



Inside Out **2010**

The State of Community Development Finance


About the cdfa

The Community Development Finance Association (**cdfa**) is the UK trade association for Community Development Finance Institutions (CDFIs). CDFIs are independent financial institutions that provide finance and support to help individuals and organisations develop and create wealth in disadvantaged communities or under-served markets.

Community development finance delivers innovative financial products primarily aimed at entrepreneurs in disadvantaged areas, but also addressing increasing personal debt in poorer communities. The **cdfa**'s mission is to support the development of a thriving and sustainable community development finance sector.

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Care has been taken to report all data as received, with some discretion used in making corrections and extrapolations.

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 Innovation & Skills



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Foreword

Ed Mayo
Secretary General, Co-operatives UK
Honorary President, **cdfa**



It was a real pleasure to be asked earlier this year to take over from Susan Rice in support of the invaluable work of the **cdfa**. The **cdfa** brings together a truly heroic set of initiatives, all devoted to putting money towards people-centred development, and that's a very noble goal. It's something I'm also really pleased to see having been involved in the early days of the CDFI sector.

What we are talking about is intermediaries that are trusted by the communities they serve – something that is so different from what we have seen in recent years with the growth of casino-style banking and financial markets that are uprooted from the communities they serve.

But the challenge now facing the CDFI sector is that it needs to be far more ambitious about what it can do. It is only by being ambitious that the sector can deliver on its promise of financial inclusion and social justice: finance for enterprise

development, finance for personal needs, and finance for social enterprise as well. The CDFI sector has to be a model for how people-centred finance can work. People who borrow being active – not passive – members of a larger enterprise. People who invest being able to see where their money is going for good. A relationship based on trust.

We need the support and the engagement of the state and a recognition that it has a key role, in these tough times, to help people to meet their basic needs. But this must be coupled with the opportunity for enterprise: the idea that poverty is not just about where the state steps in, but where social enterprise and cooperation can allow people to meet their needs in new ways, through self-help and mutual aid.

Introduction

As public funding cuts start to bite, the provision of fair and affordable finance to businesses, civil society and individuals has never been so important.

This is what our members do. They serve different markets, and use different terminology to describe themselves (including 'micro-finance institutions', 'community loan funds' and 'social lenders'). But all have the same goal in mind: to provide socially-driven finance to those who cannot get it from high street banks.

We call these lenders community development finance institutions, or CDFIs. And they are busier than ever before.

The important role they play was highlighted in an independent report commissioned by the Government in March this year, which found that 'CDFIs continue to address the consistent market failure to reflect the economic and social benefits of lending in underserved markets'.

Inside Out 2010 gives further evidence that CDFIs are providing a much needed financial lifeline to people, businesses and civil society organisations with nowhere else to turn.

This report covers CDFIs' activities over the last financial year. It is based on the annual survey of our members which we conducted between June and July 2010. The survey had a 94% response rate.

Inside Out focuses on CDFI lending across the three main markets they serve, which we categorise as:

- **Business:** micro and small/medium enterprises
- **Civil society:** social enterprises, charities and voluntary/community organisations
- **Personal:** consumer and home improvement lending to individuals.

Last year, CDFIs created or protected over 8,600 jobs, and also created and safeguarded over 2,000 businesses. They loaned £200m and helped their

customers to lever over £100m in additional finance from high street banks. They are key players in the delivery of the coalition government's Big Society agenda – reducing welfare dependency by promoting enterprise and self-help.

Despite recent turbulence in the financial services industry, CDFIs have been providing a consistent level of service to customers, with lending levels in this year's report broadly similar to those in last year's *Inside Out*. CDFIs continue to be a reliable source of finance to those shut out by mainstream providers.

But in order to maintain and indeed increase this level of service in the months and years ahead, CDFIs will have to tap into new sources of funding to replace those previously provided by the regional development agencies, Department for Work and Pensions, and other public sources. The forthcoming Big Society Bank may be important here; the Regional Growth Fund may help as well. CDFIs will also be looking towards private sector funding sources, income from their own business models – perhaps by adjusting their interest rates and fees – while keeping loans as affordable as possible for customers.

In order to achieve maximum economic and social impact, CDFIs, among other issues need:

- A sustained strategic public policy framework to enable the sector to increase its scale and reach
- A capital injection to meet increased demand for finance
- Clarity regarding ongoing public support in the wake of the abolition of Regional Development Agencies, and on the role of the devolved administrations
- Changes to the Enterprise Finance Guarantee scheme to make it more suitable for CDFI lending
- The continuation of Community Investment Tax Relief, and amendments to the scheme, to secure more investment into the sector
- Support for organisational capacity building.

Chapter 1

Overall CDFI sector

Though the report will go on to look at CDFIs in their three key markets of business, civil society and personal lending, this chapter will look at performance across the whole of the CDFI sector.

KEY FIGURES

- The **cdfa** has 66 members lending in the UK, operating across 175 branches
- The combined CDFI loan portfolio stands at £531m
- CDFIs made 19,000 loans, totalling £200m last year
- CDFIs helped customers to leverage over £100m in additional finance from high street banks last year. Cumulatively they have helped to lever almost £600m in mainstream finance.

The following table shows the outcomes of CDFI lending for 2009/10 and cumulatively since 2004.

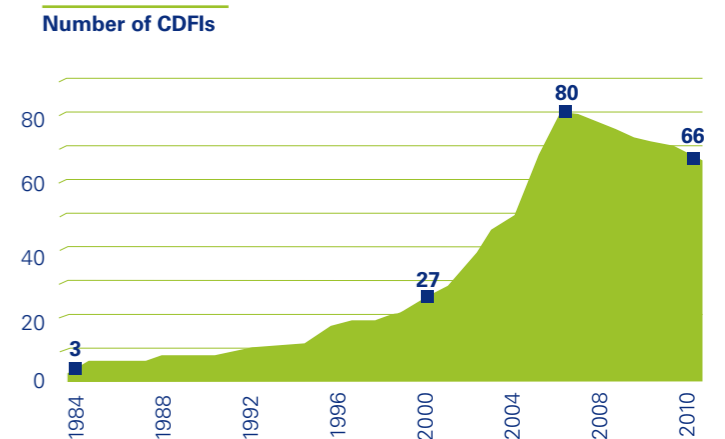
Overall CDFI outcomes

	09/10	Cumulative
Value of loans disbursed	£200m	£672m
Individuals financed	15,288	41,120
Organisations financed	3,558	12,706
Jobs created	2,992	78,698
Jobs safeguarded	5,638	26,522
Total funds levered	£100m	£593m

1.1 Size and coverage

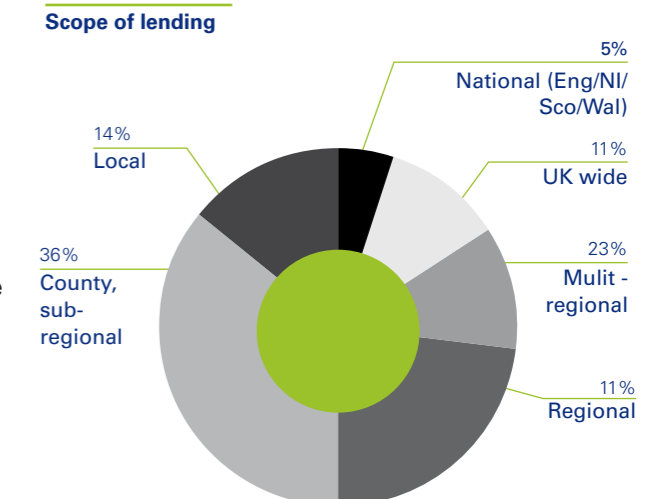
Growth of CDFIs

Recent years have seen a tailing off in the number of CDFIs in the UK, with the drop in numbers corresponding with the closure of dedicated government funding for enterprise lending in disadvantaged communities (the Phoenix Fund, administered by the then department for Business, Enterprise and Regulatory Reform, ran from 2000 to 2008). However, despite consolidation in the number of CDFIs operating in the UK, they are now operating across 175 local branches and total lending activity continues to rise, as well as the number of CDFI customers. Additional information on these numbers will be discussed in subsequent chapters.



Scope of lending

Economies of scale are often achieved not only through consolidation, but also, of course, through expansion. CDFIs' geographic scope of lending is evenly split between those serving one or a few local communities, and those operating with regional or national reach. Although this greater geographic reach usually confers increased operational efficiency, it is not at the expense of localism. CDFIs maintain a close link to communities through their 175 outlets.



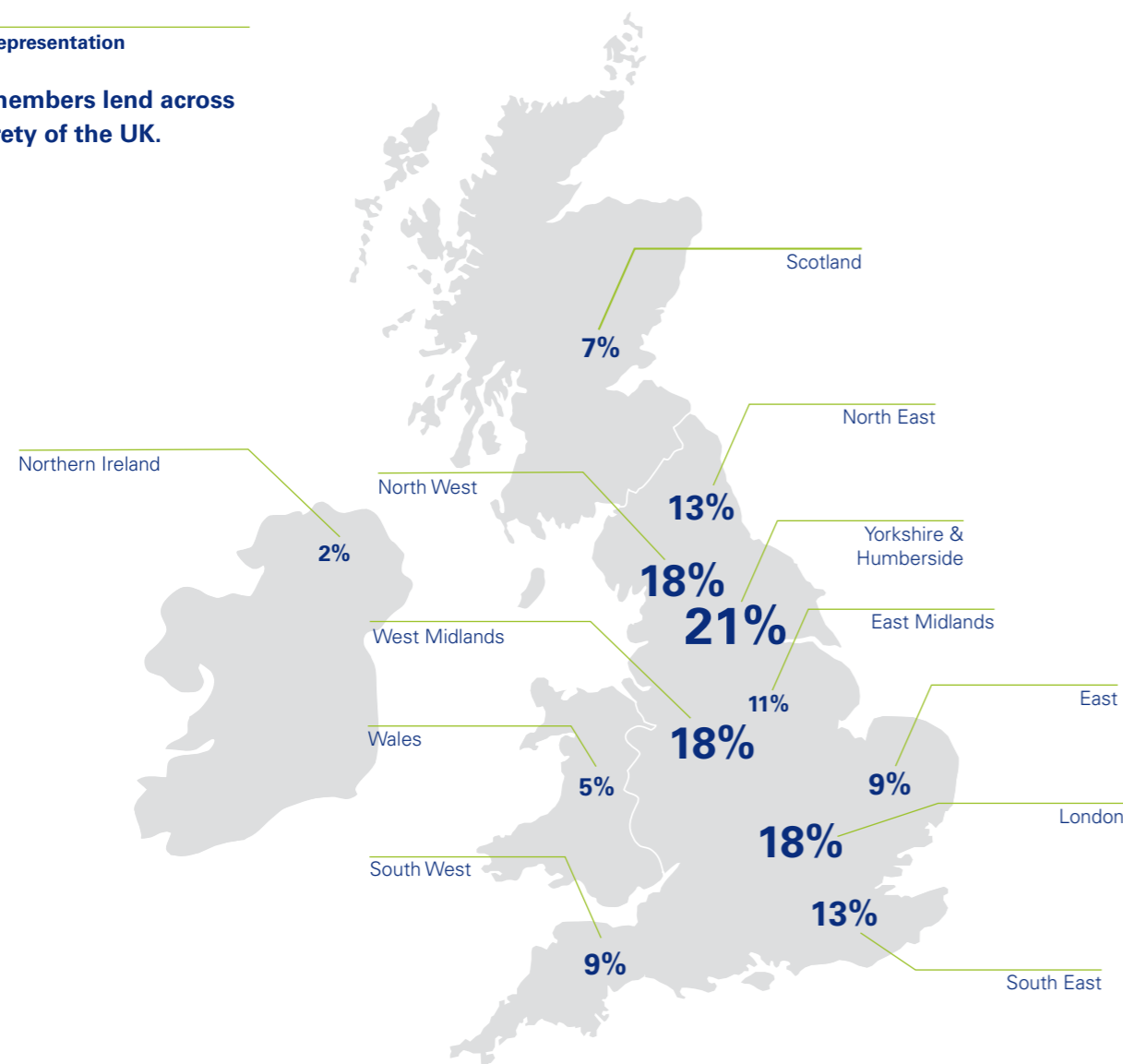
Coverage

Provision of CDFI credit varies greatly, with coverage well matched to areas with the highest levels of deprivation. Of course pockets of deprivation exist across the UK, and some CDFIs are working to address more localised market failures in financial service provision.

However, there is not complete coverage across the UK of CDFI services. CDFIs are the only lenders that specialise in addressing commercial market failure and providing support – and they do not impose any pre-conditions to accessibility (referral or membership is not required of CDFI customers). Scaling up the model across the UK would achieve a dramatic increase in affordable credit available to viable businesses, social enterprises, community projects and financially excluded individuals. A sustained and strategic public policy framework is needed for this to happen.

Regional representation

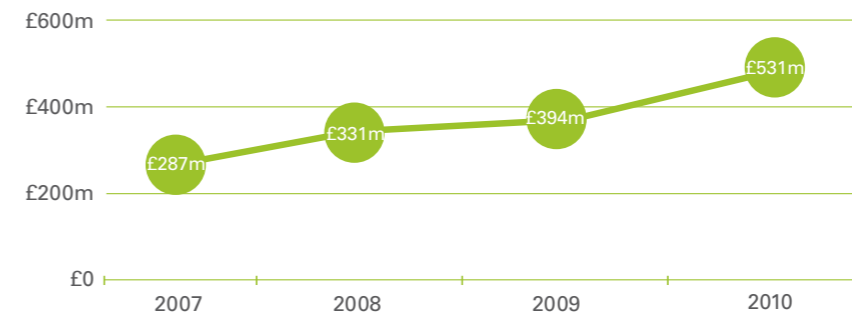
11% of members lend across the entirety of the UK.



