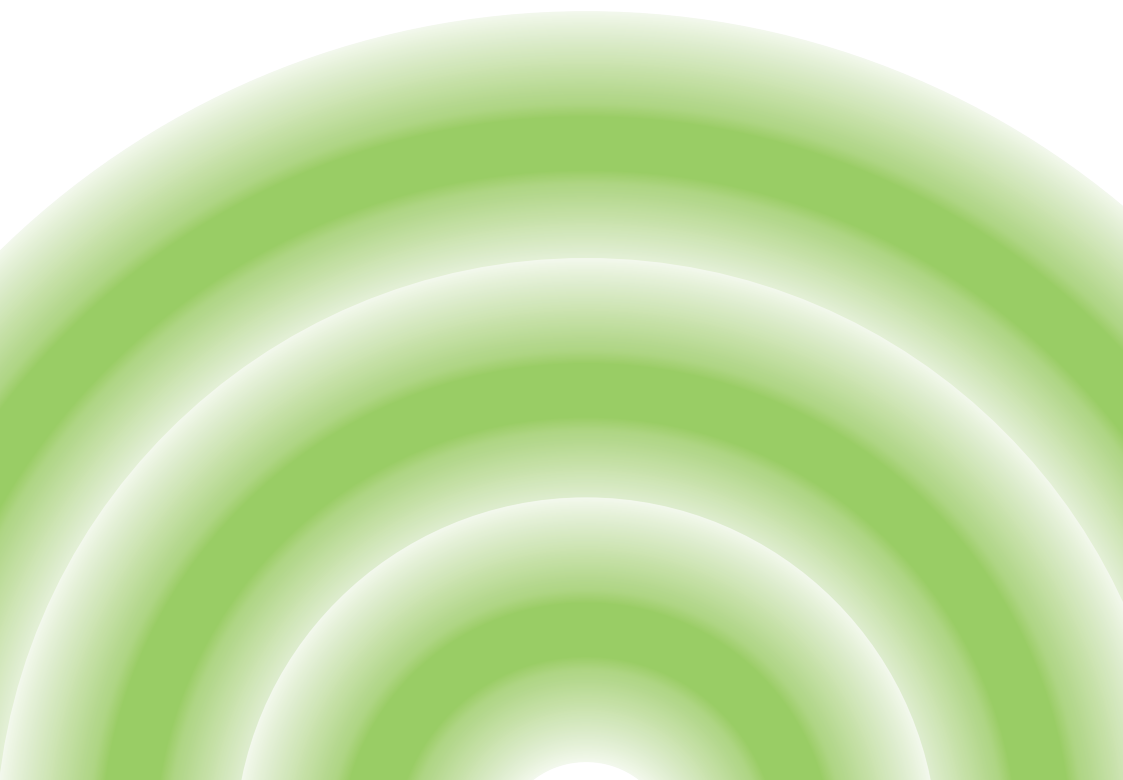




Inside Out

2005

The State of Community Development Finance



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By Sarah McGeehan



Community Development Finance Association

Room 101
Hatton Square Business Centre
16/16a Baldwins Gardens
London EC1N 7RJ

Tel: 020 7430 0222
Fax: 020 7430 2112
Email: info@cdfa.org.uk
Web: www.cdfa.org.uk

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Ivan Lewis

Economic Secretary to the Treasury

I welcome the publication of the third *Inside Out* – The State of Community Development. I am very pleased to see significant growth and development in the sector, and recognise the valuable contribution that CDFIs are making to the Government’s commitments to promoting enterprise for all and access to financial services. I am sure that this productive partnership will continue in the years ahead.



This is a time of great opportunity for the sector, with a supportive policy environment and Government initiatives to promote the sustainable development of CDFIs now in full operation, at both the regional and national levels. I would encourage CDFIs to continue working with Regional Development Agencies to improve the enabling conditions for enterprise creation by disadvantaged groups in deprived areas. Additionally, over the next two years the Financial Inclusion Growth Fund will provide a significant boost to the coverage, capacity and sustainability of third sector lenders as they look to expand their lending for those individuals encountering exclusion from mainstream financial services. I fully believe that the Government’s commitment to the CDFI sector will reap real dividends with increasing numbers of CDFIs advancing towards sustainability.

I also welcome the **cdfa**’s continued role in supporting growth in the sector, including through the annual community development finance conference Money £or Change, and the development of CDFI specific training to share best practice examples.

I look forward to continuing to work with the **cdfa**, practitioners and stakeholders to achieve further progress towards our objectives.

A handwritten signature in black ink, appearing to read 'Ivan Lewis'. The signature is written in a cursive, flowing style.

CDFIs share a common purpose – to provide access to finance for businesses and individuals who are unable to access it from commercial banks. CDFIs aim not just to fill these gaps but to create social change through the impact of the finance and services they offer. However, this common purpose hides a range of different operating structures, markets, products and levels of maturity. This – the third annual report on the state of the community development finance sector – reveals some of these distinctions as well as providing an in-depth picture and analysis of the sector in the UK.

The picture that emerges from this year's findings is one of a sector providing a range of solutions to financial exclusion. This year's report shows that community development finance is:

- Achieving both scale and growth
- Showing signs of increasing maturity
- Finding new ways to manage risk and increase the quality of its assets
- Increasing access to capital, and
- Balancing local delivery with going to scale

The growth in the sector is clear not just from the absolute number of CDFIs, the loans delivered or customers served – although there is certainly growth in these areas. CDFIs are achieving greater coverage, with stronger representation across the UK than ever before. Although full service coverage is still some way off, there are also signs that as CDFIs grow, they serve larger and larger geographical areas, creating a virtuous cycle of growth and impact.

