

Inside Out

2009

The State of Community Development Finance

Weathering the storm





**Community Development
Finance Association**

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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.



I welcome the publication of the sixth *Inside Out* report, which gives a comprehensive picture of community development finance over the past year.

The Government recognises the important role community development finance institutions (CDFIs) play in supporting individuals and businesses in deprived areas who are unable to access finance from commercial banks. We have been working closely with CDFIs throughout the economic downturn, to ensure they can continue to provide real help to those who have struggled to obtain finance. Direct funding through the Regional Development Agencies has provided investment and support. Other CDFIs make use of the Community Investment Tax Relief and the Enterprise Finance Guarantee. This year's figures demonstrate that this support is yielding social and economic returns.

Government also provides support for the **cdfa**. We recognise that it plays a critical role in advocating for this emerging sector, as well as driving up standards and boosting capacity through initiatives such as *Change Matters* and its professional development programme.

As we progress towards recovery, CDFIs will continue to be important sources of finance to new and expanding businesses, social enterprises and individuals.

A handwritten signature in blue ink that reads "E. Mervyn Davies".

Lord Davies of Abersoch

Minister for Trade, Investment and Small Business

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Introducing CDFIs

Welcome to *Inside Out* 2009, the only report giving a comprehensive picture of the performance and outputs of community development finance institutions (CDFIs).

CDFIs are independent organisations supporting the third sector, businesses in disadvantaged areas and financially excluded individuals unable to access finance from the usual sources, such as banks or building societies.

CDFI customers include entrepreneurs struggling to raise finance for business start-up or expansion, or, in the current economic climate, to stay afloat; social enterprises and charities whose funding needs cannot be met by banks or grant-making bodies; and individuals who would otherwise be the target of high interest doorstep lenders, payday loan companies and loan sharks. When the finance is repaid, it is re-loaned or reinvested again and again into those communities.

The services CDFIs provide have always been important. When the economy was booming they catered for the large swathe of the population that found it difficult to access financial services, even in the era of so-called 'easy' money.

In these more straitened times, CDFI finance is even more important in sustaining enterprise, protecting jobs and combating social and financial exclusion.

About this report

Now into its sixth year, *Inside Out* provides data and commentary on what's really happening in community development finance. If you want to know where CDFIs are, whom they serve, what products they offer and how they operate, *Inside Out* can tell you.

CDFIs provide affordable finance to three market sectors, categorised in this report as follows:

Affordable finance provided to three market sectors	
Business:	Enterprises in deprived communities
	Micro: with fewer than 10 employees
	Small: with 10-49 employees
	Medium: with 50-249 employees
Social enterprise:	Third sector organisations and businesses trading for a social purpose
Personal:	Financially excluded individuals

Most of the data in this report is based on our annual survey of members, carried out between June and July 2009. The survey was distributed to the 68 **cdfa** members and associates who were actively lending or investing at that time, representing the vast majority of CDFIs in the UK, with a response rate of 93% (63 responses). Respondents provided information on a range of topics including size and type of organisation, products and services, portfolio performance, accounts, partners, impact measures and future issues.

All of the information returned in the survey relates to the period from April 2008 to March 2009 or, in the case of accounts information, the last reported financial year. The majority of respondents provided thorough feedback, though some were unable to capture or produce all data requested.

The **cdfa** recognises this and is working with its members to improve their ability to report data through the delivery of training and *Change Matters* – the CDFI performance framework. This includes agreeing common definitions and ways of calculating key information such as write-off and delinquency rates, interest rates and target markets.

1.1 Key impacts 2009

The sector's key impacts in 2008/09, summarised in Figure 1, show that by 2009 CDFIs had helped to create or sustain over 96,000 jobs and had loaned and leveraged nearly £1 billion (£964 million) into the UK's most disadvantaged communities.

Figure 1 CDFI impacts		since 2003*
	2008/09	Cumulative
Total of loans made	£113,134,045	£472,023,393 *
Individuals financed	8,794	25,832 *
Businesses financed	2,143	9,148 *
Jobs sustained	4,762	75,706
Jobs created	5,055	20,884
Training places provided	1,274	26,143
Total funds levered	£126,460,145	£492,396,360

The survey also found that:

