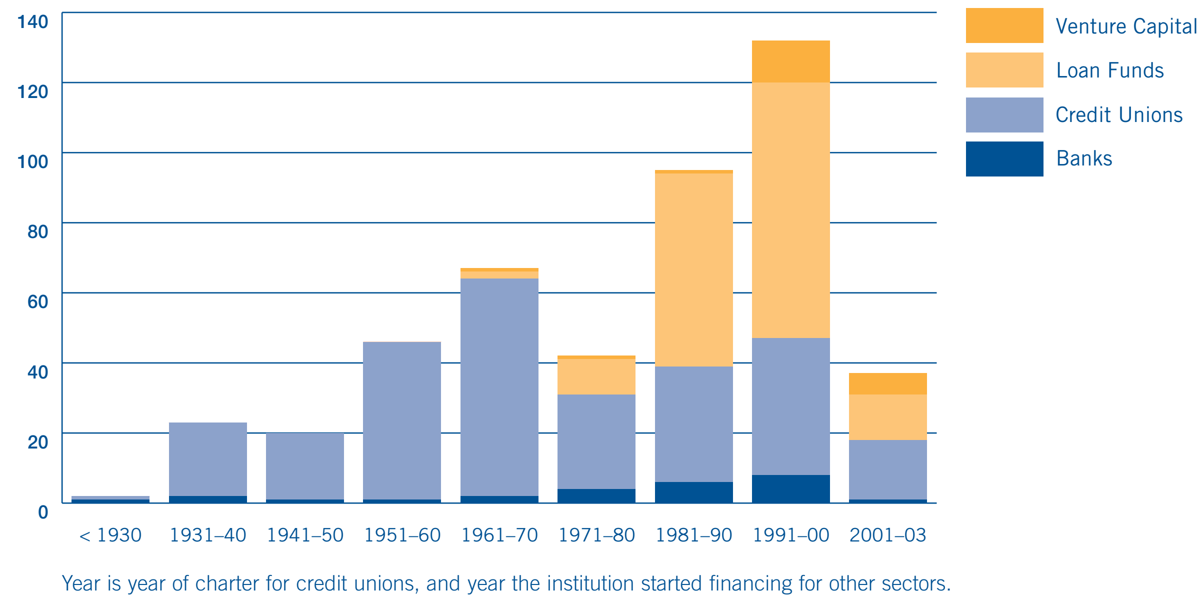
The roots of the CDFI industry go back to the early 1900s. Some of the first CDFIs were depository institutions including credit unions and banks. They collected savings from the communities they served in order to make capital for loans available to those communities. Credit unions and banks dominated the CDFI field until the 1960s and 1970s when community development corporations and CDLFs emerged to make capital available for small businesses and affordable-housing developers.

In the 1990s, the CDFI industry grew significantly. Thirty-six percent of the CDFIs in our sample were established after 1990. Several factors contributed significantly to this growth, most notably the creation and subsequent growth of the CDFI Fund (see p. 11). The federal government also strengthened provisions and enforcement of the CRA during the 1990s.[3] In particular, the 1995 CRA regulations, which classified loans and investments in CDFIs as qualifying CRA activities, increased those activities. National trade associations and intermediary organizations played a crucial role, emerging as important players dedicated to organizing and professionalizing the CDFI industry. A range of CDFIs have also emerged to serve the needs of Native American populations in the last couple of years. Most important, by the mid-1990s, the industry had established a successful track record of making effective, prudent use of capital in economically disadvantaged markets.

In the last two years, the industry appears to have slowed down the growth of new CDFIs, while consolidating and growing the existing CDFIs. In 2002 and 2003, 16 new CDFIs were established (from our sample), compared with 32 that were established in the prior two years (2000 and 2001). In addition, the industry is just beginning to experience its first few mergers, but we expect that trend to continue during the next couple of years. At least two CDFIs in the CDFI Data Project (CDP) sample were involved in mergers in the last year, and at least 15 additional CDFIs are involved in merger/consolidation discussions.

The four institution types have distinct histories and growth trajectories (see Figure 3). Community development banks and credit unions are the most mature sectors, with institutions dating back to the turn of the 20th century. They have had slow and steady growth for the past several decades. Loan funds are much newer, with 84% of this sector established in the 1980s and 1990s. VC funds are newer still: only two VC funds in this study began financing before 1980, and 76% started financing after 1996.

Figure 3 **Number of New CDFIs by Decade**



Year is year of charter for credit unions, and year the institution started financing for other sectors.

[3]The Community Reinvestment Act of 1977 places responsibilities on depository institutions to lend to, invest in, and serve all of the communities in which they receive deposits from customers.

What Is the CDFI Fund?

In 1994, the federal government established the CDFI Fund as a new program within the U.S. Department of the Treasury. Its goal is to strengthen the growing network of CDFIs, using them to make capital and financial services available to the nation's underserved people and communities. The CDFI Fund operates three principal programs:

- The **CDFI Program** provides loans, equity investments, and grants to CDFIs to support capitalization and capacity building, enhancing the ability of CDFIs to create community development impact in underserved markets. This program comprises three components: financial assistance, technical assistance, and Native American CDFI development assistance.
- The **Bank Enterprise Award (BEA) Program** provides financial incentives to banks and thrifts to invest in CDFIs and support other community-development finance work.
- The **New Markets Tax Credit Program** is a new effort to provide tax incentives to the private sector to encourage companies to make more than $15 billion in investments in low-income communities.

The CDFI Fund is now one of the largest single sources of funding for CDFIs and the largest source of hard-to-get equity capital. It plays an important role in attracting and securing private dollars for CDFIs by requiring them to match their award with nonfederal funds; the Fund reports that $1 of its investment leverages $21 of private sector investments. Between 1995, its first year of funding, and 2004, the Fund made more than $720 million in awards to CDFIs and financial institutions through the CDFI and BEA Programs. CDFIs have received more than $490 million in awards, of which approximately 75% is equity capital. Although the CDFI Fund's funding has decreased under the Bush administration, it remains a critical resource for CDFIs.

CDFI Certification

CDFIs certified by the CDFI Fund must meet a number of criteria, including pursuing a primary mission of community development and providing financing as a primary line of business. The primary benefit of certification is access to the CDFI Program, which provides grant and loan support to CDFIs through a competitive application process.

As of February 2005, there were 740 certified CDFIs. Of the CDFIs in the CDP study, 293, or 61%, are certified CDFIs. Some CDFIs—including many surveyed by the CDP—are not certified, either because they have chosen not to apply for certification or they do not meet all of the Fund's eligibility criteria. Most banks and loan funds represented in this study are certified CDFIs (see Figure 4). The lower percentage of certified credit unions (56%) and venture funds (62%) is due to the judgment of many qualifying CDCUs and CDVC funds that the costs of applying and reporting outweigh the benefits.

Figure 4 **Percentage of Certified CDFIs in the CDP Sample**

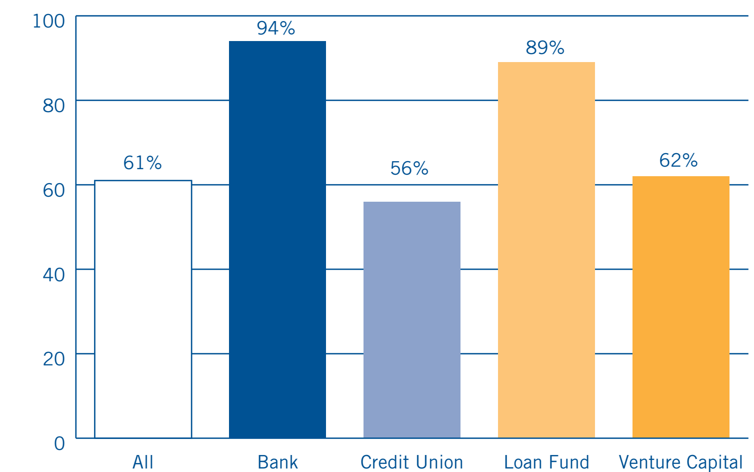
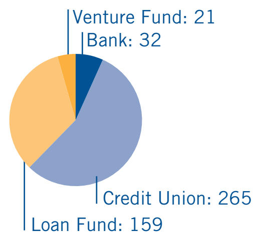


Figure 5

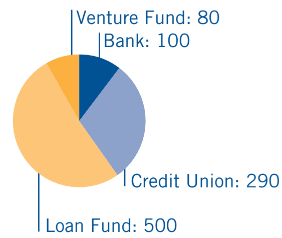
Size and Scope of CDFI Field

The FY 2003 CDP data set represents 477 of the approximately 1,000 CDFIs operating in the United States. The CDP estimates that there are, in total, approximately 100 community development banks, 290 CDCUs, 500 CDLFs, and 80 CDVC funds. The CDP sample (Figure 5) represents a significant percentage of each of the CDFI sectors.

CDP Sample



Total Number of CDFIs



**Estimates from CDFI trade associations and intermediaries*

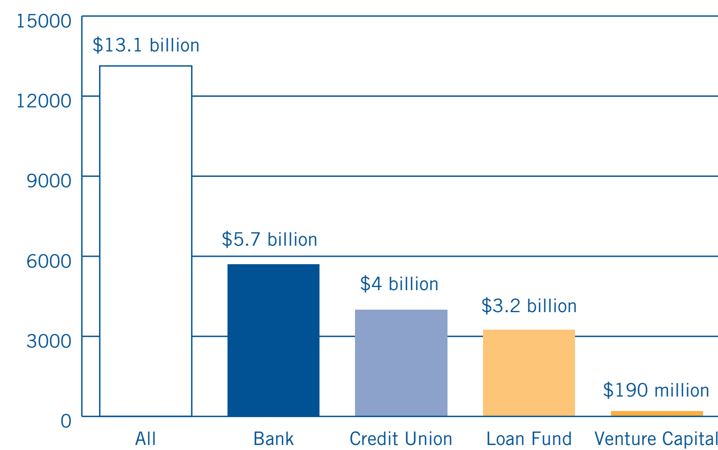
Asset Size of CDFIs

The CDFIs in this study managed $13.1 billion in assets at the end of FY 2003 (see Figure 6 for a breakout by institution type). While this represents a significant amount of capital for underserved communities, it is still quite modest compared with the mainstream financial sector. As of December 31, 2003, for comparison, U.S. financial institutions alone controlled almost $9 trillion in assets.[4] Thus, although the growth of the CDFI sector over the past decade is significant in relative terms, the industry remains a specialized, niche player in the wider financial services industry.

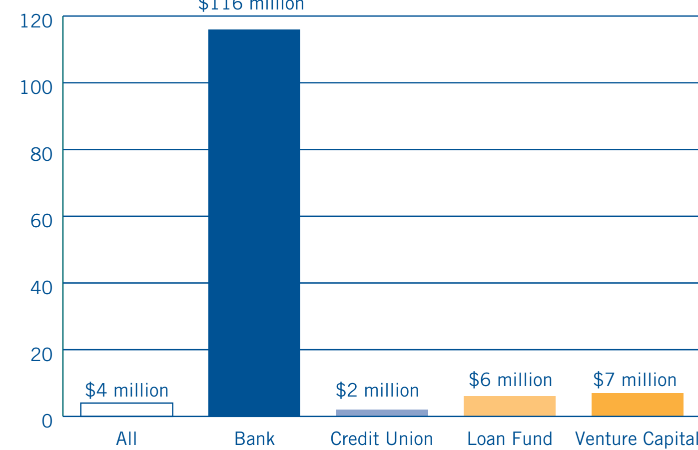
Institution size varies substantially across and within the four CDFI sectors. The CDCU sector represents a large number of small organizations, the inverse of the banking sector. For example, 32 community development banks together hold more in assets ($5.7 billion) than the 265 credit unions ($4.0 billion). The median bank holds approximately $115 million in assets, and the median credit union only $2 million. Loan funds represent 25% of our sample (or $3.2 billion), with a median size of $5.6 million. VC funds also tend to be small institutions relative to banks. Specializing in the niche products of equity and near equity, they manage less than 2% of total assets reported, with a median asset size of $7 million.

Figure 6 Total Assets

Total Assets (in millions)



Median Assets (in millions)



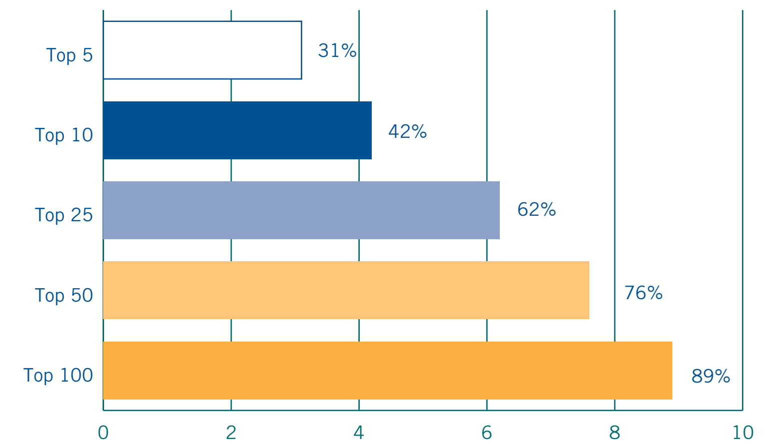
[4] As of December 31, 2003, according to the Federal Deposit Insurance Corporation

Distribution of Assets

A small number of CDFIs also hold a substantial portion of the field's total assets. The largest five CDFIs control 31% of the sample's assets, and the largest 10 control 42% (see Figure 7). The largest five CDFIs include institutions in three of the four sectors: three banks, one loan fund, and one credit union.

While most organizations (70%) in the field have less than $10 million in assets, overall industry results are skewed by a handful of very large institutions; of the 29 CDFIs with more than $100 million of assets, 3 are loan funds, 8 are credit unions, and 18 are banks.

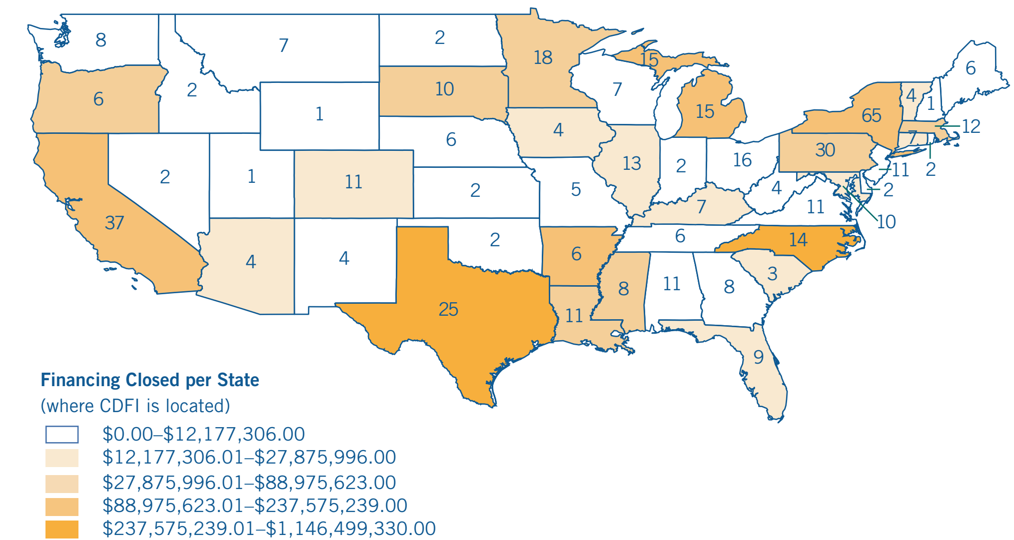
Figure 7 Concentration of Assets



Markets Served

CDFIs tend to concentrate in certain areas of the country. The Northeast, Upper Midwest, Texas, and California have a high concentration of CDFIs (see Figure 8). CDFI financing activity also concentrates in those areas because of the high number of CDFIs in those areas. A few states that also house the largest CDFIs (North Carolina, Illinois, New York, and Texas) also hold a high concentration of CDFI financing activity. Five states (North Carolina, Texas, California, Michigan, and New York) are home to the CDFIs that did 64% of total financing activity in FY 2003.[5] CDFIs in our study are located in 48 states, the District of Columbia, and Puerto Rico.

Figure 8 Total Financing Closed and Number of CDFIs by State



[5] While 43 CDFIs in our study serve a multistate or national population, all of their financing is captured in the state where the CDFI is located.

CDFIs serve a mix of rural and urban markets across the country, with 40% of CDFI clients from major urban areas,[6] 33% from rural areas, and 28% from minor urban areas (see Figure 9).[7] The banks had the highest concentration in major urban areas (66%). Credit unions, loan funds, and VC funds exhibit strikingly similar patterns of geographical coverage; all of those CDFI institution types averaged between 30% and 40% of clients in rural areas.

There is significant variation in the geographical markets served by CDFI types, ranging from a city or town to a national service area (see Figures 10 and 11). In general, credit unions tend to serve smaller geographical markets because their customers are typically in close proximity to the credit union, often going to the credit union branch for services. Venture funds, however, cover larger geographical areas. Seventy-six percent serve a state or multistate service area because their specialized equity products require a larger market area to operate efficiently. Loan funds vary in the markets they serve, and are the only CDFI type, with 11 loan funds, that serve a national service area. Many began serving a smaller area but developed niche products and expanded to a larger service area.