1.2 Lending activity

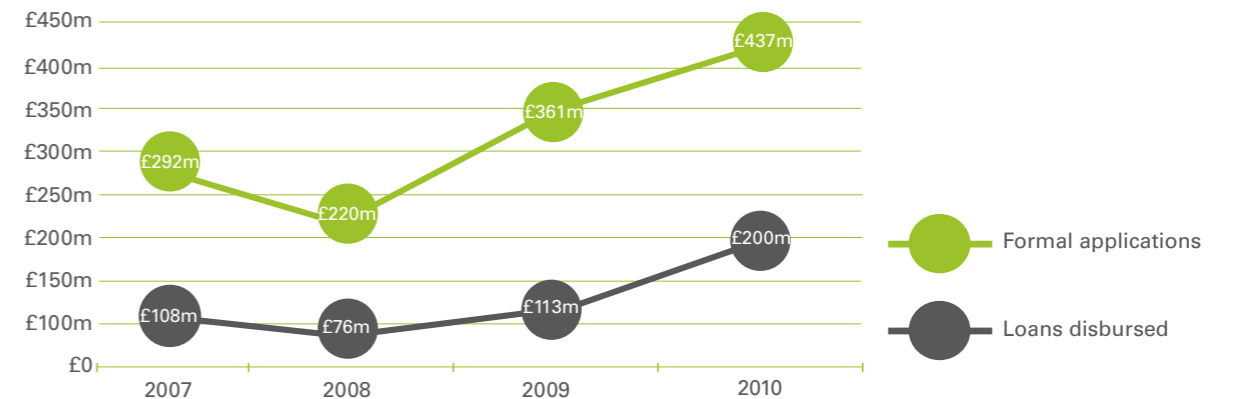
Overall, CDFI lending activity continues to grow – even as the number of CDFIs decreases – through organisational consolidation and expansion. The aggregated CDFI portfolio (the value of all CDFIs' loan books) has risen by 85% since 2007 to over half a billion pounds.

Sector portfolio outstanding



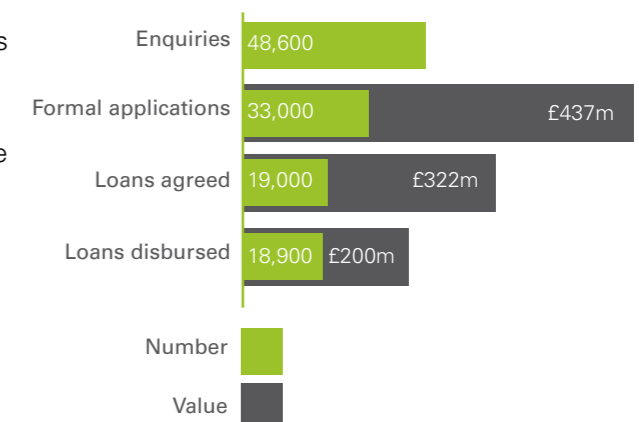
Similarly the total value of applications for CDFI loans, as well as actual loans disbursed, is on the rise. Last year, CDFIs were able to agree more loan applications than ever before, with over half the value applied for granted.

Sector applications and loans disbursed



Although not all CDFIs collect such data, 53 reported nearly 50,000 enquiries for loan finance during the reporting period. Latent demand suggests that many individuals do not know the CDFI model exists to aid access to finance. Through a capital injection and awareness raising CDFIs could become common knowledge in the financial landscape.

Sector lending 09/10



1.3 Loan assets

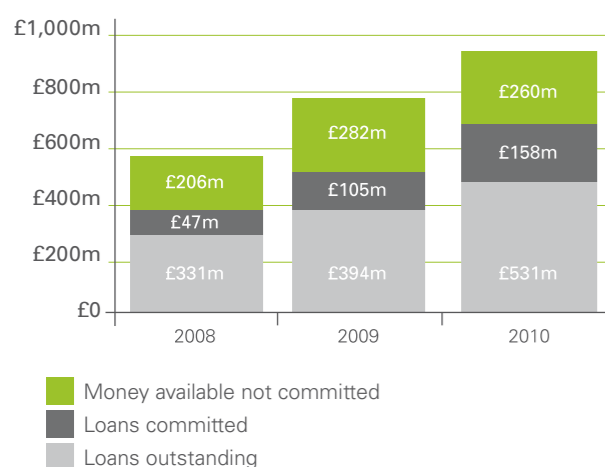
CDFIs have been steadily growing their fund sizes. Over half of CDFI funds are between £1m and £5m in size.

Sector loan fund sizes*

Loan fund sizes	% of CDFIs
<£100k	4%
£100k - £500k	12%
£500k - £1m	16%
£1m - £3m	30%
£3m - £5m	22%
£5m - £10m	8%
>£10m	8%

The value and detail of the aggregated CDFI sector loan fund shows that total assets continue to grow and also that CDFIs manage their funds responsibly. The proportion of funds committed or outstanding has risen to 73%, with the remainder in reserve. As recent experiences in the mainstream banking sector showed, maintaining reserve capital is especially important in economically turbulent times. However, the drop in the proportion of capital in reserve is also indicative of the lack of funding being made available to the sector.

Total sector lending assets



Uncommitted capital available	% of members
0 - £250k	30%
£251k - £500k	23%
£501k - £1m	19%
£1m - £2m	17%
£2m+	11%

A breakdown of loan fund assets shows that over half of CDFIs reported available capital of less than £500,000. CDFIs require a capital injection to allow them to continue to scale up their operations and reach sustainability. Unless adequate and appropriate funding sources are accessed, some CDFIs will face the prospect of winding down lending activities over the next few years.

1.4 Performance

Unsurprisingly, when looking at the CDFI sector as a single entity, much variation is found. Different markets, target customers within markets, funder requirements, business models, products and a range of other variables make it difficult to represent 'the average CDFI' in any meaningful way – there is no such thing. The ranges of various performance indicators show just how disparate CDFIs are in the UK. Detailed analysis will appear in chapters devoted to specific markets. Definitions of the indicators and details on how they are calculated are provided in the glossary.

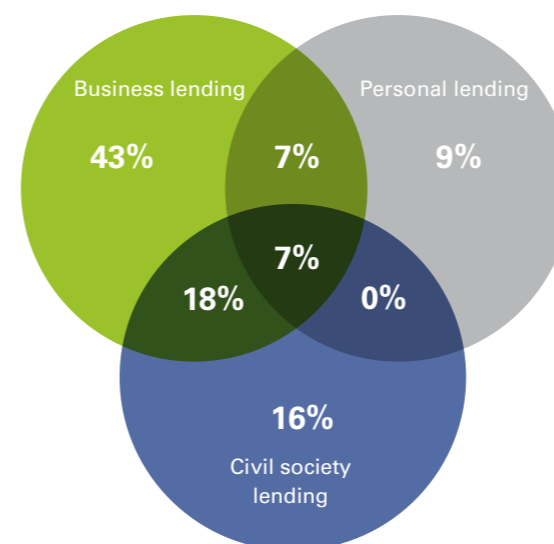
Key performance indicators**	Average	Range
Deployment	68%	35% - 100%
Portfolio yield	9%	2% - 30%
Portfolio at risk 30 days+	24%	3% - 61%
Annual write-offs	11%	1% - 40%
Loan fund self-sufficiency	48%	4% - 159%
Operational self-sufficiency	74%	9% - 311%

* Loans outstanding & lending capital available & loan commitments
 **For a full set of definitions, see glossary

1.5 Markets served

CDFIs provide loans and other financial services to consumers, businesses and civil society organisations (charities, community groups and social enterprises) unable to access mainstream finance. Three-quarters of CDFIs serve businesses, about 40% civil society, and nearly one-quarter consumers.

Markets served by CDFIs



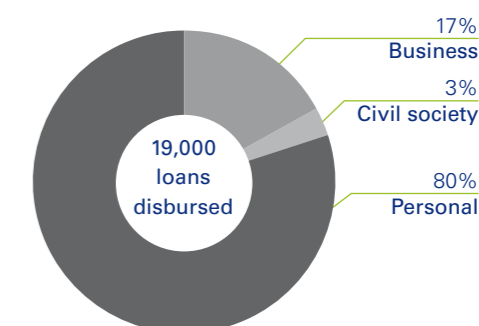
The distinction between each market is not always clear or easily defined. For example, a personal-lending CDFI may provide a £700 consumer loan to help a young person start a sole trading enterprise. Similarly, a loan to a social enterprise can be seen as a business loan as well.

Also, many CDFIs serve multiple markets, most commonly between the business and civil society markets, and between the personal and micro-enterprise markets.

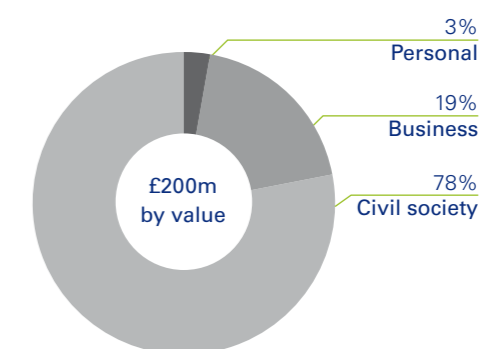
The nature of the markets served dictates the quantity of loans made – both in terms of customer number and loan value. Personal loans are, by nature, small in size relative to business and other organisational loans. Therefore, although the total value of personal loans is small (comprising just 3% of the total CDFI loan value), personal borrowers are by far the largest customer group (comprising 80% of total CDFI customers). Conversely, civil society customers, although small in number (just 3% of total), hold the greatest loan value (nearly 80% of the total); much of this, however, is due to the activities of a small handful of very large, specialised providers.

Total annual sector lending

Number of loans disbursed 09/10



Value of loans disbursed 09/10



1.6 Income

CDFIs require capital for lending activities as well as revenue for operations. The income required for both capital and revenue may be generated internally by charges on products and services (earned income), or secured from outside the organisation, in the form of grants or commercial finance (external income).

Before looking at income data, it is important to bear in mind that CDFIs serve inherently risky markets. CDFIs do not get customers into unmanageable debt: they intend to lend only to those who can pay back the loans. These customers have been pre-determined by mainstream lenders as unviable, too risky, or not worth the time.

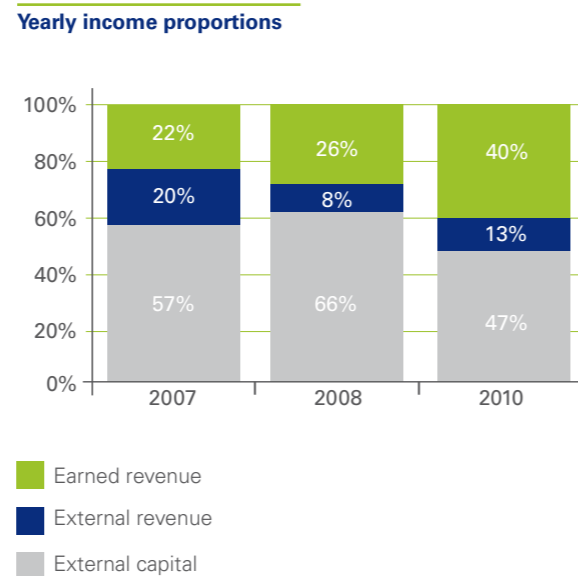
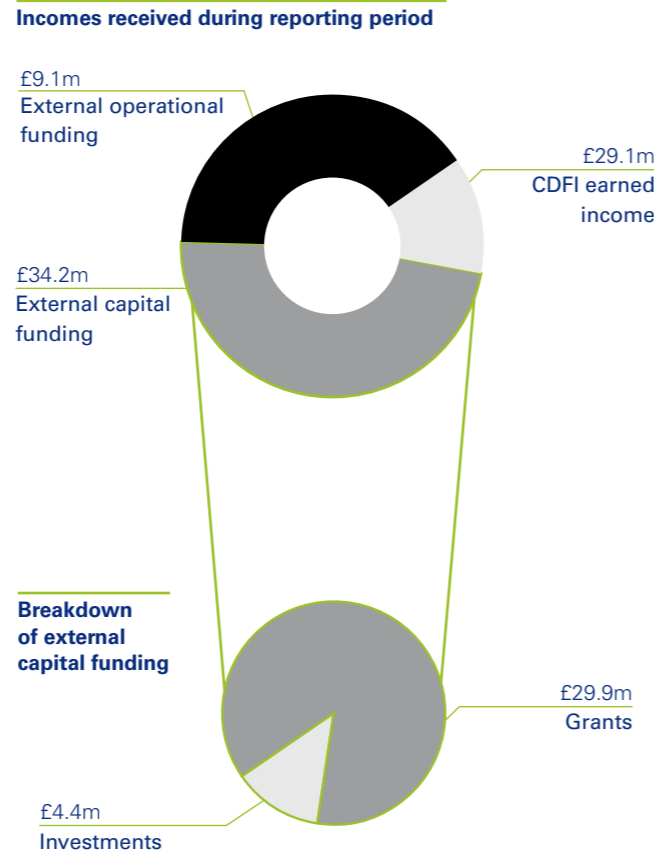
Also, CDFI customers are relatively resource-intensive to serve, given that many often require extensive up-front and ongoing business or financial capability support and advice. In addition, most CDFIs carry out extensive due diligence checks when vetting applicants.