However, it is not just the number of CDFIs who have grown but their activity levels have also increased with CDFIs now providing £181,000,000 in loans and investments – a 23% growth in portfolios on 2004. CDFIs are also controlling more capital than ever before. CDFIs now have nearly £450,000,000 available to lend and invest.

In addition, CDFIs have financed more than 18,000 businesses and people, sustained 88,000 jobs and created 11,000 more. They have levered an extra £285,000,000 of funding into the businesses and households they serve and improved the net income of 210,000 households.

Key findings

Products and services

- CDFIs have a total loan and investment portfolio of over £181,000,000.
- The largest proportion of lending by value is still to social enterprises representing over half of CDFI portfolios followed by lending to microenterprises, which has grown this year to over 30% of CDFI portfolios. By contrast, a significant proportion of CDFIs' lending by number is to individuals at nearly 60% followed by 30% by number to microenterprises¹.
- The value of CDFIs loans and investment written in 2005 increased again to over £77 million.
- CDFIs provide business loans for purchase and renovation of buildings, working capital, equipment purchase, market and advertising and gap financing. The largest number of CDFIs and the largest proportion of loans they deliver are for working capital and equipment purchase.
- CDFIs provide personal loans for emergencies, home improvements, debt consolidation, meeting the costs of going back to work, training and purchase of domestic equipment. The largest proportion of these lenders' loans are for purchases and debt consolidation.
- CDFIs provide loans from £50 to £1,000,000. The average loan to microenterprises is £7,250, to small businesses £50,000, to social enterprises £43,500 and to individuals £600.
- CDFIs charge varying interest rates which change in different markets – higher for microenterprise and individuals and lower for larger businesses and social enterprises.

Income streams and capitalisation

- CDFIs control capital of nearly £450,000,000 up from £400,000,000 in 2004.
- Over half of CDFIs control capital of more than £500,000 and the most common fund size is CDFIs with capital of between £100,000 and £500,000.
- In the 12 month period from October 2004 – September 2005, CDFIs secured £24.2 million in grants and investment from a variety of sources – £19.6 million for capital and £4.6 million for revenue suggesting an overall ratio of 4 to 1, capital to revenue.

¹ £128m removed from portfolio breakdown analysis comprising of one large social enterprise provider, three equity providers and two CDFIs where a breakdown is not available

Key findings

- The income CDFIs received comprised of £9.6 million or 42% in investment and £13 million or 58% in grants suggesting every £1 in grants levers an additional 0.72 pence in investment.
- The Phoenix Fund and trusts and foundations were the largest contributors of revenue support for CDFIs. The Phoenix Fund, a variety of local funds and commercial banks were the largest contributors of capital for on-lending and investing to CDFIs.
- CDFIs are reporting an expected shift over the next 3 to 5 years from grant sources of support to an increasing proportion of generated income including from portfolios, support and training and a variety of other income generating activities.
- CDFIs report a similar shift toward raising investment under CITR either directly from investors or through intermediaries such as wholesalers.

Operations

- CDFIs are spread across the UK and are serving increasingly large areas. CDFI representation remains strong in the North West, London and the West Midlands. Over a third of CDFIs now serve regional development agency regions or larger areas.
- Although over 40% of CDFIs have been financing less than 2 years, there is an overall growing maturity in the sector with a much smaller proportion of new starts in the sector. There is also now a body of CDFIs in their consolidation phase which have been financing between 2 and 5 years.
- In a shift from previous years, more CDFIs than ever before are diversifying in to several markets with 50% of CDFIs now focusing on more than one market. Micro-enterprise remains the key market for CDFIs with 50% of organisations serving this key market.
- Overall, CDFIs are more likely to provide loans for startup businesses although there are distinctions depending on the type or size of businesses. Social enterprise lenders are more likely to provide finance for established businesses.
- CDFIs work with a variety of partners and are most likely to work with business support providers.
- CDFIs are currently working with the formal financial sector in all sorts of ways – and for many banks are key partners providing grants and, increasingly, access to commercial and quasi-commercial capital.

- CDFIs are also providing a variety of business support and money advice services themselves with over half of CDFIs now providing some level of explicit advice or support services aside from the support provide during loan inquiry and application stage.

Performance

- Ability to report on performance remains mixed but is increasing.
- Those CDFIs who can, report an average delinquency rate (defined in this report as loans that are over 90 days late with repayments) of 11.2% in microenterprise lending, 3.7% in social enterprise lending and 6.7% in consumption lending.
- Defaults (or write offs) have risen slightly from 7.2% in 2004 to 8% in 2005.
- Deployment rates have increased significantly since 2004 to an average of 62% of capital available, up from 49%.
- The portfolio yield ratio captures the interest and fees a CDFI earns over a 12 month period as a percentage of their outstanding portfolio. The average yield is 7.8%, although this average masks a range of performances from a low of 0.37% to a high of 17.9%.
- The operational self-sustainability (OSS) ratio captures the amount of an organisation's expense (or costs) that is covered from all forms of earned revenue – and is an indication of an organisation's ability to self-sustain itself. The average OSS for the sector was 36.1%, although this ratio also masked a range from a low of 0.22% to 123%.

About this report

Inside Out is based on the Community Development Finance Association (**cdfa**) annual member survey. In 2005 returns rose to 62 up from 55 in 2004 and 26 in 2003. This third *Inside Out* from the **cdfa** focuses on updating information on the operations of CDFIs and adding new insights on their services, customers and impacts. It is the only report on the community development finance sector to draw on annually compiled and analysed quantitative data.