Figure 9 Rural–Urban Distribution

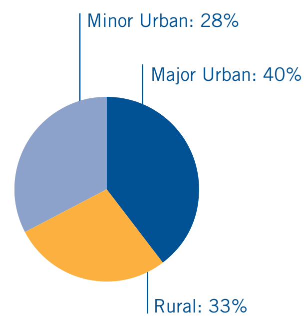


Figure 10 Geographical Markets Served

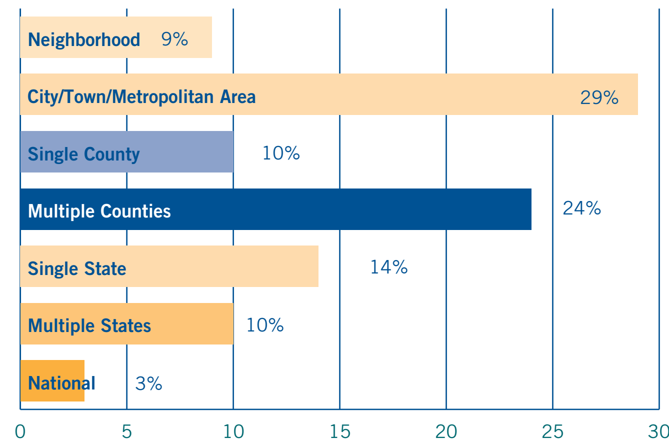


Figure 11 Geographical Market Served by Institution Type

	All	Bank	Credit Union	Loan Fund	Venture Capital
Neighborhood	28	0	27	1	0
City, Town, or Metropolitan Area	96	17	48	29	2
Single County	34	4	21	9	0
Multiple Counties	78	6	16	53	3
State	45	1	4	31	9
Multiple States	34	2	1	24	7
National	11	0	0	11	0
Number of Respondents	326	30	117	158	21

[6]Major urban is defined as a metropolitan statistical area with more than one million residents.
[7]Minor urban is defined as a metropolitan statistical area with less than one million residents.

CDFI Outcomes, Impacts, and Clients

The work of CDFIs reaches many individuals and communities, particularly those traditionally underserved by mainstream financial institutions. CDFIs strive for—and achieve—social and economic benefits that align with their institutional missions. The community development impacts of CDFIs' financing and other products go well beyond easily measurable impacts. These impacts include helping borrowers open their first formal bank account, improving financial literacy or entrepreneurial skills, opening bank or credit union branches in markets not typically served by financial institutions, and providing much-needed technical assistance.

CDFI Client Characteristics

CDFIs are successful in reaching underserved customer groups—low-income families, minorities, and women, in particular. Sixty-nine percent of CDFIs' clients are low income, 59% are minorities, and 52% are women (see Figure 12). Credit unions, with their focus on financial services for low-income individuals, had the highest percentage of clients that were low income, at 73%.

CDFI Sectors Served and Outcomes

CDFIs provide financial and nonfinancial services to a variety of sectors and clients.[8] While there is substantial variation among and between sectors, CDFI activities fall into six main categories: microenterprise, small and medium-sized business, community services, housing, consumer, and other (see Figure 13 for a breakout by sector). CDFIs that finance these different strategies are looking for different outcomes and impacts.

Figure 12 Customer Profile by Institution Type

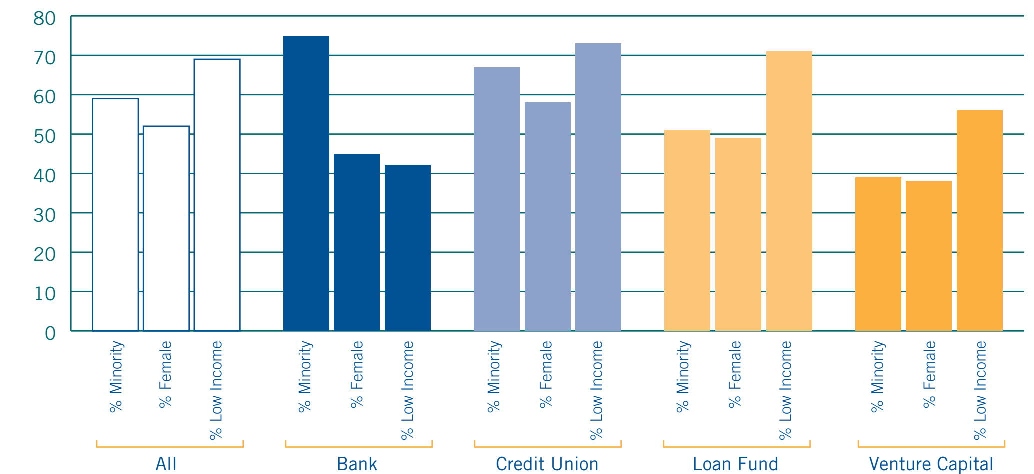
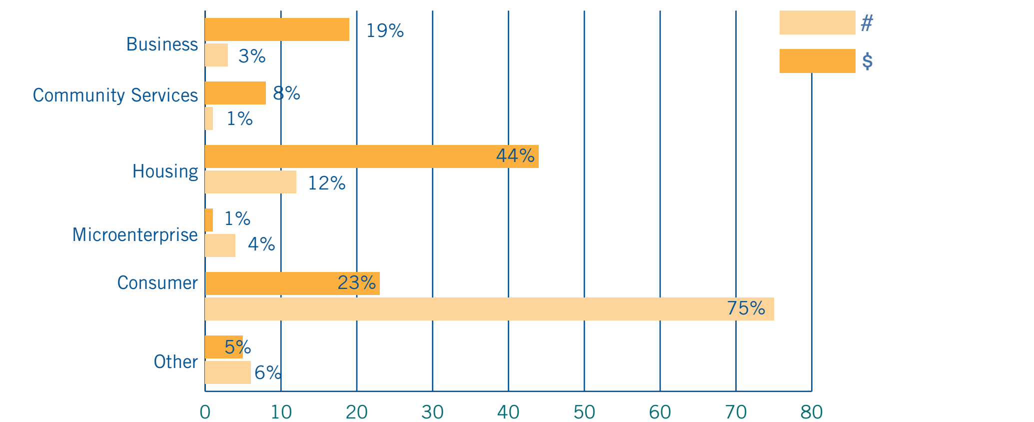
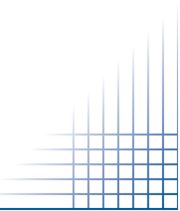


Figure 13 Financing Outstanding by Sector



[8]Several CDFIs cannot break out their financing outstanding into these sectors; therefore, the total figures in each sector underrepresent the total financing activity among sectors.



Microenterprise

- $75 million outstanding at fiscal year end (FYE) 2003
- 9,982 transactions outstanding at FYE 2003
- 6,923 microenterprises financed in FY 2003

Microenterprise development includes financing to businesses that have five or fewer employees, with a maximum loan or investment of $25,000. This financing is typically for the start-up or expansion of businesses, working capital, or equipment purchase. Clients are typically low- or moderate-income individuals in the very early stages of small business development. They have a skill or idea they want to turn into a business but may lack the capital or the technical and management expertise. Most CDFIs that assist microenterprises provide substantial technical assistance, such as entrepreneurial training, business coaching, and networking opportunities. In the early stages of business development, these skill-building activities are often more critical to businesses than the infusion of capital. Microenterprise loans help provide self-employment opportunities for these entrepreneurs, many of whom would not have these opportunities without CDFI loans.

One hundred and twenty-two CDFIs in our sample (26%) provided microenterprise financing in FY 2003, of which 87 were loan funds and 31 were credit unions. Microenterprise financing is characterized by a high number of transactions and relatively small dollar amounts of loans. For the loan fund sector in FY 2003, microenterprise financing accounted for only 3% of financing outstanding in dollars outstanding but 27% in terms of the number of loans.

Small and Medium-Sized Businesses

- $983 million outstanding at FYE 2003
- 8,925 transactions outstanding at FYE 2003
- 2,288 businesses financed in FY 2003
- 32,030 jobs created and maintained in FY 2003 (includes activity from microenterprise financing)

Small and medium-sized business development includes loans and equity investments to businesses that have more than five employees or need more financing than microenterprises. In their loan and investment decisions relating to these businesses, CDFIs consider social benefits such as how many jobs will be created, what kind of salaries and benefits are offered, whether the business is located and provides services in a disinvested location, and what the environmental impact of the business will be.

One hundred and forty-three CDFIs in our sample provided business financing, including all of the VC funds, 79 loan funds, 30 credit unions, and 17 banks. Business financing represents virtually all (98%) of venture funds' financing outstanding and one-third of banks' financing, and smaller percentages of the credit unions' and loan funds' financing.

The CDFIs in our study that financed both microenterprise and small and mid-sized businesses created and maintained more than 32,000 jobs.[9]

Community Services

- $446 million outstanding at FYE 2003
- 2,046 transactions outstanding at FYE 2003
- 768 community service organizations financed in FY 2003
- 12,025 new and existing childcare slots assisted in FY 2003
- 6,715 new and existing educational slots assisted in FY 2003

CDFIs provide financing to community service providers—human and social service agencies, advocacy organizations, cultural facilities, religious organizations, healthcare providers, childcare centers, and education providers—that provide critical and much-needed services to low-income people and communities. Many community service providers have one or more niche markets in which they operate. This expertise enables them to provide critical advice on issues affecting the particular industry. The borrowers are primarily nonprofits, and often require some form of technical assistance such as cash flow forecasting or securing other funds.

Seventy-eight CDFIs in our sample provided community service financing, with a majority (56) being loan funds. Community service financing accounted for 8% of all CDFI financing outstanding in FY 2003. In 2003, CDFIs financed 768 community facilities in distressed communities across the country.

Housing

- $2.3 billion outstanding at FYE 2003
- 34,022 transactions outstanding at FYE 2003
- 44,689 housing units assisted in FY 2003
- 16,555 mortgages closed in FY 2003

Housing financing among CDFIs includes two primary subcategories: financing to housing developers and direct mortgage lending to low-income individuals.

CDFIs make loans to housing developers for predevelopment, acquisition, construction, renovation, working capital, and mortgage loans. These loans support the development of rental housing, service-enriched housing, transitional housing, and residential housing. With a rapidly shrinking supply of affordable housing for low-income families in both the rental and ownership markets, this effort addresses a critical need in many communities. CDFIs facilitated the construction or renovation of 44,689 units of affordable housing in 2003, with 97% of the activity from CDLFs. These affordable housing units typically provide for monthly payments that run less than 30% of a household's monthly income and enable low-income individuals to own or rent quality housing while preserving sufficient income to pay for other critical products and services.

Because CDCUs generally do not track housing units (and these data were not reported from those that did not complete the CDCU survey), housing units are substantially underreported for credit unions. According to NCUA aggregate data, CDCUs closed 9,402 real estate loans for a total of $467 million in FY 2003, including a large portion of second mortgage loans taken out to finance housing unit renovation or improvements.

CDFIs also provide loans to low-income families who cannot qualify for a mortgage from the mainstream financial sector. CDFIs provided 16,555 mortgages to home buyers in 2003. They are typically first-time home buyers who also need significant help working through this process. Many CDFIs providing direct mortgage financing also offer homeownership counseling or other services. CDFIs provide this mortgage financing as an affordable product to home buyers and act as an alternative to predatory lenders in the community.

Housing financing is the largest sector, accounting for $2.3 billion, or 44%, of the sample's total financing outstanding. Banks, credit unions, and loan funds all provide substantial amounts of housing financing. One hundred fifty-eight CDFIs had housing financing in FY 2003, including 71 credit unions, 17 banks, and 70 loan funds. Credit unions primarily provide mortgage loans to individuals, and loan funds primarily provide loans to housing developers, although there are a growing number of loan funds providing mortgage products as well.

Personal Development

- $1.2 billion outstanding at FYE 2003
- 212,082 transactions outstanding at FYE 2003
- 9,285 payday loan alternatives in FY 2003

Consumer financial services are for individuals, and include all personal loans for health, education, emergency, debt consolidation, transportation, and other consumer purposes. CDFIs also provide nonfinancial services such as financial literacy training or programs that encourage savings. In many low-income communities, these services are provided not by mainstream lenders but by institutions that specialize in check cashing, payday lending, and wire transfers at exorbitant and predatory rates.

All of the credit unions, as well as 14 other CDFIs, provided personal development, or consumer, financing. Similar to microenterprise financing, consumer financing is characterized by a high number of transactions and relatively small dollar amounts of loans. The consumer financing sector accounts for 74% of all CDFI transactions in our sample, but only 23% of the dollar amount of transactions. The median loan size of $4,476 is substantially lower than that in any of the other financing sectors. Many of these loans are to people who have not previously had a relationship with a financial institution and do not have a credit history.

[9]This figure is significantly underreported. It does not capture all self-employment activity of microentrepreneurs, job data from the 138 credit unions for which we only have call report data (see Appendix A), and those CDFIs that do not track this information.

CDFI Products and Services

CDFIs deliver a range of products to meet the needs of their communities. These products include financing products, retail and depository services (such as savings and checking accounts and individual retirement accounts (IRAs), training and technical assistance, advocacy and research, and other services. Most CDFIs have strong market knowledge and long-term relationships with clients, which help CDFIs develop the right mix of products.

Figure 14 FY 2003 Financing Totals

		# of CDFIs reporting
Total Financing Outstanding in FY 2003 ($)	$8,458,797,422	462
Total Financing Outstanding in FY 2003 (#)	442,035	441
Total Financing Closed in FY 2003 ($)	$4,095,770,666	427
Total Financing Closed in FY 2003 (#)	236,454	427

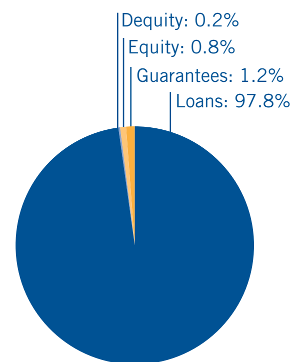
Note: Financing outstanding includes loans, investments, and guarantees outstanding, and total financing closed includes direct investments (loans and investments) and indirect investments (guarantees and loans purchased).

At the end of 2003, the CDFIs in our study had more than 442,000 financial investments outstanding (loans, equity, guarantees), totaling $8.5 billion. Financing outstanding among individual CDFIs ranged widely, with an average of $18 million. Again, the larger institutions accounted for a disproportionate share of financing. Ten CDFIs accounted for more than 45% of total financing outstanding.

CDFIs generated $4.1 billion of new financing activity in 2003: $3.0 billion in direct financing and $1.1 billion in indirect financing. Direct financing includes loans, equity investments, and debt-with-equity-features closed during the year. Indirect financing is made by other financial institutions, but the CDFI intervention (i.e., loan purchase[10] or guarantee) allows the financial institutions to finance additional community development loans and investments.

In addition, many more CDFIs are doing off-balance-sheet financing and loan underwriting for third parties. These loans do not flow through the financial statements of the CDFIs, but provide an important service that allows banks, foundations, government entities, and other entities to invest more in community development projects. The CDP plans to begin collecting these data next year.

Figure 15 Financing Outstanding by Financial Product Type



[10]Loan purchases are not a common activity for most CDFIs. The majority of the purchases are through a single CDFI, which purchases nonconforming home mortgages as a strategy to expand the scope of mortgage lending by mainstream financial institutions to low- and moderate-income borrowers.

Financing Products Offered

CDFIs use four primary types of financing products to serve their communities: loans, equity investments, debt-with-equity-features, and guarantees (see Figure 15).

Loans

Loans are far and away the most used tool by CDFIs, representing $8.3 billion, or 98%, of all financing outstanding. Loans represent virtually all financing from loan funds, credit unions, and banks. The only exception is VC funds, which are designed primarily for equity and near-equity investments.

CDFIs' loans include short-term (less than six months) and long-term (up to 30 years) loans, amortizing and balloon loans, and small (under $500) and large (more than $1 million) loans. Loan size varies greatly by the type of CDFI, largely according to the sectors and clients that the CDFI serves (see Figure 16). CDCUs primarily provide small loans to members, and because of that the average loan size at credit unions is significantly lower than that of other CDFI types. VC funds have a higher average loan size, as they typically provide larger loans coupled with investments in businesses with high-growth potential that have substantial needs for working capital, equipment, or acquisition financing.

As indicated in Figures 16 and 17, the median loan and investment sizes for CDFIs have been increasing over time; as CDFIs have increased their capital, resources, and capacity, they have been able to provide some larger loans in additional to the smaller loans to businesses and individuals. The largest increase has been in the community services sector, increasing from $75,000 in 2002 to $90,000 in 2003; this in part results from several CDFIs that are involved in financing large charter-school deals.

Figure 16 Median Loan and Investment Size by Institution Type, 2002 and 2003

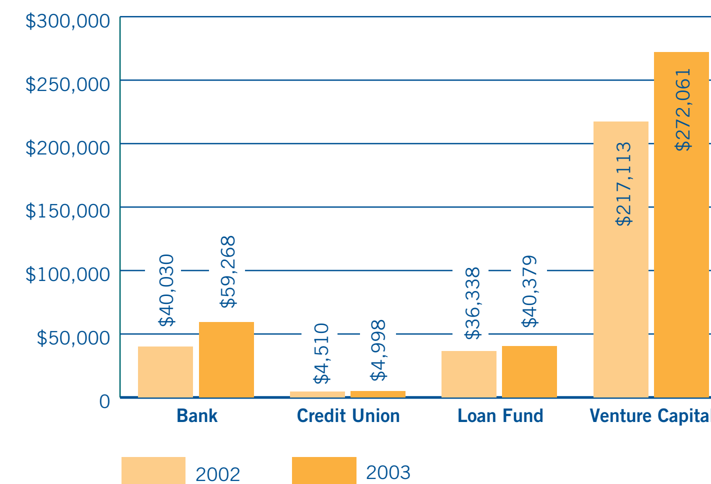
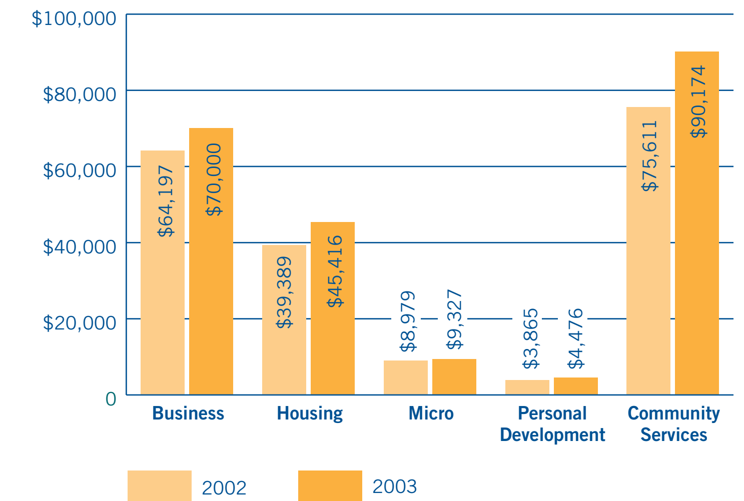


Figure 17 Median Loan and Investment Size by Sector, 2002 and 2003



Note: The CDP collects data on average loan size per CDFI. The median loan size represents the middle (or typical) loan size of the CDFIs in that sector.