Therefore, by definition, CDFIs will rarely be in a position to meet all their capital and revenue requirements purely from their lending activity.

All external revenue for operations was reported as grant income, while external capital for on-lending is a mix of grant and investment income.

Earned income is generally used to defray revenue/operating costs. However, if other sources of external revenue are secured to cover operational costs, this income is also used for on-lending purposes.

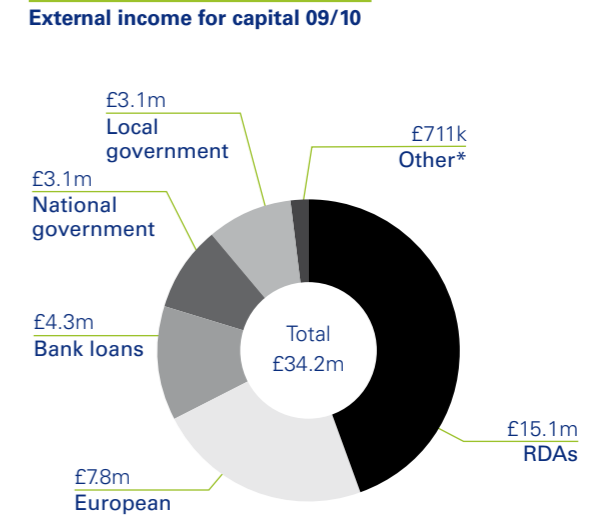
CDFIs are becoming less and less reliant on external sources of income, this year earning 40% of total income raised, up from about one-quarter raised last year. However, many external funding sources are multi-year, and therefore a significant activity in any single year may skew perception. So, for example, in 2009 the external capital raised was rather substantial due to several members reporting securing multi-year bank loans. Although the amount of the investment will not appear in 2010, these CDFIs are utilising that income over several years.



Capital for on-lending

Based on income raised during this year, Regional Development Agencies (RDAs) were the largest source, followed by EU funding and bank loans. This year over one-third of the amount raised was from banks, and that capital will be drawn down and utilised over several years. Therefore, bank income continues to be extremely important.

With the demise of the RDAs, it is unclear what support, if any, CDFIs will receive from their successor bodies, the new Local Economic Partnerships, and other public sources in England. It is also unclear what support the devolved administrations will provide.



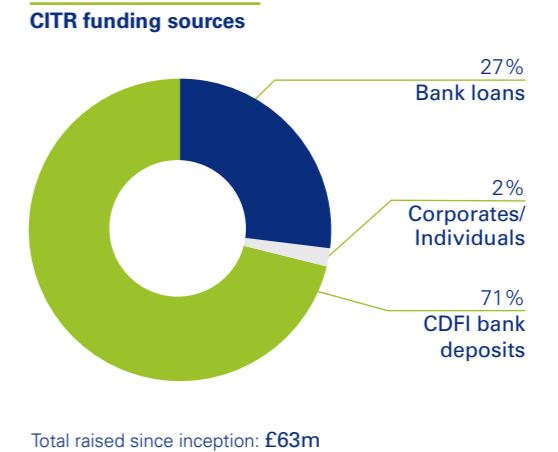
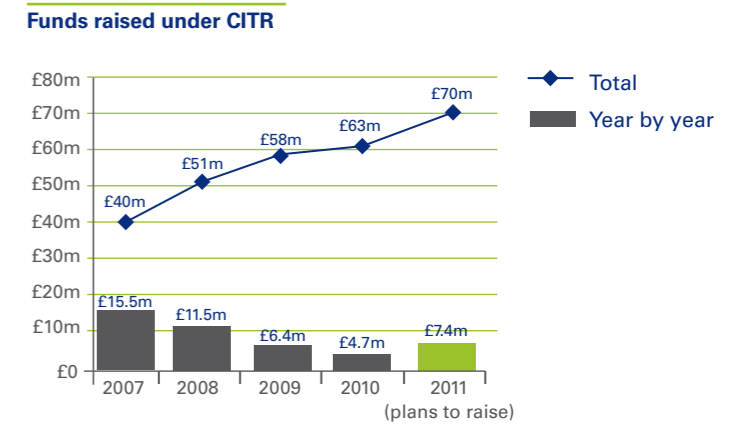
* Includes trusts, donations, CSR grants, etc.

Community Investment Tax Relief

Community Investment Tax Relief (CITR) is a scheme devised to encourage private investment into the CDFI sector by allowing accredited CDFIs – of which there are currently 15 – to offer investors 5% per annum tax relief over five years. Investment raised must be for lending to business in disadvantaged communities.

Since inception, CITR has attracted a total amount of investment of around £63m, most of which has been raised by a few large civil society lenders equipped to optimise the specific mechanisms of the scheme. The majority (71%) of investment is in the form of bank deposits, with a little over one-quarter raised through bank loans.

A scheme to drive private investment to the CDFI sector is crucial, and the concept behind CITR chimes perfectly with the Big Society agenda. Some key amendments to the scheme when due for renewal in March 2012 will enable a new and improved mechanism to help CDFIs raise finance, thereby reducing reliance on public grant-based capital.



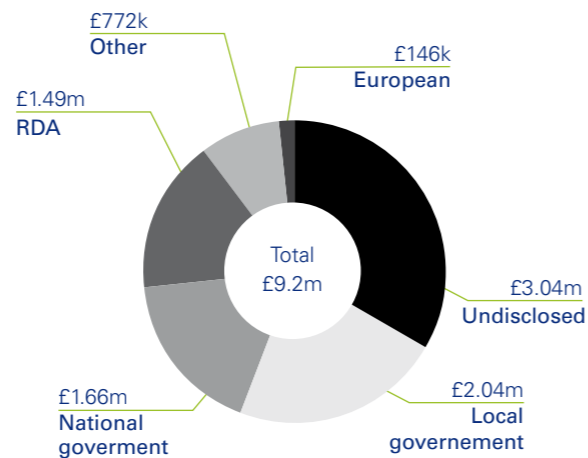
Revenue for operations

Of those sources that have been identified, it was local councils, national governments (including the devolved administrations) and regional development agencies that provided the most revenue to cover operation costs.

Despite the fact that CDFIs run lean operations, their work is necessarily resource-intensive, given the risk associated with the markets served as well as the support and other work that are an essential part of serving financially excluded customers. CDFIs need to raise roughly one-quarter to one-third of the total amount lent to cover the costs associated with lending activity.

CDFIs cannot simply undertake more capital for on-lending without a commensurate amount being devoted to adequate organisational capacity.

External income for operations 09/10

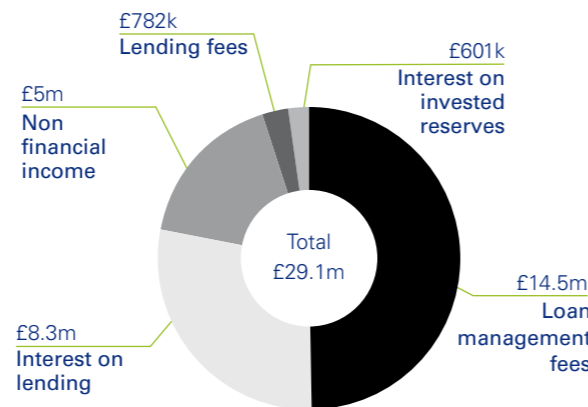


Earned income

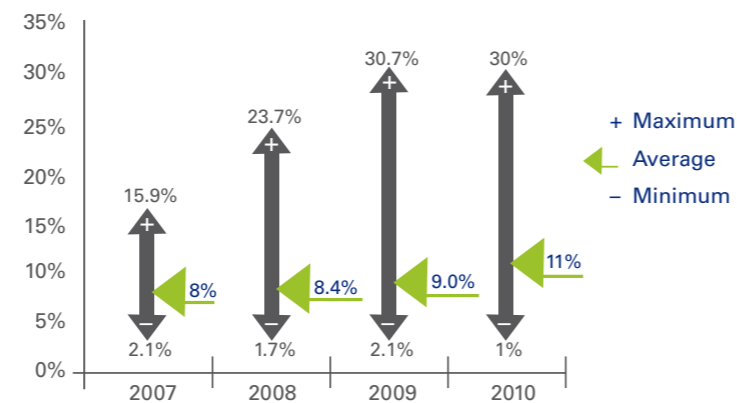
CDFIs generate income from their own business activities. Obvious sources of earned income are amounts raised from actual loans – interest and fees – which made up nearly a third of the total earned income.

Half of the total amount of earned income came from contract fees received for managing loan funds, which about a third of members reported doing. Fees for related yet non-loan activities – such as support and mentoring services – raised about 17% and are paid for by customers or other agencies. A small and dwindling amount of revenue is obtained from interest income on invested reserves.

CDFI earned income 09/10



Portfolio yields



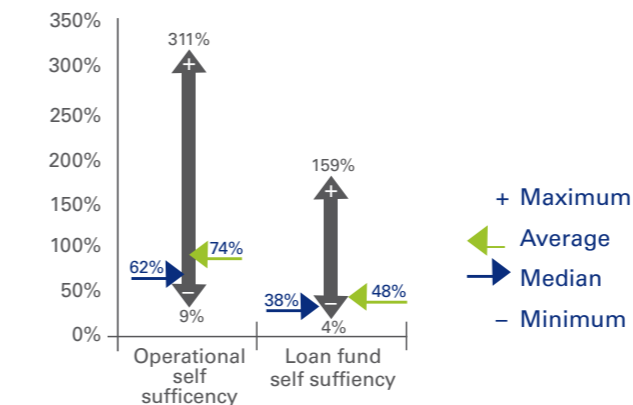
Portfolio Yield (PY) is a measure of the total income generated from the loan book (interest and fees) over a 12-month period as a percentage of the average portfolio outstanding. Portfolio yields tend to rise as loan size falls – hence the range reported by members – with personal lenders having PY near 20% and business lenders nearer to 10%.

1.7 Sustainability

For the first time, data was gathered from members to show the status of CDFI commercial sustainability, which is examined in two ways:

1. Operational self-sufficiency. The degree to which a CDFI covers all organisational operating costs through all earned income, regardless of type (loan interest and fees, loan management fees, other services fees, and so on).
2. Loan fund self-sufficiency. The degree to which a CDFI covers all organisational operating costs through income earned from portfolio activity (loan interest and fees) only.

Sustainability

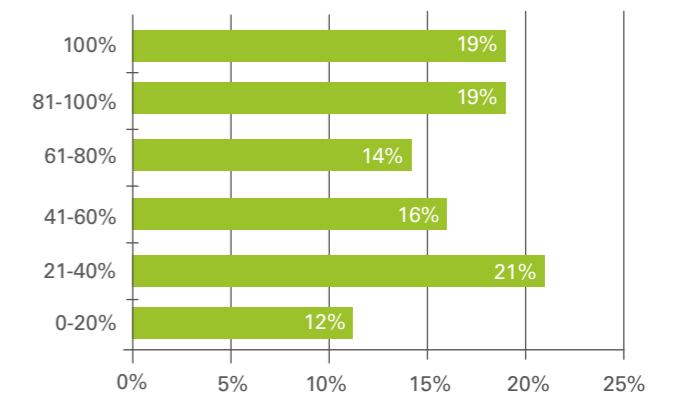


- 100% self-sufficiency means that revenue exactly covers costs; the organisation breaks even.
- Below 100%, revenue is not covering costs, which must be covered from other income streams
- Over 100%, the organisation is not only covering its costs but is bringing in additional revenue ("profit")

The diversity of the CDFI sector is evident from the enormous range in self-sufficiencies. Although some CDFIs are operating at over 300% sufficiency, these are anomalies – large civil society lenders with diverse and mature products and services generating income that more typical CDFIs cannot. Even though average operational self-sufficiency is 74%, there are more CDFIs operating below that level than above, as shown by the median score of 62%.

Loan fund self-sufficiency shows a similar, albeit reduced picture, of course, given that all of the CDFIs' expenses are pitted against just the amount the loan book generates in income. In larger, multi-faceted organisations it is, of course, problematic to assume that loan fund revenue could or should cover all the organisation's costs.

Operational self-sufficiency ranges



Looking at the range of operational self-sufficiency in more detail, we see a somewhat even distribution across the sustainability measures. Nearly 20% of members are generating an operational surplus. Nearly 20% are approaching sustainability, with about half operating at under 60% sustainability. These are the CDFIs without diversified income streams, working in more challenging markets, providing micro and personal credit.

1.8 Staffing

CDFIs in general are small, leanly run organisations, with just under half (47%) employing five or fewer staff members. However, as the more established CDFIs continue to grow staff numbers have risen since 2007 as more staff are employed to cover more expansive operations or to manage larger portfolios:

Numbers of staff

	2007	2008	2009	2010
< 4.9	61%	No data	53%	47%
5 - 9.9	22%	No data	25%	25%
10 - 19.9	10%	No data	13%	19%
20+	7%	No data	8%	9%
Total staff numbers	392		530	533

Spotlight:

Change Matters Performance Framework

The **cdfa** *Change Matters* performance framework acts as an independent health check service for members, and is currently provided to them fully subsidised by grant funding. Through a programme of site visits, our trained assessors give members a thorough analysis of their performance with the aim of driving up standards across the sector.

The process has developed over the past five years into a clear organisational performance and impact framework with which the CDFI sector is able to respond to two priorities – developing a transparent assessment framework for stakeholders, and increasing CDFIs' abilities to understand their own performance relative to the broader sector.

Change Matters reports include short-term, medium-term and long-term recommendations. Some recommendations can be easier to implement than others, but the objective report by the assessors provides a measurable and logical series of steps to take to improve performance.

With increasing interest by funders and stakeholders in this performance framework, members have responded positively to the opportunity of objective assessment, and the **cdfa** has been asked to facilitate a great deal of information-sharing on best practice.

There is also a clear need for the sector to consistently define its terminology (such as re-profiling, rescheduling, default and write-off). Consistency in reporting by our assessors is equally important; the **cdfa** regularly reviews and discusses agreed ways to establish key ratios, properly identify re-profiling versus re-scheduling, and define earned income sources. During 2010 it has consulted with member working groups to help develop several methodology guides and templates for measuring key impacts and reporting on Portfolio-at-Risk, Re-scheduling, Inputs and Expenditure on Activity. These will be disseminated to members by the end of 2010, and will be incorporated into an updated version of *Change Matters* assessments going forward.

Change Matters is supported by the Department for Business, Innovation and Skills, The LankellyChase Foundation and Lloyds TSB

Chapter 2

Lending to business

Business-lending CDFIs address market failure by lending to viable businesses that have been turned down by the mainstream banking system.

KEY FIGURES

- Business-lending CDFIs lent nearly £34m this year
- CDFIs created and safeguarded over 2,000 businesses this year
- They created and safeguarded over 8,000 jobs
- They helped customers to leverage an additional £28m in finance

2.1 Introduction

Providing responsible credit to businesses is the mainstay of CDFI activity, with around three-quarters of CDFIs serving business customers. Virtually all of these serve micro-enterprises*, while 40% also serve the small and medium enterprise** (SME) market. Many CDFIs serve micros and SMEs without formally distinguishing between these sub-markets.

There are many reasons why a viable business might be turned down by a bank:

- The amount needed by the borrower is too small to be cost effective for the banks to loan
- The borrower has no security or track record
- The borrower has a poor credit history
- The borrower's cashflow may be deemed inadequate
- They are operating in a financially-underserved, deprived community

Business-lending CDFIs are there to fill the finance gap for businesses in need. During the recession this gap has widened, with more established businesses coming to CDFIs for finance. CDFIs are diversifying to serve these clients while remaining focused on their core mission of financing the most disadvantaged.

*a business employing 0-9 staff

** a business employing 10-250 staff

2.2 Lending activity

Portfolio growth

This year, respondents reported outstanding loan portfolios of £51m for micro and £30m for SME. The apparently momentous portfolio size increases in micro this year and SME lending last year are down more to reporting variance than an actual surge. Adjusting for these discrepancies in member responses year upon year, it is likely that business lending has been growing moderately over the past few years, with a likely increase of 25% in the SME and a 10% increase in the micro portfolios between 2008 and 2010.

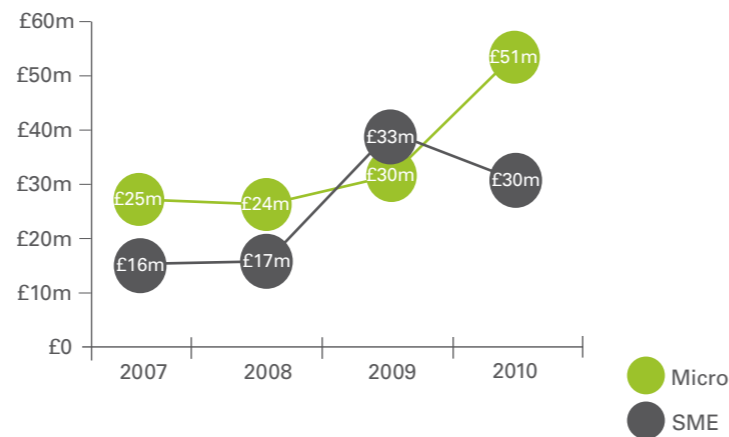
CDFIs continued to provide credit to those underserved by banks at the very time banks were curtailing the supply of credit. However, as much as CDFIs attempted to respond to the recession and credit crisis, they were able to do so only within their funding and organisational resourcing constraints, while at the same time lending responsibly. Given that CDFIs not only continued to lend but stepped up their lending during a time when banks were limiting new lines of credit and withdrawing existing ones, the impact CDFIs have had is likely to be much greater than the data indicates.

Supply and demand

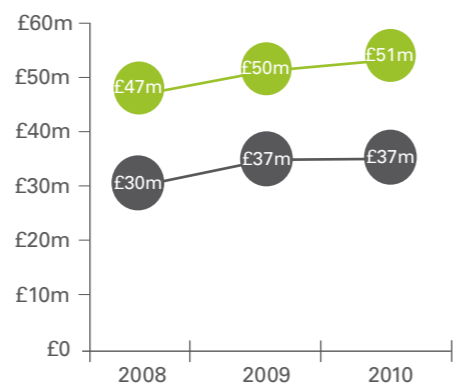
This year, about one-third of enquiries for micro loans resulted in formal loan applications, of which about two-thirds were successful. For SME customers, 60% of enquiries resulted in applications, of which nearly half were successful. Thus although the number of SME loan enquiries resulting in applications is roughly double that as for micro, a smaller proportion of SME applications resulted in loans.

Despite the fact that there was over ten times as much interest from potential customers in micro than SME loans, the value of loans actually applied for and agreed – in terms of value – is similar. This simply demonstrates the fact that micro lending is relatively higher volume and lower value than SME lending.

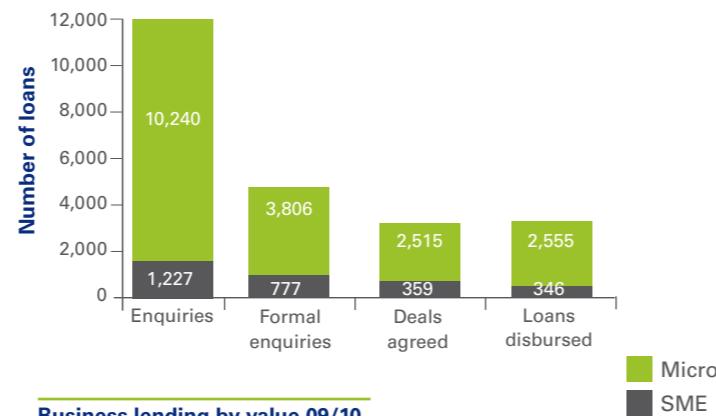
Portfolio growth: business



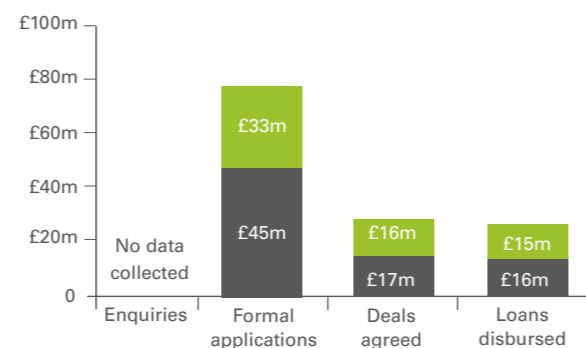
Enterprise lending growth adjusted for response variance



Business lending by volume 09/10



Business lending by value 09/10



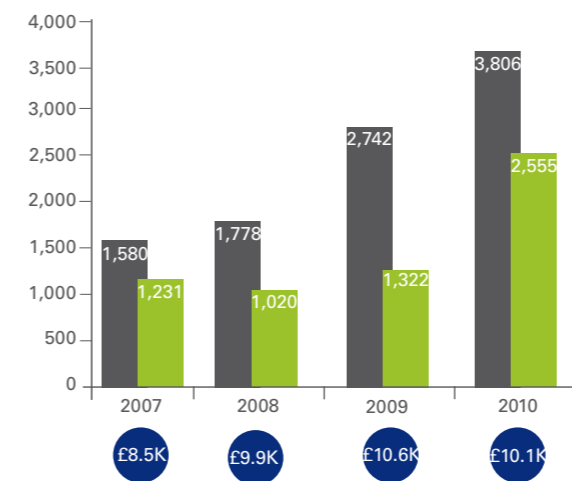
Loan conversion rates

The proportion of loan applications resulting in disbursement – the loan conversion rate – demonstrates the degree to which CDFIs are able to provide credit. This year about one third of members reported lack of organisational or capital capacity as a reason for not being able to provide credit to all qualifying applicants. Of these, between 5% and 80% of applicants were turned down due to lack of capacity, with an average of 25%.

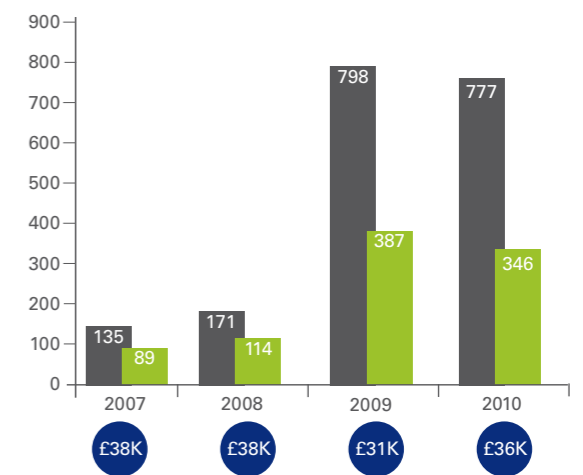
The number of applicants since the credit crisis has increased dramatically, especially in the SME market. While the number of micro loans disbursed remains relatively stable, SME disbursements are much higher as well, although the conversion rate is lower than in previous years.

Working with potential customers and processing applications is a rather resource-intensive activity. When CDFIs experience an increase in demand in the form of more applications, they must spend additional commensurate resources on that activity; a cost which is not recovered unless the loan application is successful and the debt fully repaid.

Applications and disbursements: micro enterprise



Applications and disbursements: SME

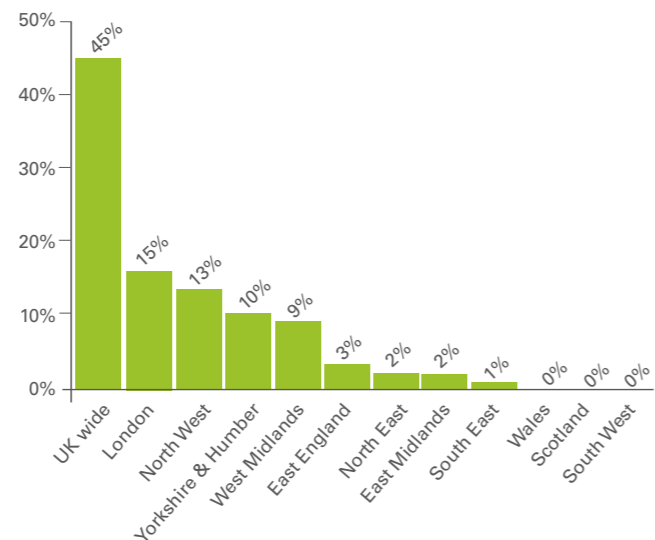


Geographic lending

Apart from a strong national presence in the micro sector, business lending generally is concentrated in the North West, Yorkshire and Humberside, the West Midlands and London, with London leading in micro and the North West in SME lending.

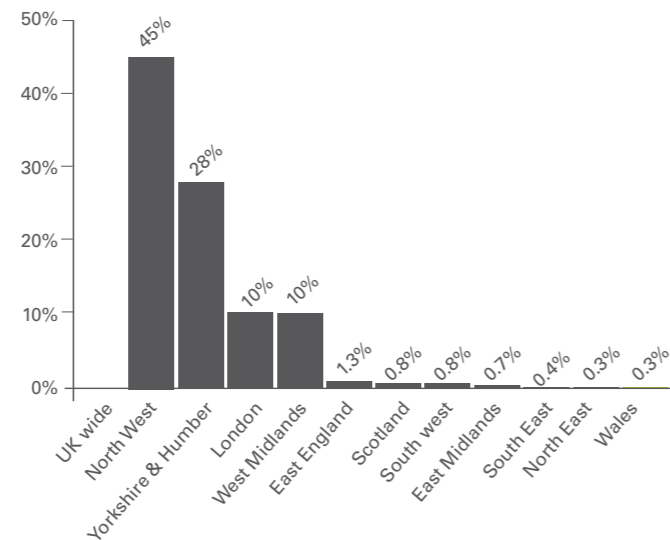
Not only are CDFIs responding to areas in greatest need, some regional development agencies – Yorkshire Forward, North West Development Agency and Advantage West Midlands – have been particularly supportive of CDFI business-lending.

Micro enterprise lending by region



Portfolio outstanding £51m

SME lending by region



Portfolio outstanding £30m

2.3 Portfolio performance

Despite CDFIs lending only to those they deem capable of making repayments, their customer base is riskier than that of mainstream lenders and therefore carries higher default and portfolio-at-risk rates. Business lenders have, with experience, become better at managing their loan book, as evidenced by this year's write-off rates being lower than the cumulative. Portfolio-at-risk and defaults are lower for SME than micro lenders for a number of reasons, including SMEs usually being more established, as well as the ease of managing a smaller number of customers. Write-off rates have stayed steady this year, however late payments seem to have increased as customers struggle to make repayments. The fact that write-off rates have not significantly risen is testament to CDFIs' delinquency management procedures.