Equity Investments

Equity investments are a newer but increasingly important tool for CDFIs as they seek to finance high-growth-potential businesses that offer financial and social return. Equity investments are made in for-profit companies, in which the CDFI receives an ownership interest. In an equity investment, the CDFI shares both the risk and the potential financial gain that the business experiences. The recent emergence of equity as a tool is reflected in its relatively modest numbers, and most such investment is concentrated in the VC sector: the $68 million in 221 equity transactions outstanding represents approximately 1% of overall CDFI financing but 54% of VC financing. Eighty-five percent of all equity investments are made by VC funds. Thirteen loan funds make the rest, some of which have VC programs within the same corporate structure as the lending entity.[11] Credit unions and banks do not use equity financing. The median investment size outstanding at venture funds is more than $350,000 and the median at loan funds is $110,000. In FY 2003, 19 CDFIs closed on $11.7 million in new equity transactions.

[11]The CDP has divided CDFIs into four institution types: banks, credit unions, loan funds, and VC funds. For VC funds and loan funds, this classification represents the CDFI's primary institution type. Some CDFIs are classified as loan funds and have programs within their organizations that do VC investing. Some CDFIs are listed as VC funds and do a substantial amount of lending. Therefore, the VC fund and loan fund categories may underrepresent the lending and investing activity within that given sector.

Debt-with-Equity-Features

Debt-with-equity-features involves loans that allow the CDFI to receive additional payments based on the performance of the borrower's company. Debt-with-equity-features includes convertible debt, as well as debt with warrants, participation agreements, royalties, or any other feature that links the investment's rate of return to the performance of the company that received the investment. Twelve VC funds (or 57% of VC funds) and 11 loan funds (7% of loan funds) use near-equity products. VC funds have always used these products in combination with equity to finance business growth. More recently, loan funds have begun using these products as well to offer an alternative to debt when the borrower requires more patient capital. In FY 2003, 13 CDFIs closed on $5.4 million in debt-with-equity-features.

Debt-with-equity-features represented 0.4% of loan fund financing but 13% of VC fund financing. Twenty-three CDFIs had debt-with-equity outstanding, representing a range of less than 1% to 36% of their financing outstanding, depending on whether it was a core product or an occasional instrument supplementing other loan and investment products.

Guarantees

Guarantees include letters of credit or guarantees provided to enhance the creditworthiness of a borrower receiving a loan from a third-party lender. CDFIs in our sample had $99 million in guarantees at the end of 2003. Guarantees and letters of credit come in different structures, but all enable other financial institutions to participate in more community development lending activity because a loan or a portion of the loan that the financial institution makes is guaranteed to be repaid by the CDFI in the event of default. Some are tied to a specific program (SBA or the State of California Trust Fund) and some are part of a CDFI's general product mix. Guarantees also serve to keep interest rates reasonable because the financial institution is not taking as great a risk because of the guarantee. Three CDFIs represent a large majority—nearly 90%—of the guarantees outstanding. In total, 21 CDFIs used guarantees, including 18 loan funds and three VC funds.

Portfolio Performance

For the industry as a whole, CDFI portfolios have performed well even during the economic recession and slow recovery of the past few years. Figure 18 demonstrates delinquencies and loan losses at banks, credit unions, and loan funds. CDCUs measure delinquency rates by different metrics than do loan funds and banks. Delinquency and loan losses are not reported for VC funds, as they measure portfolio performance by the overall return on the fund as described in the VC section. Overall, the net loan loss rate[12] for these groups of CDFIs was 0.7%, ranging from a total of 0.3% in the bank sector to 1.0% in the loan fund sector; this rivals the net loan loss rate at conventional financial institutions of 0.78% in 2003. While there is substantial variation among CDFIs, only 24 CDFIs, or 6% of the 439 banks, credit unions, and loan funds that reported, had net loan loss rates greater than 10%. Figure 19 demonstrates how the loss rate for the overall industry has been consistent during the last few years.

CDFI delinquency rates are somewhat higher than their net charge-off rates. CDFIs are able to manage these delinquencies through technical assistance and frequent contact and monitoring of their borrowers. Also, CDFIs keep adequate loan loss reserves and equity bases to further protect their investors.

Figure 19 Net Loan Loss Rates, 2000 to 2003

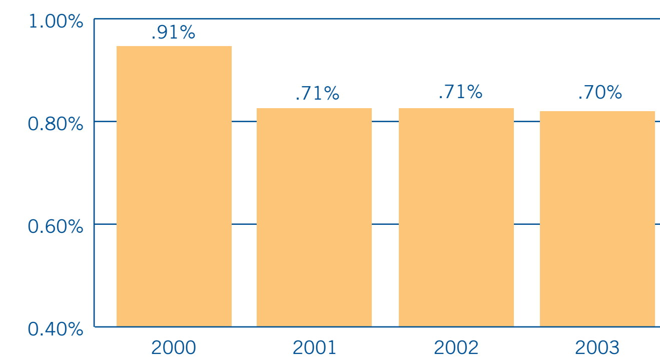


Figure 18 Delinquency and Loan Losses Rates

	Banks	Credit Unions	Loan Funds
2003 Net Loan Loss Ratio	0.3%	0.8%	1.0%
Delinquency Ratio > 90 days	1.6%	NA	3.5%
Delinquency Ratio > 2 months	NA	1.7%	NA

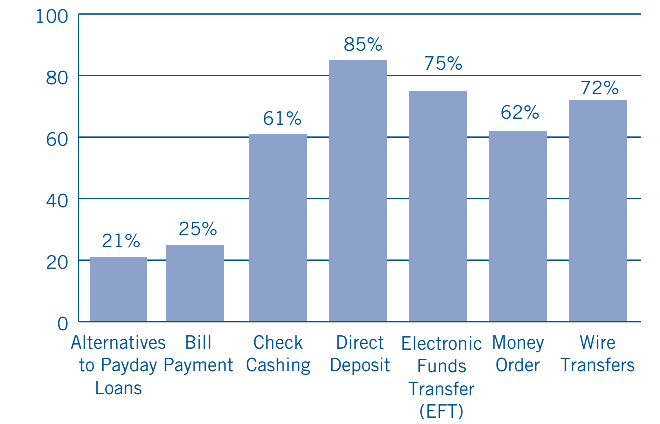
[12]Net loan loss rate is the net charge-offs during FY 2003/total loans outstanding at FYE 2003.

Financial Services

Banks and credit unions mobilize savings as well as provide access to credit. Data on deposit and transaction products were collected from 117 credit unions and 17 banks for FY 2003. These institutions offered a broad range of products such as savings accounts, checking accounts, certificates of deposit, and IRAs, as well as client services such as automated teller machine (ATM) access, check cashing, bill payment, and direct deposit. They have also crafted products unique to the field, such as individual development accounts (IDAs), which use a mix of financial education, peer support, and matching funds to promote savings among low-income customers; these savings can be used to invest in homeownership, small business development, or education.

Among credit unions and banks, direct deposit is the most widely offered service, followed by electronic funds transfer and wire transfers (see Figure 20). Alternatives to payday loans, exorbitantly high-interest short-term loans secured by the borrower's next paycheck, are also reported by 25% of credit unions. While many customers view these depositories just like any other financial institution, the difference lies in the customer base and the communities that the organizations seek to serve.

Figure 20 Financial Products and Services at Depositories



Alternatives to payday loans only includes credit unions reporting.

Training and Technical Assistance Services

In addition to providing access to capital and retail financial services, CDFIs are distinct from mainstream lenders because they provide training, technical assistance, and other assistance to their customers to help increase their capacity and their access to financing. The type and amount of training and technical assistance that a CDFI offers depends on the needs in its market, whether those needs include packaging funding for an affordable housing developer, business plan training for an entrepreneur, or credit counseling for an individual. CDFIs provided training to more than 6,400 organizations and nearly 100,000 individuals through group-based training and one-on-one technical assistance.

Figure 21 Training and Technical Assistance

	Number	CDFIs Reporting
People Receiving Group-based Training	45,109	158
People Receiving One-on-one Technical Assistance	54,775	197
Organizations Receiving Training	6,418	116

CDFI Growth from 2000 to 2003

CDFIs experienced growth in the past four years. For the CDFIs for which we have four years of data (263 CDFIs), CDFI assets grew at a CAGR[13] of 8% between 2000 and 2003, and financing outstanding for the sample grew by 18% (see Figure 22).

CAGRs at individual CDFIs varied significantly. Thirty-seven percent of the sample experienced CAGRs in financing outstanding from 2000 to 2003 of greater than 25% (see Figure 23). Sixteen percent of the sample experienced declines in the financing outstanding. This results from having repayments in their portfolio during the three-year period greater than the amount of new financing closed. Also, some CDFIs sell loans or portfolios of loans, which also may result in declining financing outstanding.

Figure 22 **Growth from 2000 to 2003**

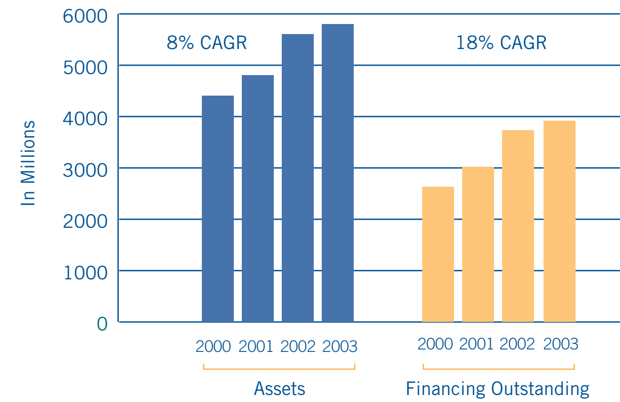
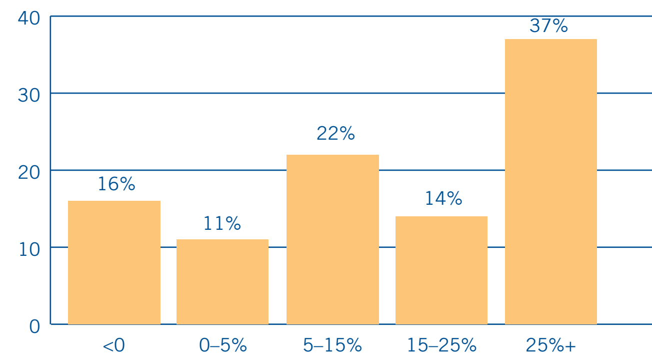


Figure 23 **Growth Distribution of Financing Outstanding**



Community Development Banks

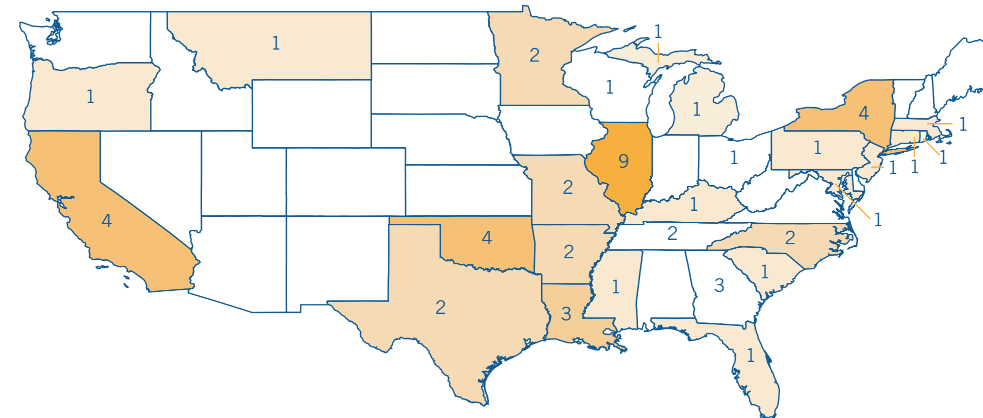
Like all CDFIs, community development banks provide capital to rebuild low-income communities through targeted lending. As depository institutions, however, community development banks, along with CDCUs, also have the unique ability to offer federally insured deposits. This depository function not only allows community development banks to meet a wider range of individual financial needs, but it also enables them to leverage scarce equity capital with deposits to generate significantly higher levels of lending in their communities. Moreover, deposits allow banks to operate with relatively modest levels of subsidy, enhancing both autonomy and financial sustainability. Thirty-two community development banks participated in the FY 2003 CDP data collection. The following summary draws primarily from CDP data and is further supported with transaction-level data reported by the National Community Investment Fund's (NCIF's) investee banks.

FY 2003 proved to be a profitable year for a majority of the 32 certified CDFI banks in the CDP data set. Together, the bank respondents represent total assets of $5.7 billion, total deposits of $4.4 billion, and $3.5 billion in loans outstanding. With $5.5 billion in capital available for lending, of which 81% is deposits, the financial strength of CDFI banks has allowed them to stabilize low-income communities while positively changing both local residents' and outside investors' perceptions of the communities in which they operate.

Size and Scope

As of year-end 2003, the CDFI Fund had certified 54 community development banks as CDFIs, the bulk of which are concentrated in the eastern half of the United States (see Figure 24). It is commonly recognized that there are significantly more CDFI banks in the country than those that are certified by the Fund. For example, the NCIF recognizes a nationwide network of about 100 banks whose primary purpose is community development. Together, the 54 certified community development banking institutions had over $8.8 billion in total assets, averaging $162 million per institution, with the median bank reporting $98 million in assets. The 54 banks also showed over $7 billion in total deposits in FY 2003, averaging $130 million per institution, with the median bank reporting $81.7 million in deposits.

Figure 24 **Community Development Bank Locations**



[13]Compound annual growth rate (CAGR) is the rate of increase over a period of time that would exist if each and every year the rate of return were exactly the same.

Figure 25 **FY 2003 Asset Size Distribution of 54 CDFI Banks**

Asset Category	Number of Banks	Average Asset Size	Median Asset Size
$15 million to $60 million	17	$38,610,118	$38,301,000
$60 million to $150 million	20	$101,543,300	$98,036,000
$150 million to $250 million	9	$196,197,333	$198,480,000
$250 million and above	8	$540,989,750	$399,515,000

Thirty-two such community development banks participated in the CDP in FY 2003. The combined assets of all 32 banks amounted to more than $5.7 billion, with the median bank having an asset size of $116 million. These 32 banks constitute about 43% of the total assets of all CDFIs in the CDP data set, despite making up less than 7% of the total number of institutions. Figure 26 provides the distribution of the banks according to asset size and shows that a quarter of the banks are in the $150 million to $250 million asset range. The 32 banks also represent over $4.4 billion in total deposits in FY 2003, with the median deposit size at $99.5 million.

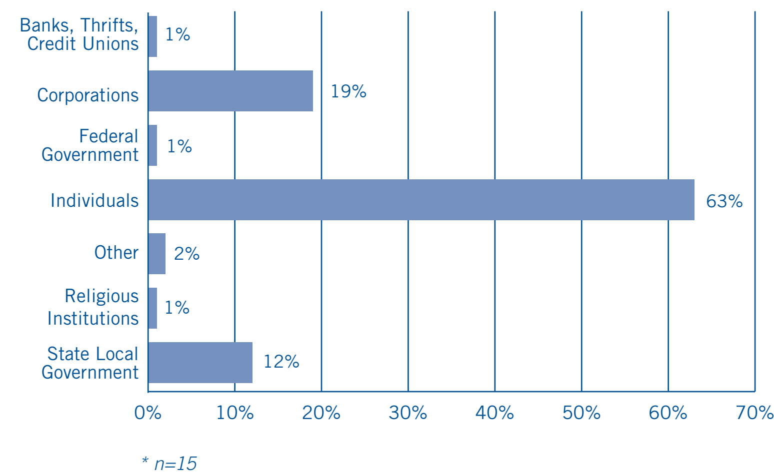
Figure 26 **FY 2003 Asset Size Distribution of CDP Bank Respondents**

Asset Category	Number of Banks	Average Asset Size	Median Asset Size
$15 million to $60 million	8	$39,003,250	$41,379,500
$60 million to $150 million	12	$102,792,566	$99,727,500
$150 million to $250 million	8	$201,635,125	$208,765,500
$250 million and above	4	$634,372,750	$446,517,500

Bank Capitalization

Among the 15 community development banks that provided information on their sources of capital, deposits from individuals and corporations accounted for the vast majority of their lending capital (82%), while government and philanthropic funding made up a significantly smaller portion (see Figure 27). The 32 CDP banks reported a total of $5.5 billion in capital available for lending, averaging $171 million per institution; deposit volume represented 81% of the total capital available for lending for the CDP subset. Industrywide, the 54 certified CDFI banks total $8.5 billion in capital available for lending, averaging $157.5 million per institution, where 82% of the total capital available for lending by the 54 certified CDFI banks is constituted by deposits.

Figure 27 **Sources of Debt Capital, Shares, and Deposits for CDP Banks***



** n=15*

A community development bank typically leverages equity with federally insured deposits (mostly from individuals and corporations) in the form of savings accounts, checking accounts, and certificates of deposit. Community development banks typically leverage every $1 in equity capital with more than $10 in deposits and other borrowings, such as loans from the Federal Home Loan Bank, with some achieving much higher leverage ratios. The leverage ratio is 11.03 for the banks in the CDP data set (see Figure 28).

The majority of the CDFI banks were profitable in FY 2003. Forty-four of the 54 certified CDFI banks posted gains, with an average net income of $1.3 million. Twenty-eight of the 32 CDP subset banks were profitable, with an average net income of $1.6 million in FY 2003.