	Delinquencies			Write-offs		
	31 - 90 days overdue	91 - 180 days overdue	181+ overdue	Annual write offs	W/O range	Historical W/O rate
Micro	6%	7%	24%	16%	1% - 73%	24%
SME	3%	1%	6%	9%	0% - 29%	11%

These figures are derived from taking the average of individual CDFI rates

The reported annual write-off rate range is quite wide because CDFIs set their own write-off policies and different markets operate different business practices. However, the **cdfa** recommends the aged portfolio at risk as the standard international measure of portfolio quality with 90+ days as the standard comparable indicator. As a recognised accounting method, portfolio at risk is more reliably captured and therefore might give a more accurate picture of portfolio performance.

2.4 Credit conditions

Cost of credit

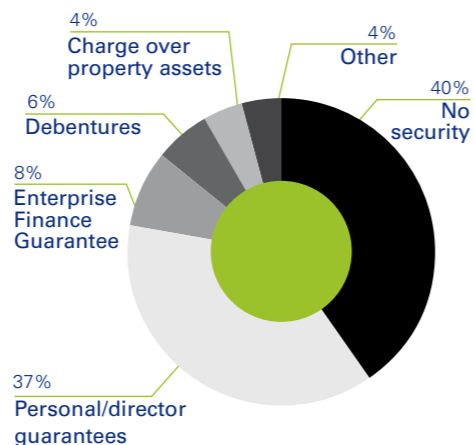
The terms of credit provided by CDFIs varies marginally between the two business markets. SMEs – larger and more established than micro-enterprises – tend to have lower costs to service and therefore enjoyed lower costs for credit. About half of business lenders adjust the interest rate based on client risk profile and nearly 40% vary the interest rate depending on loan size. Sixty per cent charge an arrangement fee and 22% charge late payment fees.

	Interest rate		Fees		APR	
	Avg	Range	Avg	Range	Avg	Range
Micro	12.3%	3% - 32%	1.5%	0% - 10%	14%	3% - 25%
SME	11.5%	5% - 18%	1.5%	0% - 5%	14%	9% - 35%

Loan security

Unlike banks, CDFIs are often willing and able to finance businesses without taking security; 40% of business loans fall into this category. This may be simply because the customer is not able to provide collateral – a primary reason for being turned away by the bank in the first place. But also some CDFIs – 23% – operate a business model based on foregoing requiring security. These tend to charge slightly higher interest rates and provide smaller deal sizes than their counterparts which require security.

Business lending: security



The Enterprise Finance Guarantee (EFG) facilitates lending to SMEs lacking the collateral to secure a normal commercial loan. Thirteen **cdfa** members are authorised to use EFG and, between them, over 200 loans worth £5.6 million have been underwritten since January 2009. Reported defaults thus far have amounted to 13% of the total lent – similar to the historic write-off rate for the SME market.

CDFI uptake of the Enterprise Finance Guarantee

13 CDFIs are accredited to use EFG (33% of enterprise lenders)		
	Average	Range
Guarantee allocations	£1.8m	£100k - £7m
	Number	Value
Loans written under EFG	207	£5.6m
Defaults	37	£710,552

Loan size

Even within business sub-markets there is no 'typical' CDFI but, instead, great variety in the way each CDFI operates. About 40% provided small loans of less than £5,000 on average to micro-enterprises, and 60% provided loans of under the average loan size of £10,000. For SMEs, two-thirds provided average loans of less than the average loan size of £35,000. CDFIs often specialise in certain loan types, for example, providing smaller seed-corn loans to sole traders or larger amounts to creative or innovative enterprises unable to secure traditional finance due to the nature of their business.

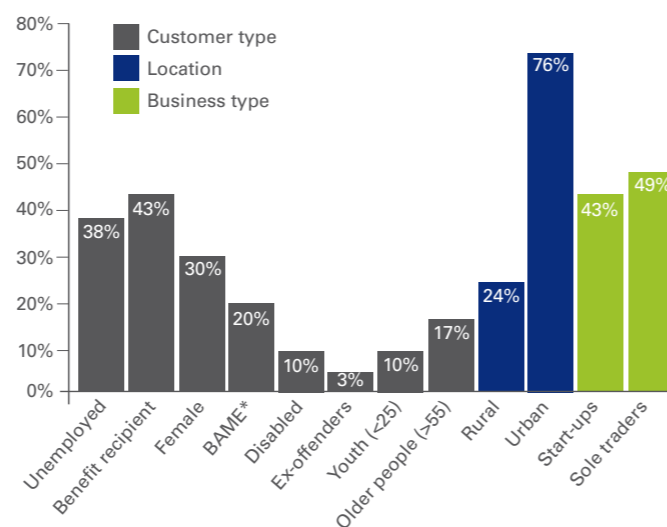
	Average deal size	Range
Micro	£10,077	£1,300 - £32,000
SME	£35,500	£6,500 - £160,000

Loan term (months)	Loan term range (months)
36	4 - 60
40	3 - 120

2.5 Customers

CDFIs serve where market failure exists. They often specialise in serving specific socio-demographic markets or, even if they do not have such a remit, find that they often serve those coming from marginalised groups. Ex-offenders, people from black, Asian and minority ethnic (BAME) groups, females and young people are all traditionally excluded from accessing mainstream credit when applying for business loans. Business-lending CDFIs clearly play a significant role in reducing welfare dependency through financing business propositions which have been turned down by the banks.

Business lending customer types



*Black, Asian and minority ethnic

Sole-traders and start-up businesses – routinely overlooked by mainstream lenders – are particularly well-served by CDFIs. However, CDFIs have anecdotally reported that since the start of the recession they have seen a greater number of more established businesses shut out by the banks. Business lenders can help fill this gap while also supporting the more traditional start ups and underserved demographics.

2.6 Business support and partnerships

Many CDFIs lending to businesses provide more than just finance, often offering business support and ad hoc advice, not only to help ensure the success of the businesses to which they have lent but also to increase portfolio performance. About a third offer formal business training and over half provide formal mentoring services – some may require these as a condition of taking a loan whilst others offer them at the customer's discretion.

CDFIs often have robust relationships not only with the communities they serve but also other relevant players for funding, project delivery and mutual support. Particularly strong relationships exist with enterprise agencies, the **cdfa**, Business Links and RDAs.

CDFIs' own marketing activities account for over one quarter of customers, a cost which CDFIs must bear and recover themselves. Referrals are very important to CDFIs, with nearly three-quarters of customers coming from external sources. Most are not screened for appropriateness by the referring agency, but some, such as Business Link, may have had enough insight into a particular client to refer on the right kind of customer. Business Link has been, for many CDFIs, an essential conduit to CDFI finance.

Attempts to forge national referral systems between banks and CDFIs have not been sustained; instead an ad hoc system is in operation, usually between local bank branches and proximate CDFIs, and so only 11% of CDFIs customers are referred directly from a bank. With a strong referral system in place with local banks and support agencies, CDFIs will be able to save on their own marketing costs to focus on lending activities.

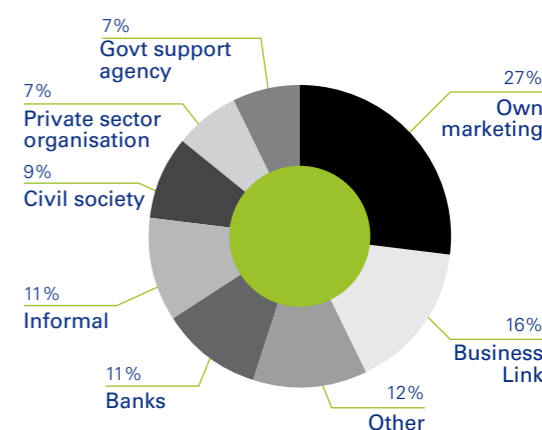
Business support services provided

	% offering
Formal training	33%
Formal mentoring	53%
Ad hoc support	83%

Partnerships: business lenders

	% relationship	Strength /4
Enterprise Agencies	100%	3.3
cdfa	100%	3.0
Business Link	100%	2.9
RDAs	92%	2.9
Other CDFIs	96%	2.6
Housing Associations	42%	2.1
Credit unions	38%	2.0
CABx	38%	1.8
Money advice services	29%	1.7

Business referrals



2.7 Outcomes

This year, respondents were asked to provide data on the number of businesses created, safeguarded and surviving for at least 12 months, and additional finance businesses were able to attract on the back of a CDFI loan.

Extrapolating data received from the 21 business lenders which provided full data across all outcome metrics shows that CDFI finance allowed for the creation or safeguarding of over 2,000 businesses and over 8,000 jobs this year. In addition, CDFI finance allowed customers to leverage in an additional £28m that they would not have been able to access without the CDFI foundational finance.

The **cdfa** is working closely with its members across all markets to establish common definitions of economic outcomes so the sector can continue to report and demonstrate its impact to its stakeholders in a consistent and robust manner.

Through independent evaluation, enterprise lending CDFIs have also been shown to demonstrate value for money from the public purse. GHK's *Evaluation of CDFIs*, published in March 2010, stated that '...

CDFIs are generally efficient vehicles for the delivery of capital to businesses... and that for each £1 of public expenditure CDFIs create or safeguard £8.57 at the local community level. However, this does not take into account the role of capital recycling, as funds are repaid and re-lent. Extrapolating from this, over the average three year enterprise loan term, it is likely that for each £1 invested into CDFIs an estimated £15 gross value added would be delivered.

Business lender outcomes*	
Loans disbursed**	£33.9m
Businesses created	1,256
Businesses safeguarded	882
Jobs created	2,784
Jobs safeguarded	5,390
Funds leveraged	£28.4m

**The weighted value of annual loans disbursed was used as a basis to extrapolate data from a sample of 21 lenders who provided full data on enterprise outcomes*

***Actual*

Case study: Black Country Reinvestment Society



Black Country Reinvestment Society (BCRS) was established in 2002 as an Industrial and Provident Society, initially to provide CDFI-style finance to social enterprises and SMEs in the Black Country, and more recently expanding its coverage to Staffordshire. By most social and economic indicators, the

area it serves ranks as one of the more impoverished in the country. Furthermore, the structure of the private sector in the area is predominantly composed of

SMEs, often very small, especially in the component manufacturing sector.

BCRS currently provides small business loans ranging from £10,000 to £50,000, and provided such facilities through the recent credit crunch – a period when the main high street banks severely tightened their lending criteria or actually exited this segment of the market. As a result, more businesses turned to BCRS for access to finance and in 2009, its last reporting year, it lent £1,368,000 and its total loan book exceeded £2 million. Cumulatively since its establishment it has issued over £6m in loans. While BCRS has moved from a social

enterprise emphasis towards a more SME focused strategy, both in response to demand and to broaden and diversify its portfolio, it continues to offer the full range of CDFI products.



The success of the strategy is founded on its ability to combine private sector sourced funding, including that from high net worth individuals, with that drawn from the public sector, both grants and funding, as well as from the co-operative and benevolent sectors.

Through leveraging on these funds, BCRS is able to increase the economic impact of that funding. Furthermore, public sector support has been crucial to provide funds to establish provisions, to cover the real risks of lending into this market segment, as well as to attract other fund providers. Current public funding streams are in place up to 2011.

Since 2002, BCRS has built up an effective business and credit infrastructure, to enable both the monitoring of the performance and, crucially, the risk of the loan portfolio, and to provide confidence to funders. As a result of operating at the riskier end of the market, BCRS has sharpened its analytic capabilities, ability to identify potential and innovative commercially viable borrowers and thus reduce provisioning requirements. The withdrawal of the commercial banking sector from this market has enabled BCRS to service this unmet demand and scale up accordingly.

From the BCRS perspective, the SME sector is, if anything, grossly under-banked with a dearth of effective facilities that could foster expansion. The larger universal and high street banks have historically been reluctant to service a sector that is seen as more volatile despite greater dynamism, more complex, although offering greater returns, and requiring relationship-driven, more simple plain 'vanilla' lending products than more exotic, mathematically-satisfying, transaction-driven facilities. In other comparable economies, particularly where the private sector is seen as the principal wealth creator,

banks play a still significant but less dominant role in providing capital resources to fund business growth.

The opportunities being provided by the coalition government offer the possibility of re-emphasising the strengths of the British financial sector, and complementing these by expanding and intensifying the role of non-bank financial institutions that can provide credit and capital products, facilities and services that have been traditionally shunned by universal banks. CDFI-type structures offer some potential, but there is a void in the market between CDFI-level loans (normally available up to £10,000) and corporate bank products, for which it is generally difficult to find availability below £1,000,000. BCRS currently lends up to £50,000 but for a variety of reasons, both regulatory and capital capacity, has not yet been able to offer amounts that would be credible to the larger SMEs. Realistically, its current estimated potential deal pipeline is considerable, roughly double its current loan portfolio, which it takes as indicative of the strength of the demand for working capital and finance that is not being met by the high street banks in the Black Country.



*Taken from A Co-operative Approach to Small Business Lending, BCRS, 2010
www.bcrs.org.uk*

Chapter 3

Lending to civil society

CDFIs not only provide finance to business and consumers, but also to civil society: social enterprises, charities and voluntary/community organisations. Traditionally, such organisations have found it difficult to access mainstream finance, with banks often not appreciating the business models or potential returns on investment.

KEY FIGURES

- CDFIs lent £153m last year to civil society customers
- A quarter of survey respondents serve civil society
- The aggregated loan portfolio of civil society lenders grew by 25% to £375m
- Outstanding loans grew by 15%
- Higher value loans have driven much of the increase in portfolio size
- The overall write-off rate is just 3.3% – a drop of 2.5% on the previous year

3.1 Introduction

Last year, 14 survey respondents (25%) reported serving civil society. Of these, nine specialise in this market, serving it exclusively, while the others also serve business customers – not surprising given that social enterprises are, after all, businesses.