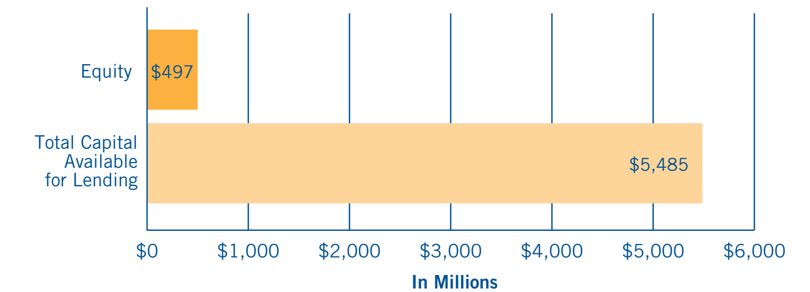
Financing Activity and Performance

Community development banks are subject to the same safety and soundness regulations as other banks. Because of their experience and knowledge of the community, however, they are also able to provide products and services that mainstream banks find too risky or too costly. For example, many community development banks lend to small entrepreneurs who acquire multifamily residential properties to renovate for sale or lease. Similarly, community development banks lend to churches and other faith-based and nonprofit institutions that play active roles in the community. In FY 2003, the 54 certified CDFI banks reported a total of $5.2 billion in loans outstanding, averaging $97 million per bank. The subset of 32 CDP banks reported $3.5 billion in loans outstanding, averaging $109 million per institution.

The CDP collected information on the types of loans provided by community development banks. The 17 institutions responding to this section of the survey reported that the vast majority of their dollars funded small business and housing-related loans (33% and 34%, respectively, of dollars loaned). However, community development banks also provided a significant number of consumer loans (47% of total number of loans), thereby providing an important community-based alternative to fringe financial service providers.

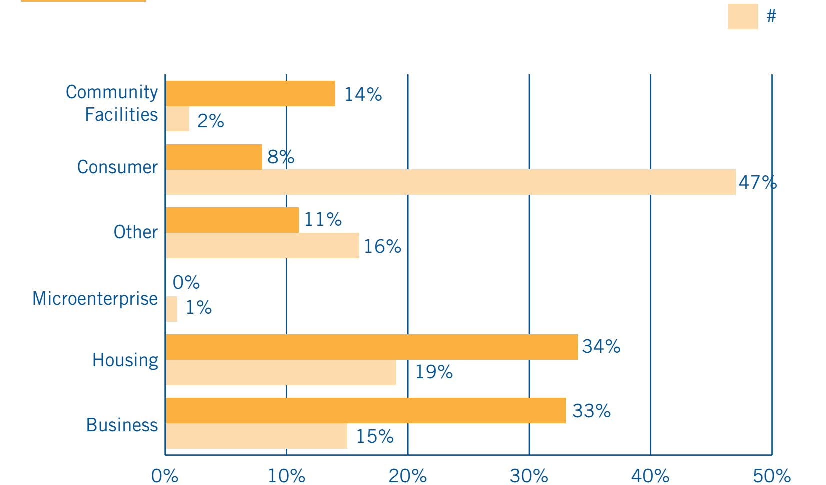
NCIF conducts an annual survey among its investees to gauge the level of their development lending activities. A development loan is defined as a loan that is made in a low-income community or to a low-income borrower. In 2003, the 13 banks reporting originated 11,878 new development loans, for a total of $404 million. On average, each bank invested more than $31 million in its target market. With an average loan size of about $42,000, these banks underwrote commercial real estate, small business, facilities, mortgages, and consumer loans that fall outside the scope of mainstream lenders. In dollar terms, 67% of all the loans originated by the investee banks in FY 2003 went to low-income communities, while nearly 64% of the total number of loans originated were development loans.

Figure 28 **Leverage at 32 CD Banks**



Note: Total capital includes equity capital and leverage provided by deposits and other borrowings.

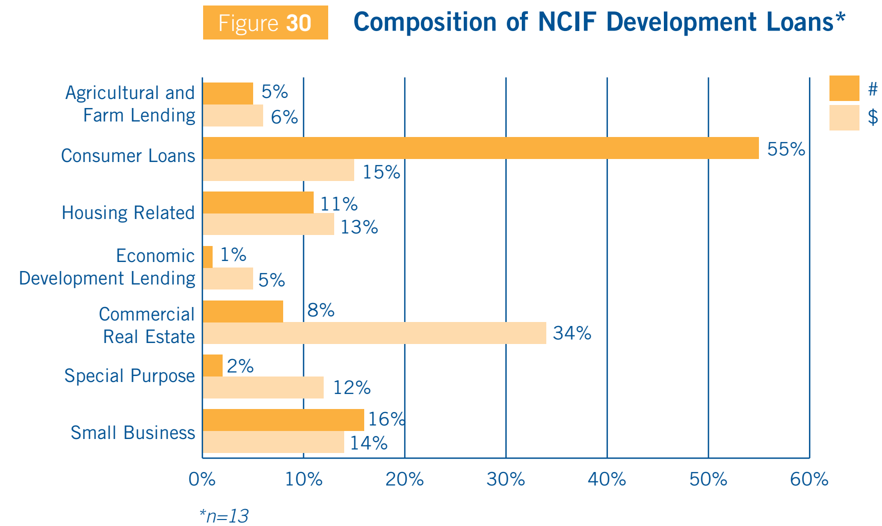
Figure 29 **Composition of Bank Loans Outstanding**



Note: For 17 CDP respondents

Like the CDP survey, this additional transaction-level data showed that most of the development loans went to businesses in low-income areas, with small business loans, commercial real estate loans, and agricultural loans making up about 54% of the total dollar amount originated. Housing-related loans, such as mortgages and affordable housing projects, made up the second-largest category, with nearly 13% of the total lending pool. The transaction-level data showed that 55% of all transactions were consumer loans.

Figure 30 Composition of NCIF Development Loans*



*n=13

Community development banks efficiently use their limited resources for development work on the basis of the ratio of development loans to equity capital. With total equity capital of about $168 million, the 13 CDFI banks reporting this data lent 2.4 times their total equity capital in development loans. Moreover, this high level of development lending was achieved at the same time that the banks were maintaining an average return on assets rate of 0.83%.

On average, the 54 certified CDFI banks had $1.89 million in loans that were more than 90 days delinquent, which represents 1.77% of total loans outstanding. The average net loan loss rate was 0.46%, with the median bank having a rate of 0.23%.

The 32 community development banks in the CDP subset showed stronger performance, with $1.76 million in loans that were more than 90 days delinquent, which represents 1.61% of total loans outstanding. The average net loan loss rate was 0.32%, with the median bank having a rate of 0.18%.

Figure 31 Portfolio Performance of 54 Certified CDFI Banks in FY 2003

	Sum	Average	Median
Loans Greater Than 90 Days Delinquent	$188,773,630	$3,311,818	$1,112,000
Delinquency Rate Greater Than 90 Days	1.77%	1.77%	1.95%
Net Loan Loss Rate		0.46%	0.23%

Figure 32 Portfolio Performance of CDP Respondent Banks in FY 2003

	Sum	Average	Median
Loans Greater Than 90 Days Delinquent	$56,223,872	$1,756,996	$749,500
Delinquency Rate Greater Than 90 Days	1.61%	1.61%	0.98%
Net Loan Loss Rate		0.32%	0.18%

Creating Impact:

Depositories Finding Solutions to Overdraft Fees[14]

Though initially designed as a courtesy service to shield good customers from the embarrassment of a bounced check, overdraft protection has since been expanded to cover all checking transactions, including those through ATM and debit cards, and is now being applied as a standard component to most checking accounts. Because of the expansion of the product's potential customer base, overdraft protection is also fast becoming a major fee-generating product for banks.

According to a recent report by the Woodstock Institute, when a customer whose checking account is covered by overdraft protection makes a transaction that overdraws the account's current balance, the bank still pays the vendor, but then charges the customer an average $30 overdraft fee. Some banks further charge a daily $5 to $6 "extended" overdraft fee for each day that the account's balance remains negative. These fees continue to snowball until the customer returns his or her account to a positive balance, sometimes resulting in an effective annual percentage rate (APR) up to 3,400%. As most banks now automatically enroll new checking account customers in overdraft protection programs without giving them prior notice, customers may not even know about the program or its fees until they make their first overdraft and the resulting fees are assessed to their account. This use of overdraft privileges is likely to rise sharply as a result of the October 2004 implementation of a new federal law on check truncation—The Check Clearing for the 21st Century Act (better known as Check 21)—which will allow checks deposited by vendors and banks to clear within 24 hours, thereby drastically reducing the several days of "float" before the check clears that many consumers have come to expect and rely on.

The pervasiveness of overdraft protection has become a new challenge for unbanked and newly banked consumers. The Woodstock Institute observed that overdraft protection is generally used by two types of consumers. The first type makes a basic checkbook-balancing error and overdraws. The second type of consumer lives from paycheck to paycheck and may be short on cash between paydays. For these customers, using overdraft protection is a convenient source of cash without the hassle of going through the underwriting and credit check of a traditional loan. For these consumers, overdraft protection becomes a short-term, high-rate loan product much akin to payday loans, both in function and large APRs. This second type of fee-generating customer is increasingly sought by many banks that now market overdraft protection as an extension of credit rather than as a last resort in avoiding a negative a balance.

"I learned about Legacy Bank from attending one of their financial management seminars. At the time, no one would open a checking account for me, much less give me a loan. But Legacy Bank gave me a second chance. I appreciate how Legacy helped me move from being unbanked to owning my own business. Without Legacy Bank, I would never have become an entrepreneur."

Legacy Bank is a CDFI Fund—certified community development bank in Wisconsin with $82 million in assets.

Christina Mitchell
Owner of Christina's Cozy Child Care

In February 2004, the six banks and six credit unions participating in the NCIF's Retail Financial Services Initiative[15] discussed ways to prevent the use of overdraft protection as quasi-payday loans. The discussions resulted in the following recommendations:

Instead of using an automatic enrollment process, once an account holder becomes eligible for the program, the customer should be able to make the decision of whether or not to enroll in overdraft protection.

Instead of using marketing messages that encourage customers to use an overdraft program as often as possible, financial institutions should market the program as an emergency route to smooth cash flow.

Financial institutions should also offer financial education as another way to encourage responsible use of overdraft protection.

Most overdraft protection programs already limit the total dollar amount a customer can overdraft, but this limit does not deter customers from incurring multiple small overdrafts in a short period of time. Banks can discourage these excessive overdrafts by limiting the number of overdrafts in a set time period or by offering personal intervention when overdrafts become too numerous.

[14]Sources: (1) Esther Park and Janet Raffel, "Structuring Overdraft Privilege for Low-Income Consumers," in *Retail Financial Services Initiative*, vol. 2 (Chicago: National Community Investment Fund, May 2004). (2) Tim Westrich and Malcolm Bush, "Banking on Bounced Checks: Federal Proposal on Bounce Protection Still Exposes Consumers to Hidden Bank Fees," in *Reinvestment Alert*, no. 26 (Chicago: Woodstock Institute, October 2004)

[15]The Retail Financial Services Initiative is a three-year project that seeks to increase the quantity and quality of financial services for low-income and unbanked consumers through developing and testing replicable business models for serving this emerging market.

Community Development Credit Unions

CDCUs function as the capillaries of the CDFI system; they are geographically dispersed, generally small, though numerous, conduits of financial products and services to economically distressed communities at the grassroots level. The 265 CDCUs surveyed by the CDP constituted 56% of all CDFIs in the study, operating in 45 states as well as the District of Columbia and Puerto Rico. Eighty-two percent of CDCUs serve exclusively local geographies, including neighborhoods, towns, metropolitan areas, and counties. These are some of the most economically disadvantaged places in the country; 80% of CDCUs are located in CDFI Fund–designated investment areas having high poverty and unemployment, while 60% are located in CDFI Fund–designated economic development and housing hot zones, areas of especially acute economic distress and housing need.

CDCUs are some of the oldest CDFIs in operation, with the oldest CDCU chartered in 1930, and the median in 1968. Thirty-one percent have a religious affiliation and are designated faith-based CDFIs.

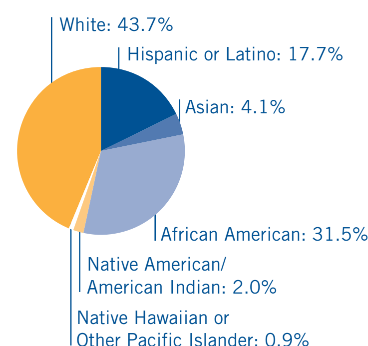
In aggregate, CDCUs form a large and powerful sector, totaling $4.0 billion in assets and 1 million members. There are also a number of very large individual institutions; eight CDCUs have over $100 million in assets, with the largest having $950 million. However, CDCUs are typically the smallest-sized CDFIs and the smallest depository institutions; the average CDCU had an asset size of $15 million and an average membership of 3,786, while the median credit union held $2 million in assets and had a membership of 1,049. The typical CDCU had only four full-time employees, while institutions below $2 million in assets—half of all CDCUs—had a median of two employees. For institutions below $2 million in assets, unpaid and AmeriCorps VISTA-stipended volunteers formed 43% of total staff.

Demographics

CDCUs serve an ethnically and geographically varied membership with a high proportion of low- to moderate-income and female members. Figure 33 demonstrates the ethnic and racial composition of the aggregate CDCU sector membership. Some highlights of membership include the following:

- The average CDCU had a 67% racial or ethnic minority membership, and the typical, or median, CDCU had an 86% minority membership. Minority members constituted 56% of the aggregate membership of the CDCU sector. As of FYE 2003, Latinos constituted 18% of total CDCU membership.
- 33% of CDCUs had a 50% or greater rural membership, and rural members constituted 20% of aggregated CDCU sector membership.
- The average CDCU had a 73% low- to moderate-income membership, and the typical, or median, CDCU had a 76% low- to moderate-income membership. Low- to moderate-income members constituted 65% of the aggregate membership of the CDCU sector.
- The average CDCU had a 58% female membership and the median CDCU had a 55% female membership, while the aggregated sector membership was 53% female.

Figure 33 Ethnic and Racial Breakout of CDCU Membership



Board and Staff

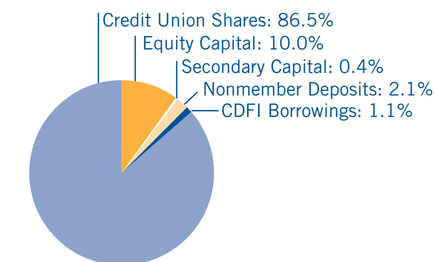
CDCUs are cooperative enterprises, with their clienteles, the CDCU members, also functioning as the owners. The governing boards are selected solely from these member owners, who are typically reflective of the local communities in which the CDCUs operate. The median board size was seven members. The typical CDCU with over 50% minority membership had an all-minority board.

CDCUs had an average of 14 and a median of 4 staff members. Women constituted the great majority of CDCU employees, 80% of the total. Minorities formed 55% of the total sector staff.

CDCU Capital

The local communities served by CDCUs are also the main source of CDCU capital. As of FYE 2003, CDCU capital sources included $3.4 billion in member share deposits, $396 million in equity, $82 million in nonmember deposits, $15 million in secondary capital loans, and $43 million in other borrowings (see Figure 34). The average CDCU had $1.5 million in equity and the median had $165,000.

Figure 34 Composition of CDCU Capital



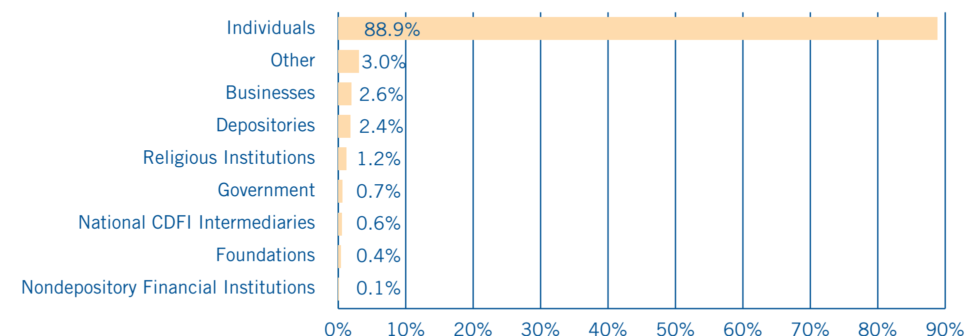
Thus, 87% of all CDCU capital was in the form of member deposits, while 98% of all member depositors were local individuals, who accounted for 92% of the dollar value of all member deposits. Figure 35 shows that local individual deposits make up the overwhelming majority of CDCU capital obtained from member and nonmember deposits and secondary capital borrowings.

Forty-seven percent of CDCUs took advantage of nonmember deposits and 19% had secondary capital loans. Banks and other credit unions provided by far the greatest share of nonmember deposits, accounting for, respectively, 26% and 25% of the total dollar value. National CDFI intermediaries and the federal government were the two greatest sources of secondary capital loans, contributing, respectively, 55% and 19% of the whole.

Depository Services and Community Savings

CDCUs serve the type of low-income and economically distressed communities that are typically ignored or underserved by mainstream financial institutions. CDCUs are often the sole option for basic depository services for those who want to avoid storing their money under the pillow or paying predatory check-cashing fees. In FY 2003, CDCUs opened an estimated 74,300[16] new accounts to people who were previously unbanked. In addition, CDCU savings deposits take on the function of retaining and increasing community capital. As of FYE 2003, individual local residents—accounting for 92% of the dollar value and 98% of the number of all member share deposits—had deposited $3.2 billion in 1.4 million CDCU accounts. Moreover, community residents accounted for 92% of the dollar value of share certificates (CDs), a long-term and more powerful savings instrument than regular share savings accounts. Figure 36 shows the short- and long-term savings activity at CDCUs as of FYE 2003.