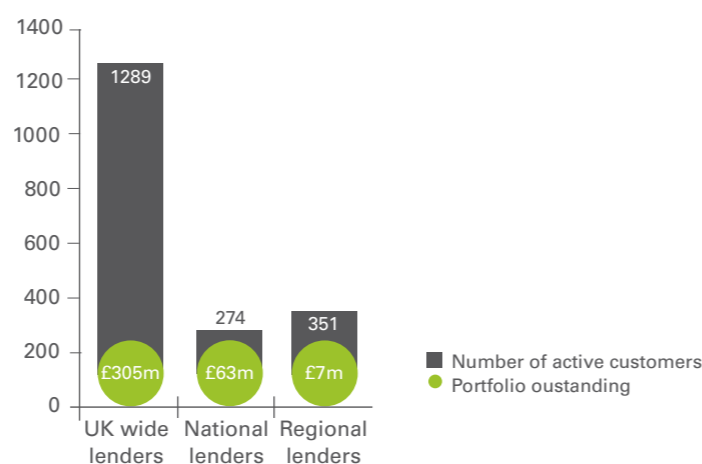
CDFIs serving this market are extremely divergent, distinguished not only by the specific markets they serve – with some specialising in social enterprise and others the voluntary and community sector – but also in terms of customer type. Some CDFIs are dedicated to large project development, others to small local endeavours. Some of the larger providers are deposit-takers – banks – and so operate a business model unlike the rest of the CDFI sector.

For this report we categorise civil society-lending CDFIs as **Large** or **Small** providers, defined as:

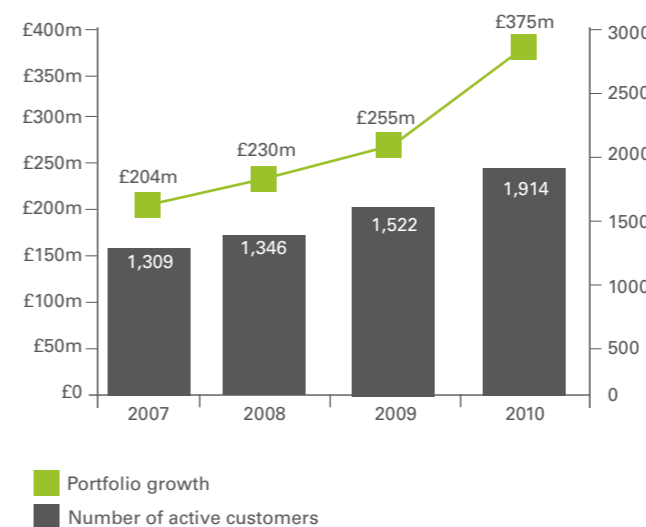
	CDFIs	Avg loan size	Geographic scope
Large	6	>£100,000	UK or nation-wide
Small	8	<£100,000	Regional/local

Not only do the large lenders have the highest loan portfolios, comprising 98% of the total civil society portfolio value, they also have 80% of the total civil society customer base.

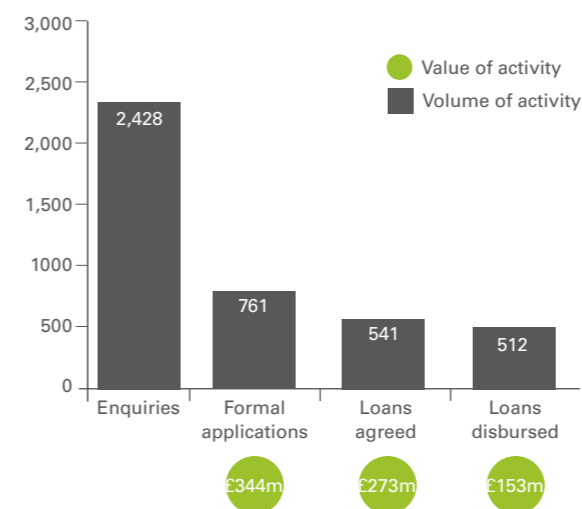
Civil society customers and portfolio



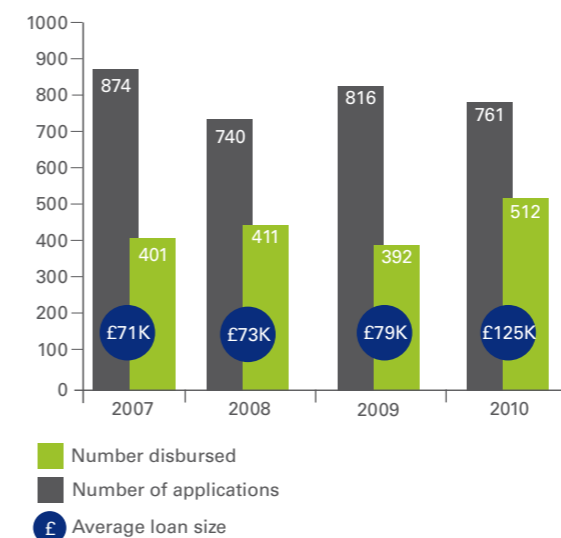
Portfolio outstanding: civil society



Civil society lending activity 09/10



Applications and disbursements: civil society



3.2 Lending activity

Portfolio growth

This year, respondents reported an aggregated loan portfolio of £375m. Adjusting for respondent variance, this represents a 25% increase in value and 15% in number of outstanding loans over the previous year. Therefore high value loans have driven much of the increase in the portfolio size this year.

Supply and demand

About 30% of enquires resulted in formal loan applications last year, of which about 70% were successful, commensurate with the experience of business lending CDFIs.

About 80% of the total value applied for was agreed, suggesting that larger loans were more successful at getting approval. This corresponds with amounts disbursed this year being an average of 70% larger than they had been previously.

Loan conversion rates

The proportion of loan applications resulting in disbursement – the loan conversion rate – demonstrates the degree to which CDFIs are able to provide credit.

Between 2007 and 2009, conversion rates for civil society lenders were roughly stable, between 46% and 56%. Last year lenders were able to approve a higher proportion of applications: 67%. And so although the number of applicants is somewhat stable, more are now successful at getting loans.

3.3 Portfolio performance

Civil society lenders have the highest performing portfolios in the CDFI sector, with large lenders performing best of all. Overall defaults are 2.5% lower than the previous year, while portfolio-at-risk remains similar. The due diligence process for the high value loans large lenders make is likely to result in such high performance. Clearly all civil society lenders are getting better at managing their portfolios as their experience grows, as evidenced by the current write-off rate versus the cumulative.

The reported annual write-off rate range is quite wide because CDFIs set their own write-off policies and different markets operate different business practices. However, the **cdfa** recommends the aged portfolio at risk as the standard international measure of portfolio quality.

	Delinquencies			Write-offs		
	31 - 90 days overdue	91 - 180 days overdue	181+ overdue	Annual write-offs	W/O range	Historical W/O rate
Large CS lenders	0%	3%	0%	0.3%	0% - 1%	1%
Small CS lenders	1.7%	5%	16%	3%	0% - 10%	6%

These figures are derived from taking the average of all CDFI individual rates.

3.4 Credit conditions

Cost of credit

The cost of credit charged by small civil society lenders is higher than that charged by large ones, reflecting risk and the need for a better return on yield when providing smaller loans over a shorter period. Large lenders tend to provide loans for large capital projects, property purchase and the like, as opposed to smaller loans required by community-based social enterprises or community groups. The difference is highlighted by the average deal sizes of the two markets. Even within the civil society small and large categories, there is no 'typical' CDFI, but instead, great variety in the way each CDFI operates, as evidenced by average loan size range.

	Interest rate		Fees		APR	
	Avg	Range	Avg	Range	Avg	Range
Large CS lenders	5.5%	1.3% - 8%	1.0%	0 - 1%	5%	2% - 7%
Small CS lenders	10.4%	3.5% - 19.5%	1.6%	1 - 4%	9%	5% - 12%

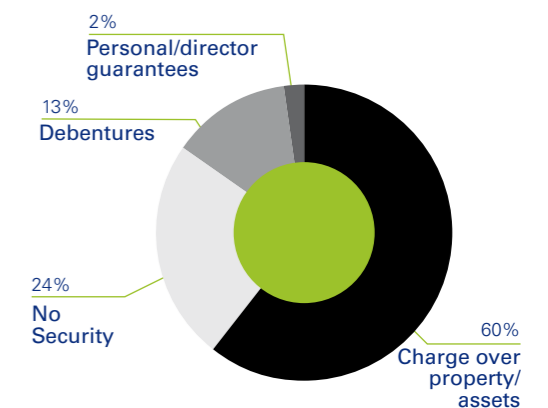
Loan size

	Loan size	Range	Loan term (months)	
			Avg	Range
Large CS lenders	£400,000	£100,000- £1m	140	36-300
Small CS lenders	£34,000	£7,500- £72,000	53	24-106

Security

Although one-quarter of civil society lenders do not take security over loans, they manage to charge very competitive costs for credit nonetheless. Charges over property and assets is the major form of security, not surprising given that many of the loans made are for these very things.

Civic society lending: security



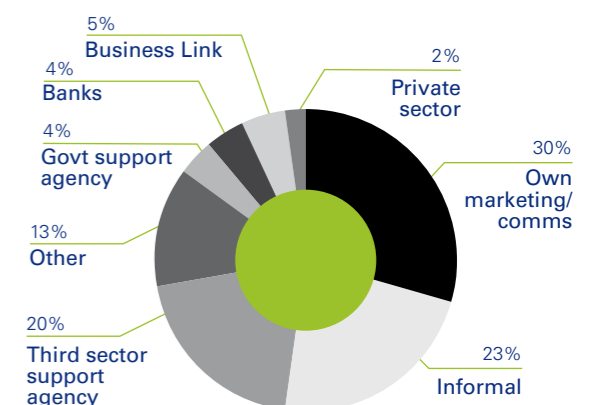
3.5 Customers

Civil society lenders provide finance to charities, voluntary organisations and social enterprises. The table below describes the breakdown of lending to these organisations.

	Charities/Voluntary/Community	Social enterprises
Large CS lenders	42%	58%
Small CS lenders	21%	79%

Civil society CDFIs' own marketing activities account for 30% of customers, a cost which they must bear and recover themselves. Referrals are very important, with 70% of customers coming from external sources. Third sector support agencies are particularly important to civil society lenders. This is not surprising given that charities, community organisations and social enterprises have well-developed trade bodies, support agencies and networks which are well positioned to refer those looking for credit on to CDFIs. Attempts to forge national referral systems between banks and CDFIs have not been as fruitful as hoped for; instead an ad hoc system is in operation, usually between local bank branches and CDFIs, with only 4% of CDFIs' customers being referred directly from a bank. Business Link plays a small role in referring social enterprise to civil society lenders, many of which would also qualify for a loan from business-lending CDFIs.

Sources of civil society customers



3.6 Customer support and partnerships

Many CDFIs provide more than just finance, offering support and advice not only to help ensure the success of customers' businesses but also to help ensure portfolio performance. One-third of civil society CDFIs offer formal training and 44% provide formal mentoring services.

Civil society support services provided

Formal training	33%
Formal mentoring	44%
Ad hoc support	78%

CDFIs often have robust relationships not only with the communities they serve but also other relevant players for a variety of reasons: funding, project delivery and mutual support. Particularly strong relations exist with the **cdfa**, Citizens Advice Bureaux and other CDFIs.

Partnerships: civil society lenders

	% with relationship	Score /4
cdfa	100%	3.4
Citizens Advice Bureaux	33%	3.0
Other CDFIs	100%	2.8
Housing Associations	22%	2.6
Enterprise Agencies	100%	2.0
Business Link	89%	1.6
Credit unions	66%	1.5
Money advice services	22%	1.0

Case study: Key Fund Yorkshire

When Darnall's busy local post office closed in August 2009 due to the private owner's personal circumstances, residents were left with a gap in services. The nearest alternatives in Attercliffe and Holdsworth were inaccessible to over 40% of the Darnall population, who rely on public transport for travel outside the area.

Darnall Forum, a Sheffield-based charity run by local residents, spotted an opportunity to help. The Forum provides a number of community development services to the residents of Darnall and surrounding areas of Sheffield, including life-long learning, employment and advice services, community engagement projects and research consultancy work.

With support from the community, local businesses, Sheffield City Council and the Post Office Ltd, it made arrangements to reopen the branch within its premises. The reopening was made possible by a £10,000 grant from the council and a £40,000 investment from Key Fund Yorkshire.

For the past ten years Key Fund has been providing an innovative mix of flexible loan and grant packages and equity investment for social entrepreneurs, voluntary and community organisations, and existing social

enterprises. Key Fund itself is a social enterprise and so understands the difficulties that organisations can face.

The Key Fund's £40,000 investment in Darnall Forum covered renovation and setup costs, and enabled the company to generate income to sustain their charitable work and employ new staff from the local area. The new post office opened in August 2010.

The new premises are ideally situated within the heart of the community and easily accessible by local residents. Reopening the post office has increased community access to vital facilities and services, as well as enabling the Forum to branch out into exciting new areas of work. Darnall Post Office is the first in the country to be run by a registered charity, not an individual.



Chapter 4

Lending to consumers

By providing responsible credit and money advice to financially excluded customers, personal-lending CDFIs offer an affordable alternative to home credit companies, payday lenders and illegal loan sharks.

KEY FIGURES

- The average APR for a CDFI personal loan is 31%, compared to 230% APR in the home credit market
- Personal-lending CDFIs charge an average of £17 per £100 borrowed, compared to £68 in the home credit market
- The average loan size is £490
- Loans outstanding have increased by 30% on last year to £7.6m
- A third of CDFI personal loans are for consumer goods; a quarter are for debt management

4.1 Introduction

Nearly one quarter of respondents (13) reported providing personal loans. Of these, all provide consumer loans and a handful – nearly one-third – also offer a home improvement loan product. Half of personal-lending CDFIs operate multiple retail outlets, running 53 branches between them.

Through providing responsible credit and money advice to financially excluded customers, CDFIs help redress the market failure which prevents many from accessing mainstream credit. Many of their customers would otherwise fall prey to predatory high cost lenders, or simply do without basic life essentials.

All personal-lending CDFIs offer services to customers in addition to credit, providing a holistic approach to financial inclusion of which credit is but one product. Additional products and services may be provided directly (for example through advice and financial capability training), or through formal partnerships (for example by helping customers set up savings accounts and bill payments).

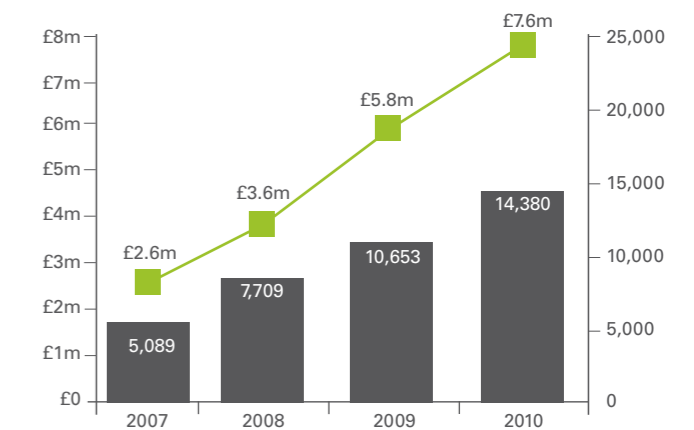
4.2 Lending activity

Portfolio growth

This year, respondents reported an aggregated loan portfolio of £7.6m, a 30% increase on last year and an increase of almost 300% since 2007.

The Department for Work and Pensions' Financial Inclusion Growth Fund is likely to have contributed towards much of this increase, having invested over £10m since 2005. Without this or similar support, the ability for personal lending to combat financial exclusion will be greatly compromised.

Portfolio growth: Personal



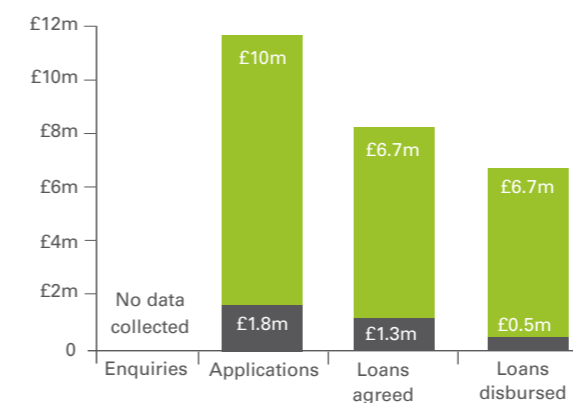
■ Value of loans outstanding
■ Number of active customers

Supply and demand

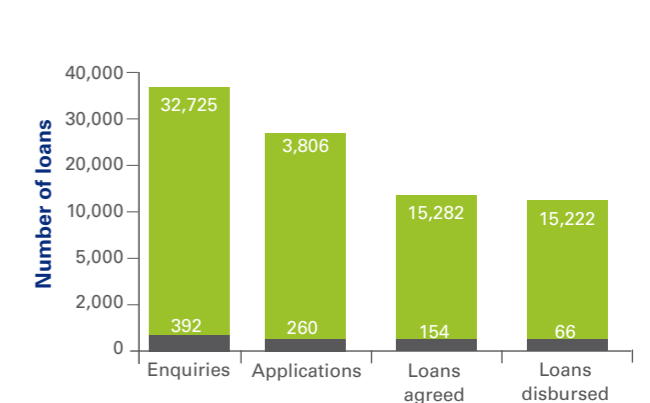
This year, personal-lending CDFIs reported that a little over 80% of enquiries resulted in formal loan applications. Of these, 57% of applications were successful, with most customers approved for the amount requested.

Although a greater percentage of consumer loans were approved – 77% – than home improvement loans – 69% – both are quite high agreement rates. These high rates reflect the nature of personal lending, where lending smaller amounts at a high volume is easier than making higher value loans to fewer people. To some degree, there is safety in numbers in this high-volume, low-value market with regards to potential damage to the portfolio.

Personal lending by value 09/10



Personal lending by number 09/10



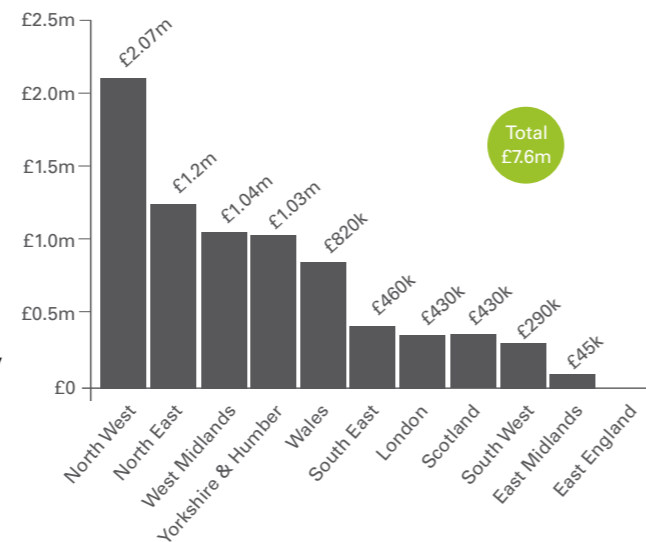
■ Consumer loan
■ Home improvement loan

Geographic lending

Lending activity in the North West is particularly strong, with a reported total portfolio value of over £2m outstanding. The North East, West Midlands and Yorkshire and the Humber each have aggregated loan books of over £1m in value. These correspond with the four regions in England experiencing the greatest deprivation, according to the Department for Communities and Local Government's *Indices of Deprivation 2007*.

Some areas – Wales and Yorkshire and the Humber – have seen marked increases mainly due to expansion by established providers. Other areas have relatively stable loan portfolios, with a few experiencing slight declines.

Personal lending portfolios by region



4.3 Portfolio performance

Personal lending portfolio at risk (PAR) and write-off (W/O) rates reflect the inherent risk of customers served.

Many CDFI consumer customers experience some degree of financial exclusion, such as the lack of a bank account or insufficient overdraft provision. In addition, few if any banks provide non-customers with loans in the relatively low amounts needed. CDFIs therefore provide a buffer between market failure and the high interest credit provided by the likes of home credit companies, payday lenders, credit cards and illegal loan sharks, where exorbitant rates often result in unmanageable and crippling debt spirals.

Home improvement loan customers tend to be unable to secure finance for essential renovations.

Often vulnerable, these customers would endure sub-standard living conditions were it not for CDFI assistance. Reported PAR and W/O rates are similar but slightly lower – about 2% – than in recent years. The reported annual write-off rate range is quite wide because CDFIs set their own write-off policies and different markets operate different business practices. However, the **cdfa** recommends the aged portfolio at risk as the standard international measure of portfolio quality with 90+ days as the standard comparable indicator. As a recognised accounting method, portfolio at risk is more reliably captured and therefore might give a more accurate picture of portfolio performance.

Delinquencies			Write-offs		
31 - 90 days overdue	91 - 180 days overdue	181+ overdue	Annual write-offs	W/O range	Historical W/O rate
4%	5%	18%	11%	4% - 32%	15%

4.4 Credit conditions

Loan size

Three-quarters of CDFIs reported average consumer loan sizes between £340 and £590, averaging nearly £500, with an average loan term of a little over a year. A few outliers reported average loan sizes as low as £164 and as high as £1,279. Home improvement loans tend to be even more similar in size, averaging £7,400 but with a quite a wide range in repayment terms.

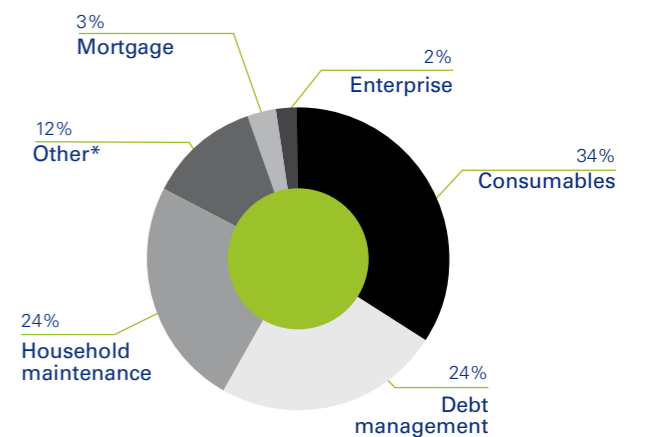
Loan size	Avg	Range
Consumption	£491	£164 - £1,279
Home improvement	£7,400	£6,500 - £9,215

Loan term (months)	
Avg	Range
14	8 - 33
70	12 - 165

Loan purpose

Although about a third of consumer loans are for purchase of consumer goods, a quarter of personal loans are for debt management, helping people out of destructive debt traps. One-quarter are for minor household upgrades, repairs and maintenance – not to be confused with formal home improvement loans, which accounted for less than 1% of all personal loans made.

Personal loan purposes



*Include rent payments, holidays, school uniforms, etc.

Cost of credit

As a proportion of the loan size, CDFIs charge less for home improvement than they do for consumer loans. This is for a number of reasons: partly because home improvement loans are spread over a longer period, generating a higher return, and, perhaps most importantly, because the CDFI takes security on the loans, often against a mortgage certificate.

	Interest rate		Fees		APR	
	Avg	Range	Avg	Range	Avg	Range
Consumer	26.1%	10% - 38%	2%	0% - 5%	31%	14% - 44%
Home improvement	7.0%	5% - 25%	0%	0%	7%	5% - 11%

CDFIs charged between 14% and 44% APR for their consumer loans, well below the 230% APR identified by **cdfa** as the average across five leading home credit providers.* Calculating for the cost to the customer per £100 borrowed, no CDFI reported charging over £25, with an average charged of just £17. Home credit providers charge £68 per £100 on average.*

*Based on an analysis of five home credit lenders, **cdfa**, October 2010

About 38% of personal-lending CDFIs adjust their interest rate based on client risk profile, and 31% vary it depending on loan size. Arrangement fees are charged by 38% of personal-lending CDFIs, and 31% charge late payment fees.

Cost per £100 lent	
Average	Range
£17	£8 - £25

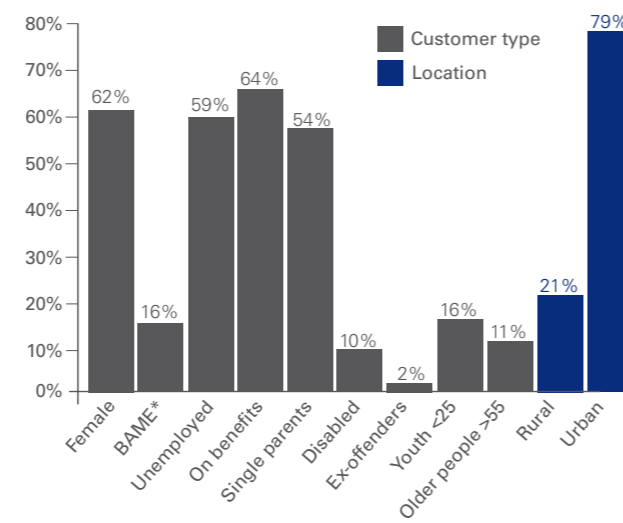
Home credit providers £/100	
Average	Range
£60	£59 - £75

4.5 Customers

Personal-lending CDFIs serve those caught between market failure and exploitative lenders. They often specialise in specific socio-demographic markets, or, even if they do not have such a remit, find that they serve those coming from marginalised groups. Those receiving benefits or experiencing worklessness, as well as women and single parents, are particularly well served by CDFIs, as are others traditionally excluded from access to fair and affordable finance.

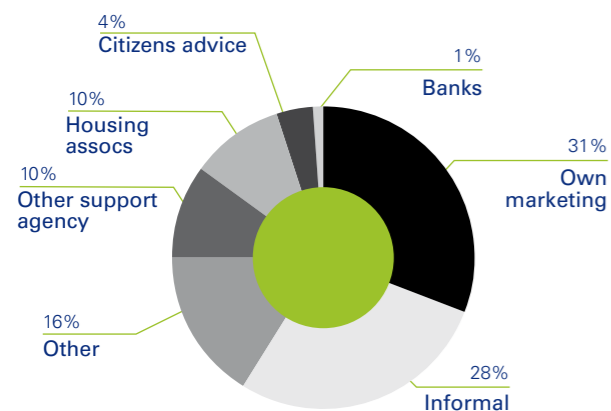
CDFIs' own marketing activities account for over 30% of customers, a cost which CDFIs must bear and recover themselves, and nearly 30% are informal word-of-mouth referral, likely from current or former customers. All personal-lending CDFIs have some type of relationship with housing associations, where 10% of customers come from. The low rate of bank referrals may in part be due to the fact that many CDFI customers would not even go to a bank knowing they will be declined, coupled with a lack of partnerships between CDFIs and banks.