Figure 35 Sources of Deposits and Secondary Capital



[16] Estimated for the entire universe of CDCUs from those CDCUs that reported these data

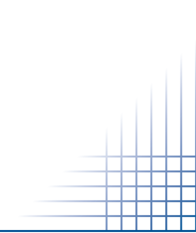


Figure 36 **CDCU Savings Activity**

	Number of Accounts	Dollar Value	Average Account Size
Regular Share Savings	987,004	$1,182,723,003	$1,198
Share Certificates (CDs)	61,428	$937,666,498	$15,264
Money Market Shares	21,476	$456,783,547	$21,269
Individual Retirement Accounts (IRAs)	25,666	$229,552,863	$8,944

Lending

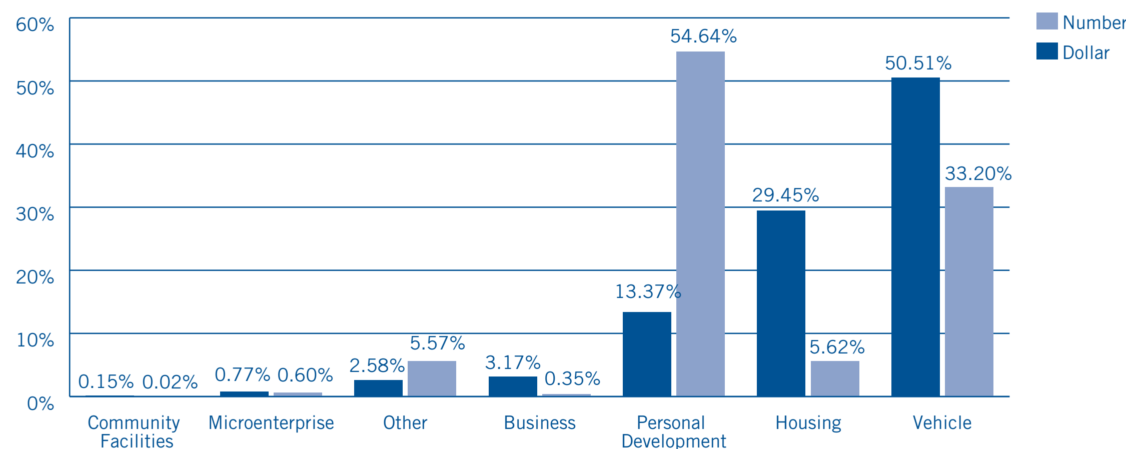
Just as CDCUs perform a vital depository function, they also provide critical lending services in areas poorly covered by mainstream institutions and sorely in need of reasonably priced credit. As of FYE 2003, CDCUs had 383,000 loans outstanding worth $2.8 billion. The average credit union had 1,455 loans worth $10.7 million on the books, while the median or typical CDCU had 231 loans worth $996,000. In 2003, CDCUs closed 207,000 loans worth $1.7 billion, with an average of 765 loans for $6.5 million and a median of 147 loans for $662,000. CDCUs deployed 71% of their assets in loans and in 2003 provided loans to 15,783 people with no previous credit history.

Certainly many, if not most, of these loans satisfied a need that may otherwise have been met by payday lenders, rent-to-own stores, pawnshops, and other predatory lenders charging interest rates as high as 700%. As a result of the savings margins from much lower CDCU interest rates, economically distressed communities retained and accumulated more of the capital they so desperately need.

Vehicle and housing loans constitute the greatest share of the CDCU loan portfolio and are critical to the economic regeneration of low-income communities. Cars are often essential for local residents to find work and get to a job, while housing purchase, construction, and rehabilitation increase local real estate values and leverage investment in the long-term economic well-being of the community. As of FYE 2003, CDCUs had 127,000 vehicle loans outstanding worth $1.4 billion and 22,000 housing loans worth $834 million. In 2003, CDCUs closed 4,493 first mortgage loans worth $345 million.

The CDCU sector specializes in small loans that reflect economic conditions and market demand in low-income communities. These loans have profit margins that mainstream financial institutions generally perceive to be too low, leaving predatory lenders as the only other option. The average size of a CDCU loan outstanding, $7,398, is by far the smallest in either the mainstream or CDFI industry. Personal development or consumer loans, typically for essential everyday expenses such as car repair, education, and medical bills, best characterize this type of small, low-profit-margin loan. Personal development loans constituted 55% of all CDCU loans outstanding, though only 13% of the dollar value, and 76% of all loans provided in 2003 (19% of the dollar value). The average size of a personal loan outstanding, $1,787, is miniscule by mainstream or even CDFI industry standards. Many of these personal consumer loans are being used to finance microenterprise activity, and the inability to track this probably accounts for a substantial underreporting of the volume of CDCU microenterprise credit. Figure 37 shows the composition of the CDCU sector loan portfolio outstanding by loan purpose.

Figure 37 **Composition of Loans Outstanding**



Other High-Impact Activities

In addition to basic deposit and lending services, CDCUs also provide special products and services uniquely tailored to assist low-income members to improve their financial condition and avoid predatory lenders. A critical service provided by CDCUs is financial counseling and training. Eighty-three percent of CDCUs provided consumer credit, business, or home-buyer counseling, assisting 16,205 members in group-based sessions and 48,911 in one-on-one sessions.[17] In addition, 1,687 local organizations such as small businesses and other credit unions received technical assistance. The sector devoted 9% of its total staff time, without compensation, to these activities.

CDCUs reward thrift by matching member savings held in special IDAs. Members can use funds saved in these accounts only for specific wealth-building purposes, such as paying for education tuition or purchasing a home. As of the end of 2003, 26% of CDCUs had IDA programs, encouraging 1,958 members to accumulate $1.4 million toward specific wealth-building savings goals.

Payday lenders target low-income people, often short of cash for basic daily expenses, for short-term, high-rate loans secured by the borrower's next paycheck. In addition to providing basic offerings such as personal development loans, which are similar to payday loans but with a lower interest rate, CDCUs have also instituted loan programs specifically to combat predatory payday loans. As of the end of 2003, 19% of CDCUs provided payday loan alternative programs, providing 21,416 payday substitute loans worth $10.8 million.[18]

Financial Performance

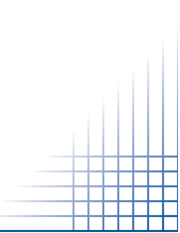
One reason mainstream financial institutions have withdrawn from economically distressed communities is that they are unfamiliar with or fearful of the typical low-income borrower's risk profile. CDCUs have to be flexible, creative, and knowledgeable about the market they serve to meet the challenge of serving people of modest means and often little financial experience. Yet CDCU portfolio performance rates is comparable to those of mainstream financial institutions. As of FYE 2003, the sector's aggregate delinquency greater than two months was 1.74% of aggregate loans outstanding, while the median, or typical, CDCU had a delinquency rate of 3.35%. The delinquency rate is somewhat higher than that of mainstream institutions, and indicates the challenges faced by CDCUs in managing lending to economically distressed areas. However, the ultimate loan loss rates are actually on par with the mainstream: a sector aggregate rate of 0.80% and an even lower 0.64% rate for a median, typical CDCU.

The sector's total net worth constituted 10.24% of its total assets, while the median CDCU had a capitalization rate of 9.82%, substantially exceeding federal statutory standards of 7% for "well-capitalized" credit unions.

The primary purpose of CDCUs will always be to serve economically distressed communities and populations; that purpose, though not incompatible with the profit motive, must override it. CDCUs do not have the option, as mainstream institutions do, of pulling up stakes and seeking greener pastures, higher rates of return, elsewhere. They continue to operate on tight margins in areas suffering from low capital availability and investment. Nevertheless, the CDCU rate of return on assets was not out of keeping with mainstream financial industry standards. The sector rate as of FYE 2003 was 0.88%, while the median or typical CDCU had a return on assets of 0.66%.

[17] Estimated for the entire CDCU universe from those CDCUs that reported these data

[18] Estimated for the entire CDCU universe from those CDCUs that reported these data



Creating Impact:

IDA Accounts

Metropolitan Community Credit Union is located in Washington, North Carolina, in a CDFI Fund–designated hot zone community and an area of especially acute economic distress and housing need. The credit union provides financial services to local residents, almost all of whom are people of modest means. In 2003, community outreach work by Metropolitan led 150 previously unbanked people to open share accounts at the credit union. In 2003, Metropolitan also started an IDA program, providing IDA matching funds and financial mentoring to four homeowners and one entrepreneur during the year, as follows:

Katrina Spencer, who is a single mother of two, was the first recipient of the IDA disbursement for homeownership. Katrina completed a personal savings and financial counseling program and was awarded $750 in matching funds toward the down payment of her home

Donald Keys worked hard to rebuild his credit, save, and qualify for his first mortgage. With assistance from the credit union, he was able to purchase a family home over 1,600 square feet in size.

Harold and Juanita Gardner, with a family of nine, were the third recipients of assistance for homeownership. The Gardners proved they could own a home by paying rent payments higher than the amount of the mortgage payment, received an IDA grant from Metropolitan, and were able to successfully finance their first home.

First-time homeowners Locasso and Jasina Battle

Locasso and Jasina Battle, with a family of seven, were the fourth recipients of assistance for homeownership that year. They worked hard and managed to save funds to go toward credit restructuring with hopes of owning their own home. After a concerted four-month effort, they were able to establish sufficient financial conditions for a home loan and are now happy first-time homeowners (see picture).

Loretta Johnson is now owner/franchisee of Papa's Pizza-To-Go in Aurora, North Carolina, as a result of assistance from Metropolitan's IDA program and a lot of saving and hard work. Together with the IDA matching grant, the credit union made available an economic developer and his assistant, who provided intensive business counseling and technical assistance to prepare Ms. Johnson for her entrepreneurial responsibilities.

Community Development Loan Funds

The CDLF sector is extremely diverse in its products and services offered to low-income people and communities; some loan funds are niche players offering a single loan product to one type of client (i.e., childcare providers), while other loan funds offer a range of different products (loans and equity) to a number of sectors (business, housing, and community facilities). There are four main types of loan funds serving low-income communities and customers: housing, community facilities, microenterprise, and business. Many CDLFs began by focusing on a single sector, most notably housing or business, but have expanded the types of clients they serve. In our sample, 42% of the loan funds focused on a single sector, and 58% served more than one sector.

The CDP sample includes 159 loan funds, which represent approximately one-third of the approximately 500 CDLFs in existence today. The loan funds in our sample had $3.2 billion in assets at the end of FY 2003. As with the CDFI industry as a whole, a few large organizations dominate the sector. The three loan funds with more than $100 million in assets accounted for $1.4 billion or nearly 42% of the sector's assets. Overall, the loan fund sector comprises primarily smaller and mid-sized organizations. The median asset size for loan funds is $5.6 million.

Financing Activity and Performance

Loan funds provided $1.7 billion in financing in FY 2003 and had $2 billion in financing outstanding at the end of FY 2003. The average amount outstanding was $17.7 million, and the median was $2.0 million. Most loan funds began as either housing or business funds, and those two sectors remain the most prevalent among loan funds in terms of dollars of financing outstanding (see Figure 38).

The loan fund sector has a majority (67%) of financing outstanding in the housing sector. Housing loans to nonprofit and for-profit developers for affordable rental housing, for-sale homes, and transitional housing is a core niche of loan funds. Loan funds provide financing when banks will not, or loan funds work with financial institutions to leverage their dollars. Because of the increased scale of the industry, CDLFs are able to make larger loans to affordable housing developers. The median loan size outstanding to housing organizations at CDLFs has increased from approximately $100,000 in 2000 to $150,000 in 2003. There are also an increasing number of loan funds that provide loans to individuals for home purchase and repair. Twenty-eight CDLFs provided housing loans directly to individuals and this financing continues to increase in the loan fund sector.

A growing number of loan funds are providing loans to community service organizations to enhance the services available in low-income communities. These clients, such as childcare centers, social service agencies, and arts facilities, often lack sources of capital because of their limited resources, knowledge about financing, and collateral. Of the 55 loan funds that provided community service financing, eight had community service as their primary financing sector, and 20 loan funds had at least 25% of their financing to community service organizations. CDLFs had $214 million in financing outstanding to community service organizations at FYE 2003 and closed approximately $115 million in loans and investments in FY 2003. Figure 39 indicates a breakdown of community services financing closed; educational loans represent 23% of this sector, and are primarily to charter schools, which are a growing niche of several CDLFs.

Loan funds typically charge interest rates based in part on the risk of the transaction. While loan funds are not as aggressive about risk-based pricing as conventional financial institutions, they typically charge higher rates for higher-risk loans (see Figure 40). Loan funds charge the highest rates for microenterprise loans (an average of 9%), because those loans carry the highest risk. Community facility and housing loans typically carry lower levels of risk and have somewhat lower rates than the business loans.

Figure 38 **Composition of CDLF Financing Outstanding**

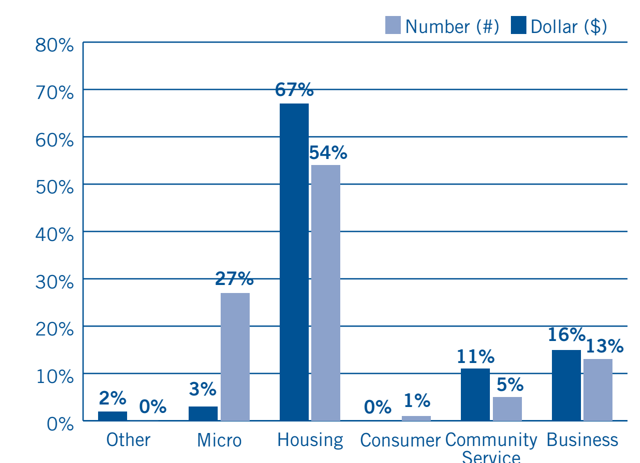
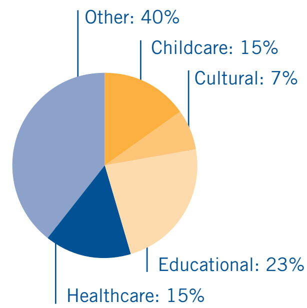
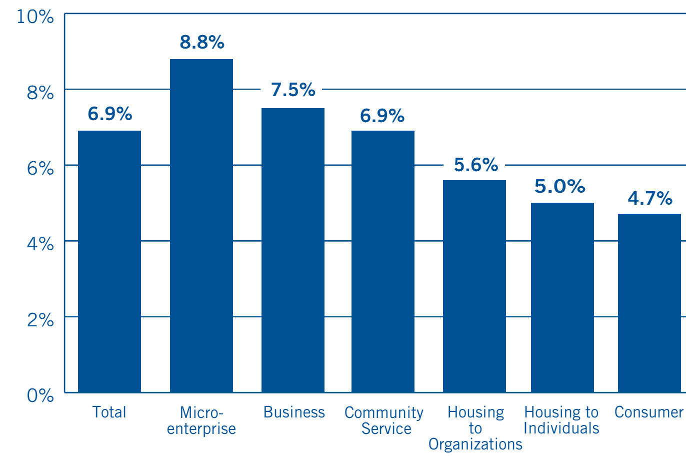


Figure 39 **Composition of Community Services Financing Closed**



Note: The largest component of "other" is social service agencies.

Figure 40 **CDLF Interest Rates Charged**

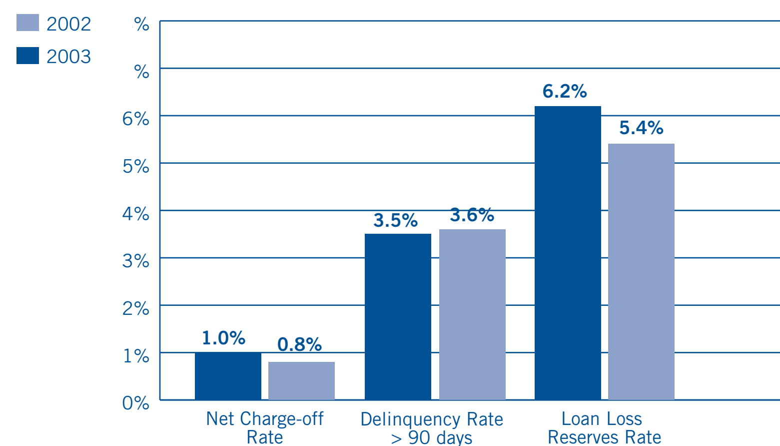


Portfolio Performance and Managing Risk

Loan funds are adept at managing risk in their markets. They manage their risk by keeping adequate loan loss reserves and equity capital to protect investors from potential losses. Loan funds also manage their risk by knowing their clients, monitoring their portfolio frequently, and offering substantial training and technical assistance both before and after the loan closing.

CDLFs charged off only 1.0% of their loan portfolios in 2003, which is slightly higher than the 0.8% in FY 2002 (see Figure 41). Forty-nine loan funds experienced no net losses in 2003, and only 13 loan funds (or 9% of the loan funds reporting) had net loan loss rates greater than 10%. These rates vary among different types of loan funds; the net loan loss rate for loan funds with a primary activity of business or microenterprise was 4.5%, while the rate for loan funds with a primary focus of housing or community facilities was 0.3%. Business lenders tend to make riskier loans, but plan for higher losses by keeping higher loan loss reserves. Figure 41 demonstrates that the loan loss reserve rate of 6.2% was more than six times the net loan loss rate, and 1.5 times the delinquency rates greater than 90 days for the sector as a whole. Overall, delinquencies and net charge-offs have been relatively consistent for the sector as a whole, although there is variation among individual loan funds.

Figure 41 **CDLF Portfolio Performance, 2002 and 2003**



Capital under Management

The total lending and investing pool, or total capital, of loan funds in our study was $2.6 billion at FYE 2003. The average capital size was $16.5 million and the median was $4.6 million.

Loan funds secure 69% of their capital from borrowed funds, or debt capital (see Figure 42). These funds are typically lent to loan funds at below-market rates. The average cost of borrowed funds for loan funds that reported this figure was 2.7% in 2003. Some larger loan funds, however, are finding creative ways to use more debt capital that is closer to market rates from financial institutions.

Equity equivalent investments (EQ2s) are a small but growing source of loan fund capital. EQ2s are highly subordinated debt instruments with features such as a rolling term and limited right-to-accelerate payments that enable them to function similar to equity. Banks are the primary investors in EQ2s because of the favorable CRA treatment.[19] Thirty-nine CDLFs secured EQ2 totaling almost $80 million at the end of 2003. Although this represents only 3% of loan fund capital, it is an important and growing source of capital, because typically it is long-term capital (7–15 years), has a rolling term, and allows CDFIs to leverage additional debt. Only nonprofit CDFIs use EQ2s.