Personal lending customer type



*Black, Asian and minority ethnic

Personal lending customers



4.6 Support services and partnerships

All personal-lending CDFIs provide money support and advice as well as access to responsible credit.

% CDFIs offering additional products	
Personal accounts	38%
Bill payments	23%
Money transfer	8%
Mortgages	15%

Nearly 40% of members help their customers open bank accounts, and nearly 25% help people pay bills, helping their customers towards financial inclusion. Should a loan applicant be unsuccessful at securing finance, CDFIs try to work with them – either directly or through a referrals system with other agencies – to provide the right kind of support measures for vulnerable individuals on low incomes.

Personal-lending CDFIs have forged relationships with a variety of community-focused agencies, with the majority having relationships with housing associations and advisory services.

	% with relationship	Strength /4
Citizens advice	80%	3.25
Credit unions	80%	3.0
cdfa	100%	2.8
Housing Associations	100%	2.4
Other CDFIs	60%	2.3
Money advice services	80%	2.3

Case study: Scotcash

Scotcash is a Glasgow-based CDFI which opened its doors in January 2007 in Glasgow city centre. It was set up to help the citizens of Glasgow gain access to financial services which, due to either their past or current situation, they have been unable to access. Here, Angela MacLeod tells of her experiences of borrowing from Scotcash.

“It was probably almost three years ago now, and I remember it was a few months until Christmas, and I wanted to make a start on getting the presents in. I needed a loan and I had always used home credit before, but I saw this advert in my housing association newsletter for Scotcash. The advert said that a £300 loan from Scotcash was about £130 cheaper than the same loan through the home credit company. To be quite honest with you I couldn’t believe it, I thought there must be some kind of catch, but I thought I would give it a try and see what happened.

“I phoned them up and they made an appointment for me. I had to go in with bank statements, proof of income and my home credit book. I was actually a bit worried about it beforehand because I didn’t know what to expect and I kind of thought that they might not be able to help me, especially when I wasn’t working.

“My appointment was with Susan and she put me at ease straight away, she was really friendly and helpful. She said she was able to approve the loan straight away because I had brought in all my paperwork and asked if I wanted to sign up. When Susan explained the loan contract to me, I could see that the advertisement I had seen was correct, this was indeed much cheaper than home credit.

“Everything went fine until my last payment. I miscalculated and thought the loan finished a week earlier than it did and I didn’t leave enough money in my account. When Susan phoned me to ask if there was a problem I was shocked, and slightly worried because I was going back to Scotcash for another loan in the summertime. However, Susan was fine about it, she asked me to check things were ok with the bank and arranged to call for the payment a week later.

“I wouldn’t actually want to go anywhere else now because I enjoy going to Scotcash and I know that my loan officer is Susan; I can look forward to catching up with her and having a wee chat while we do business. I’ve recommended Scotcash to people I know and I always tell them that they will get good service at a reasonable price. What more can you ask for?”



Summary of data

LENDING ACTIVITY 1ST APRIL 2009 - 31ST MARCH 2010

Overall lending*	Number	Value
Loan enquiries	47,809	–
Loan applications	32,867	£437,229,702
Loans agreed	19,005	£321,849,142
Loans disbursed	18,85	£199,604,515
Loans committed	600	£158,043,968
Portfolio outstanding as at 31st March 2010	23,151	£530,520,027

Lending to business	Number	Value
Loan enquiries	12,351	–
Loan applications	4,758	£81,929,792
Loans agreed	3,019	£35,987,878
Loans disbursed	3,046	£33,869,620
Loans committed	323	£2,347,254
Portfolio outstanding as at 31st March 2010	6,826	£85,974,991

Lending to civil society	Number	Value
Loan enquiries	2,341	–
Loan applications	761	£343,815,328
Loans agreed	541	£272,618,803
Loans disbursed	512	£153,220,760
Loans committed	218	£155,324,944
Portfolio outstanding as at 31st March 2010	1,914	£374,516,719

Lending to consumers	Number	Value
Loan enquiries	33,117	–
Loan applications	27,348	£11,784,582
Loans agreed	15,436	£8,001,225
Loans disbursed	15,288	£7,158,024
Loans committed	59	£371,770
Portfolio outstanding as at 31st March 2010	14,380	£7,633,594

COST OF CREDIT	Average deal size	Interest rate	Average term (months)
Micro enterprise	£10,000	12.3%	36
Small and Medium Enterprises	£35,500	11.5%	40
Small Civil Society lenders	£34,000	10%	53
Large Civil Society lenders	£400,000	6%	140
Personal lending	£490	26%	14
Home improvement lending	£7,400	7%	70

*Includes equity provision not broken down elsewhere

ASSETS

Capitalisation

Total CDFI fund assets	£949,034,291
Money available not committed	£260,470,579
Money held not on balance	£9,815,495

INCOME REPORTED DURING THE REPORTING PERIOD

CDFI earned income

Loan management fees	£14,530,183
Interest on lending	£8,259,011
Non financial income	£4,975,814
Lending fees	£782,189
Interest on invested reserves	£601,304
TOTAL	£29,148,501

External operational funding

Undisclosed	£3,040,000
Local government	£2,045,000
National government	£1,660,000
Regional Development Agencies	£1,490,000
Other	£772,000
European	£146,000
TOTAL	£9,153,000

External capital funding

Regional Development Agencies	£15,120,958
European	£7,845,998
Bank loans	£4,265,000
National government	£3,149,146
Local government	£3,141,103
Other	£710,563
TOTAL	£34,232,768

Community Investment Tax Relief

Total raised to date	£62,579,325
During reporting period	£4,691,512

PERFORMANCE

	Loans 181+ days overdue	Annual write-off rates
Micro enterprise	24%	16%
Small and Medium Enterprises	6%	9%
Small Civil Society lenders	16%	6%
Large Civil Society lenders	0%	1%
Consumer lending	18%	11%

GLOSSARY

Annual Percentage Rate (APR)

The yearly cost of a loan, including interest, insurance, and the origination fee expressed as a percentage. APR for a CDFI is calculated by taking into account the average deal size, average loan term, interest and fees charged for the loan product.

Business Innovation and Skills, Department of (BIS)

Responsible for small business and enterprise policy, among other things. The Enterprise Directorate works across Whitehall, the RDAs and key delivery partners to ensure that Government – national, regional and local – understands and responds to the needs of entrepreneurs and small businesses.

Civil society

The term ‘civil society’ is used in this report to describe the social enterprise, voluntary and community sectors.

Committed loans

Lender-approved and reserved funds that have not yet been disbursed to or drawn down by the borrower.

Community Development Finance Association (cdfa)

UK trade association for Community Development Finance Institutions

Community Development Finance Institutions (CDFIs)

CDFIs are independent organisations which provide finance and related support to

businesses in disadvantaged areas, financially excluded individuals and social enterprises/civil society organisations unable to access mainstream finance.

Community Investment Tax Relief (CITR)

The CITR scheme encourages investment in disadvantaged communities by giving tax relief to investors who back businesses and other enterprises in less advantaged areas by investing in accredited CDFIs. The tax relief is available to individuals and companies, and is worth up to 25% of the value of the investment in the CDFI. The relief is spread over five years, starting with the year in which the investment is made.

Conversion rate

The proportion of loans disbursed in a given year as a proportion of overall loan applications for that year.

FORMULA: Number of annual loans disbursed / number of formal annual applications made

Department for Work and Pensions (DWP)

The UK government department which administers the Growth Fund, a source of funding for many personal-lending CDFIs.

Deployment ratio

The deployment ratio measures the percentage of total funds that are being deployed by the CDFI in lending and investments, or commitments to lend or invest. This ratio can vary and is enormously affected by large repayment, recent

injections of capital and the age of the CDFI.

FORMULA: (Total loans outstanding + total loans committed) / total fund size

Enterprise Finance Guarantee (EFG) scheme

A government-guaranteed lending scheme intended to help smaller businesses which may be struggling to secure finance, by facilitating bank loans of between £1,000 and £1m. The scheme aims to help credit-worthy companies which might otherwise not be able to access the finance they need for working capital or investment finance due to the current tight lending conditions.

Equity investment

Equity investment is medium to long-term finance provided by an investor in return for taking shares in a company. When made by an investment fund, this type of investment is also called venture capital. Financial returns are made by selling the shares for a greater value after some years of investment. One CDFI currently provides this type of finance with a community development focus by focusing on deprived areas or communities.

Fund size

The total amount of capital committed by the CDFI for on-lending purposes.

FORMULA: Portfolio outstanding + loans committed + capital available for lending

The Growth Fund

A fund administered by the Department of Work and Pensions to increase the availability of affordable personal loans via civil society lenders such as CDFIs.

Home improvement loans

A consumer loan taken out to finance alterations, remodelling, or structural renovations to an existing dwelling.

Loan fund self sufficiency

A measure of sustainability which looks at the ability of the CDFI to cover their operational costs through income generated by its core CDFI lending activities only.

FORMULA: $\frac{\text{Earned revenues from financial services (interest, fees)}}{\text{Total operating expenses}}$

Operational self sufficiency

A measure of sustainability which looks at the ability of the CDFI to cover its operation costs through all organisational earned income streams.

FORMULA: $\frac{\text{Earned revenues (total)}}{\text{Total operating expenses}}$

The Phoenix Fund

Officially launched by the then Department of Trade and Industry in 2000, the Phoenix Fund was designed to stimulate enterprise in the UK's most disadvantaged areas. Between 2000 and 2006 the fund invested over £42m into the CDFI sector. A further £11m has been invested in CDFIs to varying degrees by the nine regional development agencies.

The Phoenix Fund was formally terminated in 2008.

Portfolio at Risk (PAR)

The principal balance of loans outstanding that have one or more instalments of principal past due by one or more days as indication for quality of the portfolio. The PAR can also be determined for loans over discrete time periods i.e 30-90 days overdue and calculated as a percentage of the gross portfolio outstanding. The portfolio at risk ratio reflects the true risk of a delinquency problem because it considers the full amount of the loans at risk.

FORMULA: $\frac{\text{value of loans overdue in period}}{\text{gross portfolio outstanding}} \times 100$

Portfolio outstanding

The total value of loans that have been disbursed and have not yet been fully repaid.

Portfolio yield

The portfolio yield ratio measures the total income generated in fees and interest payments over a twelve month period as a percentage of the average portfolio.

FORMULA: $\frac{\text{Revenue from loan portfolio}}{\text{Average gross loan portfolio}}$

Regional development agencies (RDAs)

Non-departmental public bodies established for the purpose of economic development in England's Government Office regions. Eight of the nine RDAs report to BIS, the exception

being the London Development Agency, which reports directly to the Mayor of London and the London Assembly. Similar activities are carried out in Wales by the Welsh Assembly Government Department of Economy and Transport, in Northern Ireland by the Department of Enterprise, Trade and Investment and in Scotland by Scottish Enterprise. The English RDAs will be abolished in 2012, to be replaced by new Local Economic Partnerships.

Security

This is where the creditor has a claim on a particular part of the debtor's assets in the event of default. This is contrasted with an unsecured loan, where the lender has no right to take over any particular asset if payments are not made when due.

Write-offs (annual rate)

Unpaid payments of principal which have been written off as bad debts by a lender. This figure is generally reported at the end of year net of any recoveries from bad debts in the previous year.

FORMULA: $\frac{\text{Annual net loan losses}}{\text{Average loan portfolio outstanding}}$

Write-offs (historical rate)

FORMULA: $\frac{\text{Accumulated net loan losses (i.e. net of any recoveries)}}{\text{accumulated loans made}}$

Survey Respondents 2010

- ABI Associates - Faith in Business
- Acorn Fund
- Aston Reinvestment Trust
- Big Issue Invest
- Black Country Reinvestment Society
- Bridges Ventures Ltd
- Bristol Enterprise Development Fund
- Business Enterprise Fund
- Business Finance North West
- Business Finance Solutions
- Capitalise Business Support
- Charity Bank Ltd
- Co-operative and Community Finance
- Coventry and Warwickshire Reinvestment Trust
- Cumbria Community Asset and Reinvestment Trust
- DSL Business Finance
- Donbac
- East Lancashire Moneyline *
- East London Small Business Centre
- Enterprise Loans East Midlands
- Finance South Yorkshire
- Five Lamps Organisation
- Foundation East
- Fredericks Foundation**
- GLE oneLondon***
- HBV Enterprise
- Impetus
- Innovative Finance (Hastings Trust)
- Key Fund Yorkshire
- Lancashire Community Finance

- Leicestershire Moneyline
- London Rebuilding Society
- MCF Loans
- Merseyside Special Investment Fund
- Moneyline Yorkshire
- Norfolk & Waveney Enterprise Services
- North Lincolnshire Developments
- North London Enterprise Credit Union
- North Staffordshire Risk Capital Fund
- PRIME
- The Prince's Trust
- Project North East
- Robert Owen Community Banking Fund
- Scotcash C.I.C.
- Sirius
- Social Investment Business
- Social Investment Scotland
- South Coast Moneyline
- Spirit of Enterprise Loan Fund
- Street NE
- Street UK
- The Social Enterprise Loan Fund
- Triodos Bank
- Ulster Community Investment Trust
- WEETU - Full Circle Fund
- West Yorkshire Enterprise Agency

*Includes Shoreline Housing Partnership

**Includes the entire Fredericks group

***Includes Croydon Enterprise

Inside Out **2010**
The State of Community Development Finance

cdfa

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