More than one-quarter of the loan funds' capital, or $733 million, is equity capital. Equity capital is critical to loan funds because it enables loan funds to leverage more debt, provides a cushion to protect debt and EQ2 investors, and allows loan funds to take more risks. This capital cushion is particularly critical for unregulated loan funds. Equity at loan funds is the most difficult type of capital to raise and is built from a combination of grants to the loan funds to grow their equity capital base and any net income that loan funds designate to grow their capital. Sixty percent of loan funds have equity capital rates greater than 30%, and only 17% have capital rates below 10%.

A majority of investor capital—debt and EQ2—is from banks, thrifts, credit unions, and nondepository financial institutions, which together accounted for 53% of borrowed funds and EQ2 (see Figure 43). Financial institutions are a growing source of capital among loan funds because loan funds provide a safe investment vehicle for banks, banks can receive CRA credit for their investments, and loan funds are flexible partners. As fewer banks are willing to lend to CDLFs at below-market fixed rates, more CDLFs are using traditional financial products to capitalize and manage liquidity; these products include lines of credit at floating rates, repurchase agreements, and interest rate swaps and other derivative products.

Other key sources of loan fund capital are foundations and the federal government, accounting for 15% and 9%, respectively, of total investor capital. Some foundations offer below-market and long-term loans, called program-related investments (PRIs). Sixty-nine loan funds in our study had $177 million from foundations in FY 2003. Loan funds also use several federal government programs to capitalize their loan pools, including the CDFI Fund, the SBA, and U.S. Department of Agriculture.

Other key sources of investor capital are religious institutions and individuals. Although these investors account for only 5% and 3%, respectively, of loan fund investor capital, individuals represent a large number of investors and religious investors represent some of the first supporters of loan funds. Many loan funds have as part of their purpose educating investors and providing an alternative socially responsible source into which investors can put their money, and thus some loan funds see individuals as an important investor source.

Figure 42 **CDLF Capital Structure**

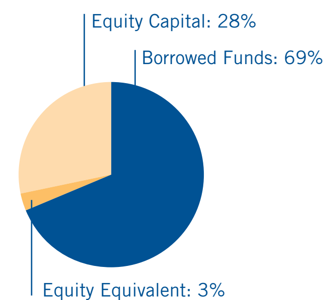
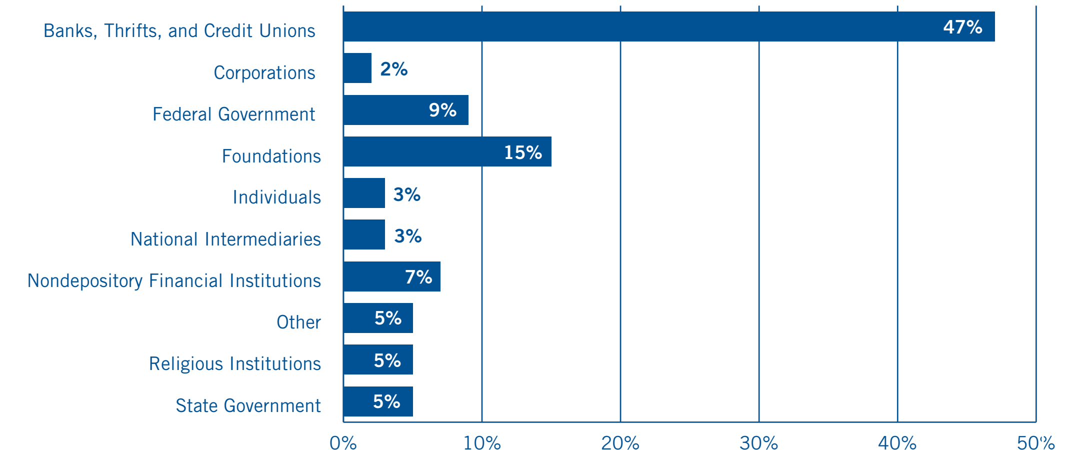


Figure 43 **CDLF Investor Capital Sources**



Note: Excludes one large loan fund that operates a secondary market program and has a unique capital structure.

[19]Lenders can receive either enhanced lending test credit or investment test credit for making EQ2 investments in CDFIs. Banks accounted for approximately 80% of EQ2s.

Creating Impact:

Reaching Native American Markets

There are a growing number of CDFIs, most notably loan funds, serving Native American communities throughout the United States. Serving Native American communities has unique challenges because of the concentration of poverty, reservation-based economies, and tribal governance. Despite the challenges, there are currently 32 Native certified CDFIs, up from only 9 in 2001. Of the 32 CDFIs, 22 are loan funds, 5 are credit unions, 4 are banks, and 1 is an intermediary. The largest share of these CDFIs are business loan funds that are trying to create new jobs and provide services to local residents. The Native CDFIs are concentrated in the Midwest and Western United States, and a couple are operating in Alaska and Hawaii.

One example is Four Bands Community Fund, a CDFI located on the Cheyenne River Indian Reservation in South Dakota. Four Bands created a partnership (Native Discovery) with Mitchell Prehistoric Indian Village in 2004, the goals of which are to increase the number of visitors who come to the Indian Village and Reservation; stimulate the sales of Native arts, crafts, and tourist-related services; and promote effective tourism partnerships between Native and non-Native communities. A key component of Four Bands' strategy is to provide financing and technical assistance to Native American businesses to expand their capacity and products in this community. Four Bands provided training, technical assistance, marketing, and loan capital to Bonnie LeBeau, a quiltmaker, to purchase materials for her home-based business (the Rose Room). Additionally, Bonnie and her husband received gap financing for a mobile home project they developed.

Bonnie LeBeau, Owner, Rose Room business, Cheyenne River Indian Reservation, South Dakota

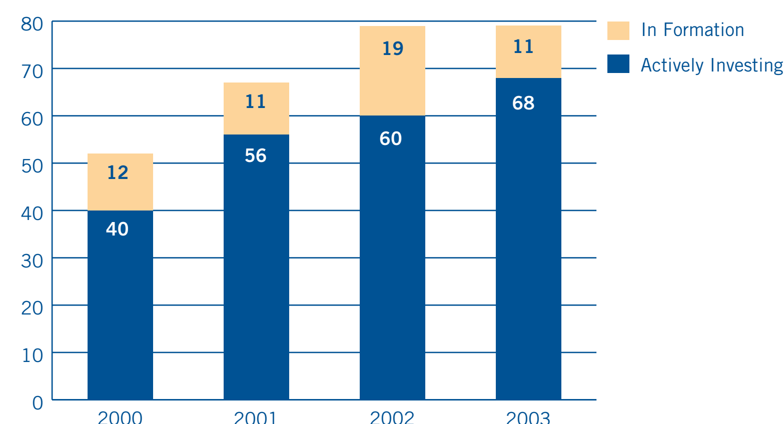
Community Development Venture Capital Funds

CDVC funds use the tools of VC—patient capital and business management expertise—to grow small businesses that create good jobs for low-income people and promote entrepreneurial capacity in economically distressed urban and rural areas. This chapter begins with a summary of the size and scope of the CDVC industry, based on the Community Development Venture Capital Alliance's (CDVCA's) ongoing research, and goes on to describe in detail the capitalization, financing activities, technical assistance activities, and social impacts of a representative sample of CDVC funds that were surveyed as part of the CDP.

The CDVC Sector: Size and Scope

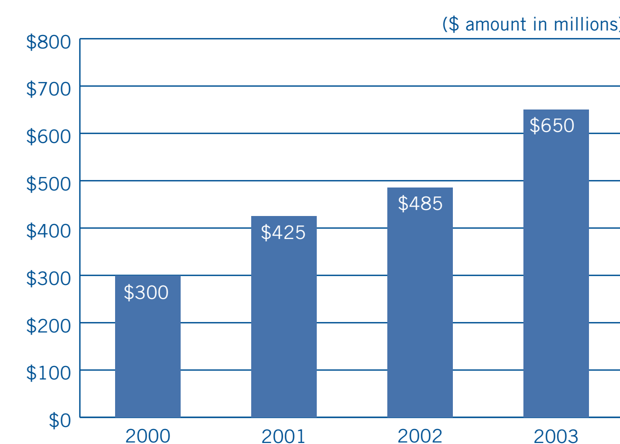
The number of CDVC funds has grown dramatically over the past 10 years, from just a half-dozen funds investing in the early 1990s to 79 funds actively investing or in formation by the end of 2003. The most significant development of 2003 was the sharp increase in the number of CDVC organizations that went from "in formation" to "actively investing," including five of the six New Markets Venture Capital (NMVC) companies.

Figure 44 Number of Funds, 2000–2003



Capital under management has also grown substantially over the past four years. Total capital under management grew from $300 million at the end of 2000 to $650 million at the end of 2003.[20] The two primary sources of new capital over this period have been the SBA's NMVC Program, which added $115 million of capital to the industry, and the successful closing by four established CDVC firms of four second funds, which by the end of 2003 had added an additional $95 million of capital.

Figure 45 CDVC Capital under Management



[20] Capital under management should be distinguished from assets and net assets, which are typically reported for other CDFIs in the CDP. See the section titled "CDVC Funds and Other CDFIs."

CDVC Funds and Traditional VC

CDVC funds act in much the same way as their traditional VC counterparts, seeking strong financial returns for their investors. But there are important differences, too. The most significant difference is the fact that CDVC organizations are mission driven. The mission of CDVC funds includes creating good jobs for people who would otherwise have limited employment opportunities, growing the entrepreneurial capacity of the regions in which they invest, and spreading wealth to entrepreneurs and employees. The combination of good financial returns and positive social impacts is often referred to as the CDVC industry's "double bottom line." In contrast, the traditional VC industry exclusively pursues financial returns.

CDVC funds tend to focus their investment activities in places where traditional VC funds rarely seek to invest. CDVC funds are active in Appalachia, rural Minnesota, Baltimore, and Cleveland—places not typically associated with VC. In fact, approximately 20% of all CDVC investments are made in rural counties, compared with only 1% of traditional VC investments.

CDVC funds are also active in regions where VC is plentiful—such as Silicon Valley, Boston, and New York City—but they often invest in neighborhoods and smaller towns overlooked by traditional VC firms.

Another feature that distinguishes CDVC funds from traditional VC is the types of companies in which they invest. Although traditional VC funds typically invest in a few "hot sectors"—high technology in the late 1990s and more recently biotechnology—the CDVC industry is invested in a more diversified set of industries.

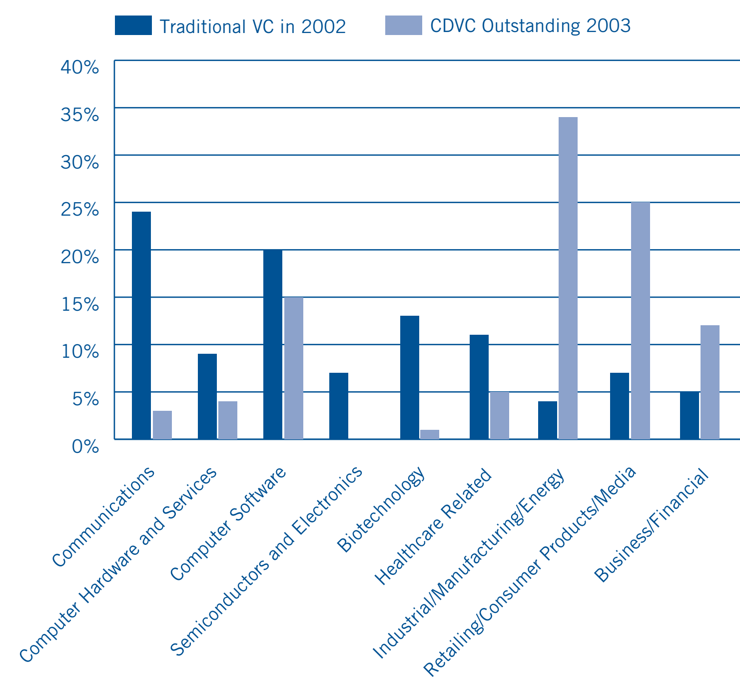
Figure 46 compares the types of companies in which CDVC funds invest to the types of companies in which traditional VC funds invest, using the Venture Economics industry sector categories. CDVC investments are based on CDVCA's Deal Database and are by dollar for all CDVC investments outstanding at the end of 2003; the Venture Economics numbers are dollars invested in 2002.[21] Industrial/manufacturing/energy is the single biggest sector for CDVC fund portfolio companies, accounting for 34% of the dollars invested; in contrast, this industry sector category accounted for only 4% of traditional VC dollars invested. Similarly, retailing/consumer products/media accounted for 25% of CDVC investments but only 7% of traditional VC. Also, where traditional VC is strong—communications, semiconductors and electronics, and biotechnology—CDVC funds tend to be only modestly involved in these sectors.

CDVC Funds and Other CDFIs

Like all CDFIs, CDVC organizations apply their financial expertise in ways that benefit lower-income individuals and communities. CDVC funds do this by making equity and equity-like investments into for-profit businesses, which, as they grow, generate positive financial returns for their investors and create good jobs for people who would otherwise have limited employment opportunities.

But, in contrast to other CDFI sectors in which the organizational structure of each sector is relatively homogenous, there are two general types of CDVC organizations—limited lifespan and evergreen funds. As the name implies, a limited lifespan model is established with a 10-year lifespan. At the end of 2003, 34% of the actively investing CDVC funds were organized as limited lifespan funds. These funds are managed either by a general partner (GP), in the case of an LP, or by the managing member, in the case of an LLC. Although the investing entity itself—the "fund"—is a for-profit entity, the GP or managing member need not be.

Figure 46 CDVC Funds' Portfolio Companies by Sector vs. Traditional VC Companies



[21] Traditional VC data are from Thomson/Venture Economics, *National Venture Capital Association 2003 Yearbook* (Arlington, Va.: National Venture Capital Association, 2003), 28, fig. 3.04.

In the evergreen model, the fund is established as an ongoing enterprise, typically either as a for-profit C-corporation or a not-for-profit 501(c)3. Of the funds actively investing in 2003, 25% were organized as evergreen for-profit funds and 41% were evergreen not-for-profits (see Figure 48).

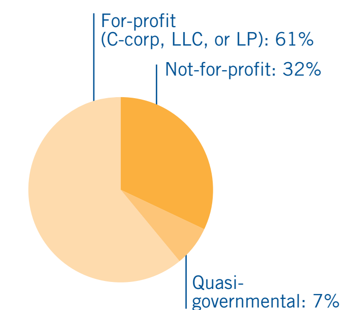
In 2003, 61% of all CDVC investing entities were for-profit, 32% were not-for-profit, and 7% were sponsored by a state or local government, which also provided the capital.

A final wrinkle is that many CDVC organizations ally a for-profit and a not-for-profit. The advantage of this hybrid approach is that the not-for-profit can seek grant dollars that can be used to defray some of the developmental costs associated with providing extensive technical assistance to the portfolio companies. For example, SJF Ventures, an LP, works with an allied not-for-profit, SJF Advisory Services, which provides entrepreneurial, workforce, and sustainability assistance services to SJF prospect and portfolio companies.

Fund managers choose among these various models based on their expectations of which investors they want to attract, tax and liability issues, their own experiences, and the goals of the organization.

The sections that follow report results on the 21 CDVC funds that responded to the CDP survey. They present data on the organizations from the CDP data set whose primary financing activity is VC; some organizations in the CDP data set are involved in both CDVC investing and traditional business lending, using the same pool of capital for both types of financing activities. To rationalize the data presentation in this report, this section reports only on the organizations that have CDVC investing as their primary financing activity. For a comprehensive overview of the entire CDVC industry, including the CDVC investment activities of the business loan funds that do CDVC investing and the NMVC companies, see CDVCA's forthcoming *Report on the Industry '03*.

Figure 47 Corporate Structure of CDVCA Funds' Investing Strategy

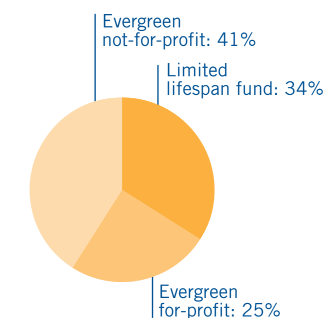


Capitalization

The 21 CDVC funds reported total capital available for investing as $318 million. Nearly 80% of this capital was equity, with the remaining being debt. Figures 49 and 50 show equity (and equity grants) capital by source and debt capital by source for the funds that reported these data.

Banks are the single largest equity investors in the CDVC industry. Bank investments accounted for 39% of all equity dollars invested. Bank investments into CDVC funds can qualify for CRA credit under the regulation's investment test. Federal and state governments were the second-largest category of investors and accounted for 13% of all equity investments. Nondepository financial institutions—insurance companies and investment banks—also accounted for 13% of the total equity capital. Foundations contributed 13% of equity. All other sources, including individuals, fund parents and affiliates, and other sources, invested the remaining 22%.

Figure 48 CDVC Models



Foundations are the largest providers of debt capital to the CDVC industry. Debt from foundations, including PRIs, accounted for 44% of all debt capital. Banks were the next largest provider of debt capital, with 26% of the total, followed by federal and state governments, which together provided 23%. The remaining 7% came from nondepository financial companies and other sources.

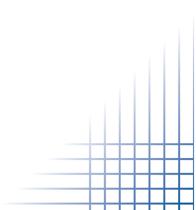


Figure 49 **Equity Capital by Source**

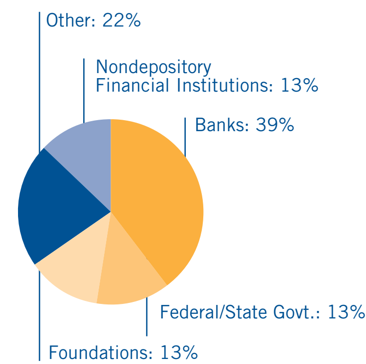
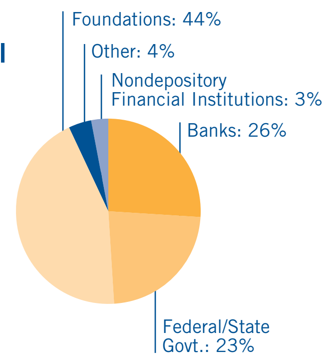


Figure 50 **Debt Capital by Source**



Financing Activities

Twenty of the 21 funds reported their investments outstanding at the end of FY 2003, which totaled $83.2 million, including equity investments of $61.7 million, near-equity investments of $14.1 million, and debt investments of $7.4 million (see Figure 51).[22] The vast majority of CDVC capital is invested as equity—common or preferred stock, LP interests, or membership shares. CDVC funds also use near-equity instruments such as debt with warrants, convertible debt, or debt with royalties. The industry showed a substantial growth in equity investments outstanding—18% from 2002 to 2003.

Figure 52 shows the dollars invested per year by type of instrument. The number of funds reporting is the number of funds reporting data, and not necessarily the number of funds actively investing. Limited lifespan funds typically make all of their initial investments into companies in the first several years of the fund's cycle, reserving some capital for follow-on investments. In the final few years of the 10-year-cycle funds, these funds have typically fully invested all of their capital and are working to generate exits and realize their profits. The modest drop in dollars invested per year reflects, in part, the fact that two of the limited lifespan funds reporting data were fully invested by the end of 2003.

Figure 51 **CDVC Investments Outstanding, 2001 to 2003**

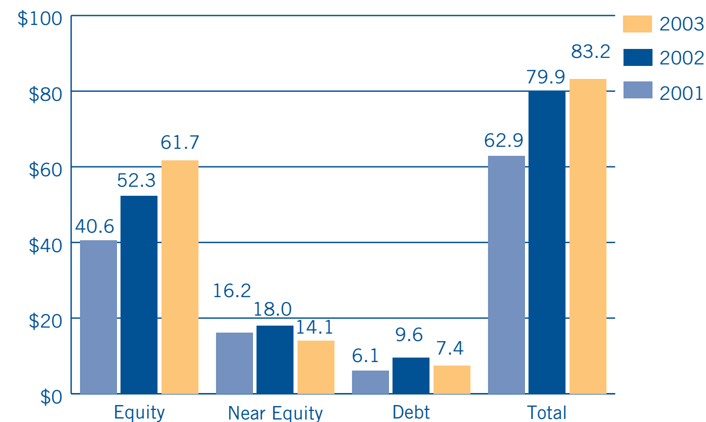


Figure 52 **Dollars Invested per Year by Instrument Type, 1999 to 2003 (millions of $)**

Year	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003
# of Funds Reporting	12	14	17	20	20
Equity	$6.1	$13.0	$12.5	$11.8	$12.5
Near Equity	$3.6	$6.2	$6.3	$5.1	$5.2
Debt	$3.7	$3.9	$3.2	$4.3	$2.3
Total	$13.4	$23.1	$22.0	$21.2	$20.0

[22]These numbers exclude the debt investments of one fund that uses the same pool of capital to make both equity and traditional debt investments.

Technical Assistance

CDVC funds provide tremendous amounts of highly targeted technical assistance to the portfolio companies in which they invest, as well as companies in which they consider investing.

The most substantial component of the technical assistance provided by funds is the business management expertise that they provide to the companies in which they invest. The data reported by 12 funds show that these funds provided targeted technical assistance to 101 companies. Funds spend substantial amounts of time providing technical assistance to their portfolio companies. Technical assistance can include marketing help, recruiting top management, arranging new financings, strategic planning, and workforce development—whatever will help the company to grow.

Another mechanism that funds use to aid prospective companies is targeted business advisory services. These services can be formal programs organized and implemented by the fund or its not-for-profit affiliate or less structured arrangements in which the fund works with companies in its investment area. These companies may or may not be companies in which the fund is considering an investment. Seven CDVC fund respondents reported providing business advisory services to 330 companies. Hours spent aiding these companies varied from just a few hours to 32 hours per company and across all funds averaged 15 hours per company.

The final way in which CDVC funds provide technical assistance to companies in their investment areas is through the review of business plans. CDVC fund managers collectively review thousands of business plans each year. The 13 funds reported reviewing 2,071 business plans in 2003, or nearly 160 plans per fund. By reviewing and commenting on business plans and helping entrepreneurs develop successful businesses, CDVC fund managers offer business management expertise where there is oftentimes too little to go around.

Figure 53 **Number of Companies Receiving Technical Assistance by Type of Technical Assistance**

	Business Plans Reviewed	Business Advisory Services	Portfolio Company TA
Number of companies	2,071	330	101
Average hours per company	NA	15	87

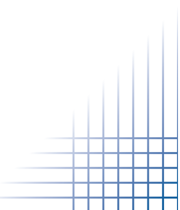
Social Impacts

CDVC funds make equity investments into fast-growing companies, especially companies that can create good jobs for low-income people. Figure 54 shows the employment impacts of the 17 CDVC funds that reported the total number of full-time equivalents (FTEs) at the time of their initial investment into each portfolio company and at the end of 2003. FTEs grew from 6,075 to 8,850, a 46% increase in total employment.

Figure 54 **Job Change Numbers for Selected Funds**

	FTEs at Time of First Investment	FTEs at End of 2003	Change in Employment
Total FTEs	6,075	8,850	46%

Note: Based on the 17 funds that provided complete data on total FTEs



The focus on low-income job production is reflected in the higher rates of job creation for low-income jobs versus non-low-income jobs (see Figure 55). The nine funds that collected data on these measures reported a 124% increase in the number of low-income jobs at their portfolio companies and a 37% increase in non-low-income jobs. Overall, total FTEs at these nine companies grew 89%.

CDVC organizations make investments into portfolio companies, boosting their employment, offer business and management expertise to prospect and portfolio companies, and review hundreds of business plans per year. Tallying all of the individuals who have been aided by CDVC organizations, the 17 funds reported aiding 9,819 individuals. Funds estimated that 56% of people aided were low-income, 39% were minority, and 38% were women.

Figure 55 **Comparison of Low-Income and Non-Low-Income Job Change Numbers for Selected Funds***

	FTEs at Time of First Investment	FTEs at End of 2003	Change
Low-Income FTEs	1,768	3,958	124%
Non-Low-Income FTEs	1,188	1,633	37%
Total FTEs	2,956	5,591	89%

** Based on the 10 funds that provided complete data on low-income and total FTEs*

Financial Returns

While it is too early to generalize about the financial returns of the CDVC industry, there are a few organizations that have been around long enough to suggest a possible range for financial returns. It should be emphasized that these are preliminary results. Many factors that are highly correlated with financial returns—vintage year,[23] industry focus, stage focus, and management team, for example—cannot be controlled for here because the sample is too small.

Preliminary results for the two funds with investment histories of more than 10 years show gross internal rates of return (IRRs) of 11.8% and 16.5%. Gross IRRs exclude the cost of fund management and any carry, or profit interest, that the fund's management might have.

These results compare favorably with the numbers recently reported by Investors' Circle (IC), an angel network of socially responsible VC investors. A study conducted by McKinsey & Co. and the Harvard Business School gathered information on $72 million of investments into 110 portfolio companies financed since 1992 by IC's members. The research found that the gross IRRs on IC's investments were 8% or 14%, depending on how the investments were simulated.[24]

As today's CDVC funds mature, they will pass the 10-year mark, which is the standard lifespan for a traditional limited lifespan VC fund and the point at which it is reasonable to determine its financial returns. As of 2004, only three organizations with substantial CDVC investing experience have been investing for this long, and none of these is a traditionally structured 10-year limited lifespan fund. For this reason, none of the older funds was under pressure to exit investments within the 10-year period, as traditionally structured funds would be. Thus, numbers for net returns are difficult to determine for these funds.

[23]Vintage year is the year the venture capital fund began making investments.

[24]This study is summarized in the Community Development Venture Capital Alliance's publication, *Financial Returns and Double-Bottom Line Venture Capital: What Do We Know?* See also Steven Carden and Olive Darragh, "A Halo for Angel Investors", *The McKinsey Quarterly*, no. 1 (2004).

Creating Impact:

Exiting a VC Investment with Social and Financial Returns[25]

Murex Investments sold its equity position in Computer Systems and Solutions (CSS) for $262,500, an asset it acquired for $3,500 14 years ago, for an IRR of 36%. "We took equity in Kimberly's [the CSS CEO's] potential years ago with only her word of honor," says Bob Fishman, Murex founder. "We took the risk because of the strength of the relationship, and that bet is finally paying off."

Murex, a Philadelphia-based U.S. Treasury–certified CDFI, first backed the small laptop repair and sales company because of its potential to benefit both social and economic bottom lines for the region. Subsequently, CSS used the capital to create 23 high-quality jobs as the business grew to $3,000,000 in sales. The Murex exit was part of a sale of the laptop repair end of the business to a private individual.

As part of its initial investment agreement, Murex insisted that CSS pay at least a living wage ($7.90/hour) to all its employees and donate a percentage of profits to charity every year as part of a corporate "give-back" policy. The company also shares profits with employees.

"We've always thought the social requirements made good business sense," says CSS founder and CEO Kimberly Crew. "When you treat employees right and they share in the upside, they are more motivated to create profits, so I had no problem with the Murex terms." As a result of the sale, CSS is sharing more than $250,000 with an employee bonus pool and charity.

"This deal is exciting for a lot of reasons," says Joel Steiker, Murex CEO. "CSS has become a very strong woman-owned business, it provides good jobs for low- to moderate-income people, and the financial success is a testament to the Murex development model. With intelligent assistance alongside the funding, small businesses can reward investors, employees, and our communities."

Employee, Computer Systems and Solutions, Essington, Pennsylvania

Like other CDFIs, Murex provides access to capital for double-bottom-line companies. But Murex adds in an unusually strong dose of intensive, sustained technical assistance. Over the years, assistance to CSS has included incubation space during the seed and early stages, loans to finance the continued expansion, and hundreds of hours of one-on-one consulting with Murex's in-house business developers.

Murex was founded by Resources for Human Development, a 35-year-old $110,000,000 nonprofit with 3,000 employees, which is headquartered in Philadelphia.

[25]This article was excerpted from *Innovation Philadelphia*, vol. 2, no. 8. (February 2005)

Microenterprise Financing

Microenterprise financing provides support to a discrete set of small businesses. Microenterprise loans are usually defined as less than $35,000,[26] and invested into businesses with five or fewer employees. Typically these businesses are owned by traditionally disadvantaged populations, including women, ethnic minorities, and low-income individuals.

Microenterprise financing is an important component of the work of CDFIs. Microenterprise development efforts, including financing, technical assistance, and training, are a tool for poverty alleviation, community development, economic development, and refugee and immigrant resettlement efforts.

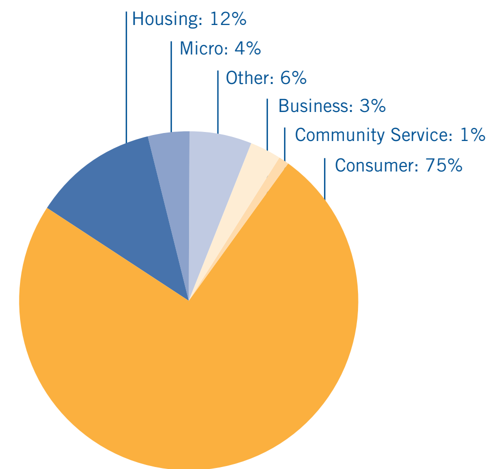
This chapter presents and discusses FY 2003 CDP data from a large group of CDFIs that provide financing to microenterprises.[27] The intent of this chapter is to highlight the size and scope of microenterprise activity within the CDFI industry, to examine how microenterprise support is delivered by various CDFIs, and to briefly discuss the issue of sustainability with respect to microenterprise services. The chapter draws primarily from CDP data and secondarily from data collected by the MicroTest project at the Aspen Institute.

The Context of Microenterprise Financing within CDFIs

Of the 432 CDFIs that reported to the CDP at least one loan outstanding for FY 2003, 28% (119 CDFIs) held some microenterprise loans in their portfolio.[28] The total amount of the microenterprise portfolio in this group of 119 CDFIs was $73.4 million. The average microenterprise portfolio at the end of FY 2003 was $617,000, and the median was $287,873. The range of microenterprise portfolios in the group was very broad: from a low of $1,902 to a high of over $8 million. Twenty-two CDFIs held at least $1 million in microenterprise loans.

In FY 2003, 432 CDFIs reported approximately 441,000 outstanding loans.[29] Figure 56 demonstrates that of the loans identified with a particular purpose, 4% are microenterprise loans. This represents the fourth-largest use of CDFI funds (in terms of number of loans), behind consumer loans, housing, and other uses. This share of loans by microenterprise is similar to the 3.6% of CDFI loans reported to the CDP for FY 2000 by a somewhat smaller sample[30] of lenders (379 CDFIs in 2000 compared with 432 CDFIs in 2003).

Figure 56 Distribution of Loans by Purpose, FY 2003



The Delivery of Microenterprise Lending

Of the CDFIs that reported microenterprise lending activity in FY 2003, 71% are loan funds and 26% are credit unions (see Figure 57). These two CDFI types provided 97% of all the microloans reported to the CDP.[31]

Figure 57 Microlending by CDFI Type

Type of CDFI	Number of CDFIs	Number of Microloans	Microloans per CDFI
Loan Fund	86 (71%)	8,177 (83%)	95
Credit Union	31 (26%)	1,280 (13%)	41
Bank	3 (2%)	298 (3%)	99
Venture Capital	1 (1%)	134 (1%)	134
Total	121 (100%)	9,889 (100%)	82

In terms of portfolio size by CDFI type, loan funds as a group held 78% of the total outstanding microenterprise portfolio (see Figure 58). About $12 million in microlending by credit unions constituted another 16% of the total portfolio.

Figure 60 distributes the 119 CDFIs engaged in microenterprise lending according to the size of their microenterprise portfolio. It shows that 66% of the total microenterprise lending portfolio is held by those CDFIs with microenterprise portfolios in excess of $1 million. The average total portfolio of these lenders is more than $59 million, and microenterprise loans make up 3.7% of their loan portfolios. Basically, large microenterprise lenders are large lenders, and even though microenterprise lending represents a small fraction of their overall portfolio, it is nevertheless an important contribution to the amount of financing of microentrepreneurs in the United States. The CDFIs with microenterprise portfolios ranging from $250,000 to $1 million have a greater share of microloans in their total portfolios than either very small or very large microlenders.

Figure 58 Microenterprise Portfolio by CDFI Type

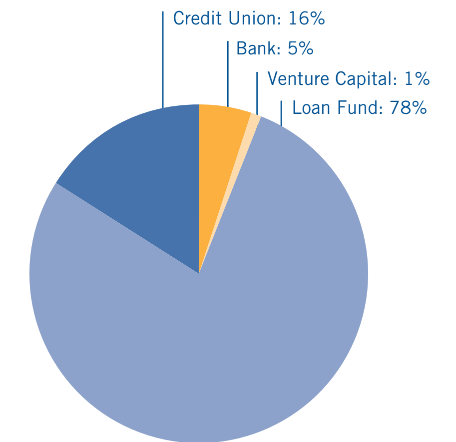


Figure 59 Microenterprises Financed by CDFI Type, FY 2003

	Loan Funds	Credit Unions	Banks	Venture Capital Funds	Total
Total Microenterprises Financed	5,964	648	198	25	6,835
Percent of Total	87%	9%	3%	0.4%	100%
Average Number of Microenterprises Financed	72	26	40	25	60
CDFIs Responding	83	25	5	1	114
Percent of Total	73%	22%	4%	1%	100%

[26] The CDP defines a microloan as less than $25,000, and Aspen and MicroTest define it as less than $35,000.

[27] The CDP authors would like to thank Ilgar Alisultanov for his assistance in analyzing the CDP FY 2003 database for this chapter.

[28] These figures are based on all CDFIs reporting at least $1 outstanding in microloans at the end of FY 2003. There were 121 CDFIs with outstanding microloans. Two of these CDFIs did not report the dollar amount of outstanding microloans.

[29] The numbers represented in the tables in this section include some direct financing products in addition to loans (e.g., equity investments, guarantees); however, because 371,089 of 371,524 direct financing products in the CDP database are loans, we use the term "loan" for ease of reference.

[30] *Microenterprise Support within Community Development Financial Institutions* (Washington, D.C.: The Aspen Institute, 2003), 8.

[31] These figures are based on all CDFIs reporting at least one outstanding microloan at the end of FY 2003.

Figure 60 Size of Microenterprise Portfolios within CDFIs (FY 2003 Data)

Size of Micro Portfolio	Number of CDFIs	Average Micro Portfolio	Average Total Portfolio	% of Total Portfolio in Micro	Total Micro Portfolio
Less than $250,000	58	$92,387	$10,363,580	0.9%	$5,358,427
$250,001 to $500,000	24	$374,152	$2,654,202	14.1%	$8,979,653
$500,001 to $1,000,000	15	$691,029	$5,698,585	12.1%	$10,365,440
More than $1,000,000	22	$2,213,607	$59,057,453	3.7%	$48,699,348
Total	119	$616,831	$17,222,951	3.6%	$73,402,870

Figure 61 shows the incidence of microenterprise lending among CDFIs. While lending to microbusinesses is a part of the activities of more than a quarter of all CDFIs, 10% of all CDFIs have made microlending the main focus of their community development activities.

Figure 61 Incidence of Microenterprise Lending

Microenterprise Loans	Number of CDFIs	% of All CDFIs	% of Active Microlenders
All CDFIs	432	100%	N=121
CDFIs with:			
At Least One Microloan in Portfolio	121	28%	100%
At Least 10% of Loans in Micro	77	18%	64%
At Least 25% of Loans in Micro	61	14%	50%
At Least 50% of Loans in Micro	45	10%	37%
At Least 75% of Loans in Micro	31	7%	26%
At Least 90% of Loans in Micro	27	6%	22%
100% of Loans are in Micro	6	1%	5%

To estimate the total amount of financing outstanding to microenterprises as of the end of FY 2003, it is necessary to look beyond the figures reported to the CDP by these 432 CDFIs. Figures reported to the MicroTest project by 31 microenterprise lenders that did not report to the CDP add another $11 million to the $73.4 million reported to the CDP, for a total of approximately $84.4 million in microloans outstanding in 150 CDFIs and microenterprise programs. Given that there are dozens more microenterprise lenders than these 150 for which portfolio data are available through either the CDP or MicroTest, it is certain that this $84.4 million figure undercounts the total amount of financing by CDFIs to microenterprises in the United States.

Portfolio Risk and Sustainability

Microenterprise loans can carry a higher level of risk than other types of CDFI investments. Often, the entrepreneur is unable to access a bank loan because of a poor credit rating or lack of demonstrated business experience. Sometimes, the business itself is in a risky or low-yield sector of the local economy, or the business is in start-up mode with little demonstrated operating history. One would expect to see somewhat elevated levels of delinquency, then, in the portfolios of those CDFIs focused on lending to microentrepreneurs.

Figure 62 shows delinquency data for three groups of CDFIs: those “stand-alone” microenterprise lenders who lend primarily to microbusinesses; those CDFIs that have at least one loan in their portfolio to a microentrepreneur, but also lend to other sectors; and those CDFIs that do not finance microenterprises.

Figure 62 Delinquency Data, FY 2003

Delinquency Rate:	31–60 days	61–90 days	>91 days	Average Outstanding Portfolio
Microenterprise-Only CDFIs	4.8%	2.4%	7.1%	$1,314,209 (n=25)
CDFIs with at Least One Microenterprise Loan	3.4%	1.1%	3.6%	$22,631,332 (n=61)
CDFIs with No Microenterprise Loans	1.2%	0.7%	1.5%	$22,940,112 (n=69)

As expected, portfolio quality indicators vary for these groups of CDFIs. Importantly, however, all groups—including the CDFIs dedicated to financing a high percentage of microbusinesses—demonstrate strong portfolio quality.

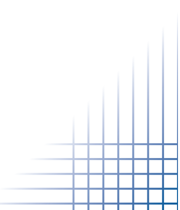
Lending programs typically strive to cover as much of their credit program’s operating costs as possible through revenue earned from the operation of that program. Operational self-sufficiency is a sustainability measure that indicates the percentage of a credit program’s operating costs covered with earned income. Basically, the higher the operational self-sufficiency ratio, the more sustainable the credit program. Although average rates of operational self-sufficiency have hovered just above 30% for programs in MicroTest over the past three years, the rate increased in FY 2003 to 38% (see Figure 63). Some lenders are achieving much higher results (7 of the 44 lenders in FY 2003 covered at least 70% of their credit program’s operating costs), but for many this remains a tough challenge.

Figure 63 Indicators of Microenterprise Lending Program Sustainability

Sustainability Measures	FY 2000	FY 2001	FY 2002*	FY 2003
Average Microenterprise Program Budget	$552,899 (n=45)	$630,856 (n=53)	$746,048 (n=49)	$677,174 (n=48)
Average Operational Self-Sufficiency	33% (n=44)	31% (n=50)	32% (n=49)	38% (n=44)

*Some indicators may slightly differ from data in previous publications due to updated information.

Although progress is being made by many microenterprise-focused lenders (particularly those with large outstanding portfolios and effective cost-containment strategies), the issue of sustainability will likely remain a topic of some importance and debate within the field for several more years.



Creating Impact:

Financing a Microentrepreneur[32]

Manuela and Jose began building their entrepreneurial dream even while working full-time jobs at a “big-box” appliance store and raising their five young children. In their free time, they created handmade party favors in their small, two-bedroom apartment.

By 1996, they were able to open their first retail store and customers quickly began asking for other party items, especially clothing. That prompted the couple to begin carrying baptismal gowns, kid-sized tuxedos and frilly white dresses for first communions, and the fancy party dresses worn for the traditional Hispanic quinceañera, the celebration of a girl's 15th birthday. Manuela and Jose fill an unusual market niche, stocking a wide variety of party and special occasion items aimed in part at the area's large Hispanic community. Especially popular are their handmade party favors.

Building their business has meant obtaining financing. And for that, the couple turned to Neighborhood Development Center (NDC), a CDFI that works in both inner-city Minneapolis and St. Paul to help emerging entrepreneurs launch businesses that serve their communities. Since opening their first business, the couple has obtained four loans and a line of credit. Along with financial support, NDC also has provided some technical expertise on managing and operating the business. NDC loan officer Rachel Dolan describes Manuela's payment history as “stellar,” adding, “She is never late with a payment; if anything she prepays.”

These days, Manuela and Jose are the proud owners of four stores and a four-bedroom home in a stable, moderate-income neighborhood in Minneapolis. Moreover, after years of patching together income from full-time employment plus their small businesses, both were able to quit their outside jobs in early 2000 and now are full-time entrepreneurs.

And that makes Manuela beam with pleasure. Aside from enjoying contact with customers in her stores, Manuela says that what she likes most about operating a business is “being able to progress through our own effort—our own hard work. When we arrived (in Minneapolis) we lived in a small, ugly apartment. After all our hard work, we now have a nice house. ... Business has been good.”

Manuela and Jose, small business owners

Photo by Jane L. Hale provided courtesy of the Microenterprise Fund for Innovation, Effectiveness, Learning and Dissemination (FIELD), a project of the Aspen Institute.

[32]This entrepreneur profile is excerpted with the permission of FIELD (Microenterprise Fund for Innovation, Effectiveness, Learning and Dissemination) from http://fieldus.org. The CDP authors wish to thank the Neighborhood Development Center for their permission to include this profile.

Appendix A: Methodology

As partners in the CDP, five national trade associations and intermediaries, Aspen Institute, Community Development Venture Capital Alliance (CDVCA), National Federation of Community Development Credit Unions (NFCDCU), National Community Capital, and National Community Investment Fund (NCIF), worked together as the Data Collection and Cleaning Committee to collect data across the four types of CDFIs. Each data collector was responsible for collecting CDP data from its member or constituent CDFIs. National Community Capital acted as project manager, consolidating all of the data collected.

The Data Collection and Cleaning Committee defined common data points and definitions across the various institution types and developed data cleaning protocols that all data collectors were required to follow. National Community Capital, as data consolidator, also applied financial formulas during data consolidation to perform further quality assurance. Each trade association was responsible for designing its own survey instruments for distribution to its constituent CDFIs. The instruments were based on consensus language that defined cross-sector CDP data points, as well as on language appropriate for individual CDFI sectors.

Overall, the CDP sent out 616 surveys for FY 2003 and compiled data for 477 CDFIs, a response rate of 77% and an increase of 8% from 442 CDFIs in FY 2002. This data set represents one of the largest and most comprehensive samples of CDFI data to date in the field. Nonetheless, it represents only a subset of the CDFI industry.

CDFIs reported information based on their own FY, which may be different from the calendar year and may vary from institution to institution.

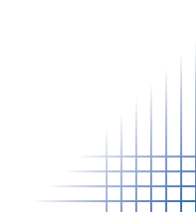
Not all questions were relevant to all CDFIs and thus some were not answered by every institution. In addition, some CDFIs were unable to answer some of the survey questions. As a result, the number of responses to individual questions may frequently be less than the total study size and is noted accordingly.

Use of Public Data for Credit Unions

The CDP sent surveys to 265 CDCUs for FY 2003. The survey requested data on organizational characteristics, financial position, products and services, and community development outputs as of the end of FY 2003.

A total of 117 credit unions (44%) sent back completed questionnaires. For 148 nonresponding credit unions, financial data were obtained from regulatory “call reports” prepared by all federally insured U.S. credit unions. Data on nonfinancial fields were unavailable for nonrespondents.

Consequently, when a survey question sought the same information provided on the call report, these data were obtained for all 265 CDCUs. Thus, it was possible to include an aggregated tally for the whole CDCU movement (as defined by this study) for these data points. For those survey questions, the sample size was all 265 credit unions. For requested data unique to the survey (and thus not available for nonrespondents), this report presents only the numbers drawn from the respondents. The sample size in these cases is limited to the 117 institutions that responded.



Appendix B: Glossary of Terms

Staffing and Governance

Full-Time Equivalents (FTEs): Includes full- and part-time employees of the organization and volunteers who fill regular staff positions. Excludes temporary staff and professional services conducted outside the office by third parties, such as accounting, bookkeeping, and legal counsel. One FTE is at least a 35-hour workweek.

Specialized Staff (FTEs): Staff dedicated to one or more specific functions.

Lending/Investing: Includes all FTEs performing the following functions: portfolio management, loan/investment underwriting and outreach, and loan/investment administration.

Training and Technical Assistance: Includes all FTEs providing training and technical assistance. Training refers to a forum such as a workshop, while technical assistance is customized to an individual or specific organization.

Financial Services: Includes all FTEs providing services such as savings products, checking accounts, and other services (e.g., wire transfers). Includes all work performed by tellers.

Capital Available for Financing

Total Lending/Investing Pool or Capital Available for Financing: Includes all capital for lending and investing held by a CDFI, as of the end of the fiscal year. This lending/investing pool includes only capital shown on the statement of financial position as received—it does not include capital commitments, grants receivables for capital, or undrawn funds, with the exception of the venture fund sector (which includes committed capital).

Total Lending/Investing Pool = Borrowed Funds + Deposits + Shares + Nonmember Deposits + Secondary Capital + Equity Equivalent Investments + Equity Capital.

Borrowed Funds: Loans payable related to financing. Also referred to as debt capital or investor capital. Funds lent to a CDFI from a third party that the CDFI will relend or reinvest in the communities it serves.

Deposits: Funds placed in a depository institution by individuals or organizations, typically earning interest and insured by governmental agencies.

Shares: A deposit made in a credit union that confers ownership rights in the credit union to the depositor.

Nonmember Deposits: Funds placed in a credit union by individuals or organizations that are not members of the credit union. Nonmember deposits do not confer ownership rights in the credit union to the depositor and are typically limited to a small percentage of a credit union's total deposits.

Secondary Capital: A specific type of capital used only by low-income designated credit unions. It is defined by the National Credit Union Administration as having several key characteristics: uninsured, subordinate to all other claims, minimum maturity of five years, and not redeemable prior to maturity.

Equity Equivalent Investments (EQ2s): Unsecured debt that has some of the same advantages as equity because it is subordinate to all other debt and carries a rolling term, the investor has a limited right to accelerate payment, and interest is not tied to income. The investing bank also receives advantageous CRA credit.

Equity Capital: Also referred to as net assets dedicated to lending by nonprofit loan funds, and equity by credit unions, banks, and venture funds. It is the amount of equity at the CDFI that is available for lending or investing.

Capital under Management (Venture Capital, VC): Traditional VC funds, organized as limited lifespan funds, are described in terms of their "capital under management," not their "total assets" as banks, credit unions, and loan funds are. Capital under management is the total amount of capital that investors have committed to the fund and includes drawn and undrawn capital. The chapter on CDVC funds reports CDVC capital under management by summing the capital commitments of each of the limited lifespan CDVC funds and the total assets of each of the evergreen funds.

Capital Sources

Nondepository Financial Institutions: Includes all financial institutions that are not banks, thrifts, or credit unions, including mutual funds, insurance companies, and finance companies.

Sectors Served

Microenterprise: Financing to for-profit and nonprofit businesses with five or fewer employees (including the proprietor) and with a maximum loan/investment of $25,000. This financing may be for the purpose of start-up, expansion, working capital, equipment purchase/rental, or commercial real estate development or improvement.

Business: Financing to for-profit and nonprofit businesses with more than five employees or in an amount greater than $25,000 for the purpose of expansion, working capital, equipment purchase/rental, or commercial real estate development or improvement.

Housing: Financing to housing developers for predevelopment, acquisition, construction, renovation, lines of credit, working capital, and mortgage loans to support the development of rental housing, service-enriched housing, transitional housing, or residential housing. Includes housing financing to individuals (e.g., loans) to support homeownership and home improvement. Home equity loans are not included here unless the purpose of the home equity loan is to finance housing-related activities (e.g., home repair, purchase of another home). All other home equity loans are classified by the purpose of the loan (e.g., a home equity loan that helps the borrower start a business is classified under business).

Community Services: Financing to community service organizations such as human and social service agencies, advocacy organizations, cultural and religious organizations, health- care providers, and childcare and education providers. Uses include acquisition, construction, renovation, leasehold improvement, and expansion loans, as well as working capital loans and lines of credit.

Consumer Financial Services: All personal loans (secured and unsecured) to individuals for health, education, emergency, debt consolidation, and consumer purposes. Generally, personal loans for business are classified as microenterprise or business; personal loans for home improvement or repair are classified as housing.

Other: Any activities not covered in the sectors defined here (includes financing to other CDFIs).

Financing Outstanding

Total Loans Outstanding: The number of loans for which principal was outstanding as of the last day of the FY. These loans may have originated during the FY or in a previous year. This number includes any loans that have been restructured, but not those loans that have been written off.

Debt-with-Equity-Features: Includes convertible debt, as well as debt with warrants, participation agreements, royalties, or any other feature that links the investment's rate of return to the performance of the company that received the investment.

Equity Investments: Investments made in for-profit companies in which the CDFI receives an ownership interest in the equity (stock) of the company.

Guarantees: Includes guarantees or letters of credit provided to enhance the creditworthiness of a borrower receiving a loan from a third-party lender.

Total Loan Losses: The net amount charged off. Losses are reported after default, foreclosure, and liquidation and are the net of any recovered assets. If any amount is reclaimed in the current FY on loans/investments that were written off in previous years, that amount is subtracted from the amount written off in the current FY.

Loan Loss Reserves: Funds set aside in the form of cash reserves or through accounting-based accrual reserves that serve as a cushion to protect an organization against potential future losses. Loan loss reserves typically show up as a contra-asset on the balance sheet.

Deposit Products and Services

Individual Development Accounts (IDAs): Matched savings accounts, similar to 401(k)s, that can be used by low-income households to purchase homes, seek postsecondary education, capitalize small businesses, or engage in other types of economic development activities.

Geographical Area Served

Major Urban Area: A metropolitan statistical area of equal to or greater than one million. Includes both central city and surrounding suburbs.

Minor Urban Area: A metropolitan statistical area of less than one million. Includes both central city and surrounding suburbs.

Rural: All areas outside major urban and minor urban areas.

Clients Served and Outcomes

Low-Income: A customer who has an annual income, adjusted for family size, of not more than 80% of the area median family income for metropolitan areas, or the greater of (1) 80% of the area median family income or (2) 80% of the statewide nonmetropolitan area median family income for nonmetropolitan areas.

Jobs Created: The change in the number of jobs at a microenterprise or business financed between two fiscal years (i.e., the net job change). When calculating the number of jobs at the microenterprise or business, only permanent full-time-equivalent jobs are counted.

Jobs Maintained: Total number of employees at a microenterprise or business financed at the time a given loan or investment closed.

Jobs Assisted = Jobs Created + Jobs Maintained.

Housing Units Created: Includes new construction or units projected to be constructed or complete rehabilitation of existing housing units that were previously unoccupied.

Housing Units Renovated or Preserved: Renovated includes units that have been renovated or are projected to be renovated. Preserved includes mark-to-market and similarly preserved units.

Appendix C: The CDFI Data Project

The CDP is an industry collaborative that produces data about CDFIs. The goal of the CDP is to ensure access to and use of data to improve practice and attract resources to the CDFI field. The CDP collected FY 2003 data on 477 CDFIs. The data set includes approximately 150 data points on operations, financing, capitalization, and impact. Supported by The Fannie Mae Foundation, The Ford Foundation, and The John D. & Catherine T. MacArthur Foundation, this initiative convenes leading organizations in the CDFI industry.

Partner Organizations

Aspen Institute
Economic Opportunities Program
One Dupont Circle NW, Suite 700
Washington, DC 20036
Ph: 202.736.5800
Fax: 202.467.0790
www.fieldus.org
National nonprofit that disseminates best practices and educates policymakers, funders, and others about microenterprise

Association for Enterprise Opportunity
1601 North Kent St, Suite 1101
Arlington, VA 22209
Ph: 703.841.7760
Fax: 703.841.7748
www.microenterpriseworks.org
National member-based trade association of more than 500 microenterprise development programs

CDFI Coalition
3240 Wilson Blvd, Suite 803
Arlington, VA 22201
Ph: 703.294.6970
Fax: 703.294.6460
www.cdfi.org
Lead organization in the United States that promotes the work of CDFIs

CFED
777 North Capitol St NE, Suite 800
Washington, DC 20002
Ph: 202.408.9788
Fax: 202.408.9793
www.cfed.org
National nonprofit that promotes asset building and economic opportunity strategies, primarily in low-income and distressed communities

Community Development Venture Capital Alliance
330 Seventh Ave, 19th Floor
New York, NY 10001
Ph: 212.594.6747
Fax: 212.594.6717
www.cdvca.org
Certified CDFI intermediary that serves community development venture capital funds through training, financing, consulting, research, and advocacy

National Community Capital Association
620 Chestnut St, Suite 572
Public Ledger Building
Philadelphia, PA 19106
Ph: 215.923.4754
Fax: 215.923.4755
www.communitycapital.org
Leading national network that finances, trains, consults with, and advocates for CDFIs

National Community Investment Fund
2230 South Michigan Ave, Suite 200
Chicago, IL 60616
Ph: 312.881.5851
Fax: 312.881.5801
www.ncif.org
A certified CDFI that channels equity, debt, and information to locally owned banks, thrifts, and selected credit unions with a primary purpose of community development

National Federation of Community Development Credit Unions
120 Wall St, 10th Floor
New York, NY 10005
Ph: 212.809.1850
Fax: 212.809.3274
www.cdcu.coop
A certified CDFI intermediary that serves over 200 low-income credit unions across the United States