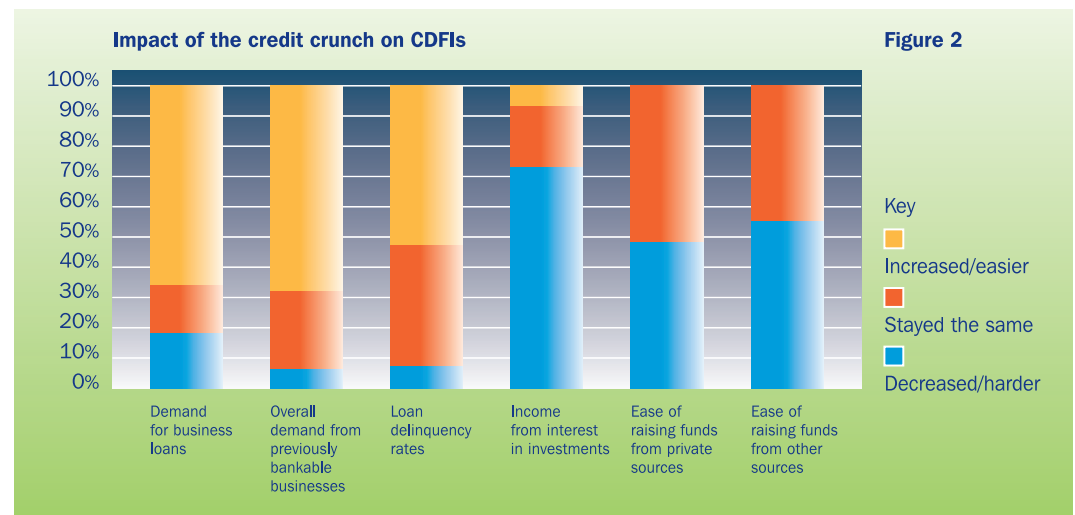
- Respondents report making nearly 11,000 loans in 2009, compared to around 8,400 the previous year. The total value lent has increased by 50%, from £76 million in 2008 to £113 million in 2009 (see Section 3.3).
- Demand for finance increased by £160 million – to £360 million – this year; CDFIs were able to serve only one-third of this demand (see Section 3.3).
- Loan/investment portfolio grew by 19% in 2009, to £394 million (see Section 3.1).
- For the first time, earned and investment income made up over half of CDFI income, with less reliance on grant funding (see Section 5.2).

1.2 CDFIs and the recession

This has been a challenging year for CDFIs and their customers alike. It is clear from our discussions with members that the economic climate has had a big impact on CDFIs as well as their customers. Many CDFIs are coping with a substantial increase in enquiries and loan applications by customers who would have been served by banks when the economy was healthier. Few CDFIs have seen a drop in demand, but those that have cite a reluctance to borrow money or start new businesses during the recession as the primary reasons.

The first two columns in Figure 2, relating only to business lending CDFIs, show 65% of respondents reporting an increase in demand for business loans and 69% reporting an increase in customers who would have accessed mainstream credit sources previously. These direct and significant impacts of the credit crisis coincide with a curtailment of credit by mainstream lenders.

Over half of CDFIs report an increase in delinquency rates, starting only during the latter half of the reporting period corresponding with the recession. And successive interest rate cuts have caused a drop in revenue for CDFIs with monies on deposit, with three-quarters (73%) reporting a decrease in dividends from interest-bearing accounts. At the same time, the ease of raising





One large lender has been removed from these graphs to allow for comparison

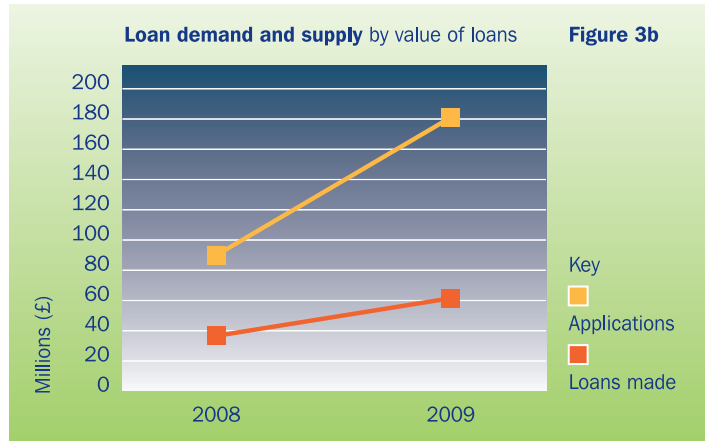
funds has either remained static or become harder. Most CDFIs rely on diverse revenue streams, often operating within tight margins. A decline in any revenue stream affects CDFIs' ability to operate effectively and support their target markets.

Despite a surge in demand and a shift in applicant type, CDFIs continue to serve customers much as they had prior to the recession by providing loans to investment-ready businesses and credit-worthy individuals, but without the capacity to meet the surge in increased amounts required. This shows that CDFIs remain focused on their mission, as well as demonstrating the immediate need for increased capitalisation.

This is illustrated by a comparison of the number and value of loans demanded and supplied over the past two reporting periods. Looking at demand by number of applications (Figure 3a), the increase has been met with a proportionate response, implying that CDFIs are applying the same criteria in lending decisions, and not drifting off mission.

Although CDFIs are keeping pace with meeting an increase in demand of number of loans, they are not in a position to meet the demand in terms of value of finance required (Figure 3b).

This surge in amount required can likely be attributed to two primary factors:

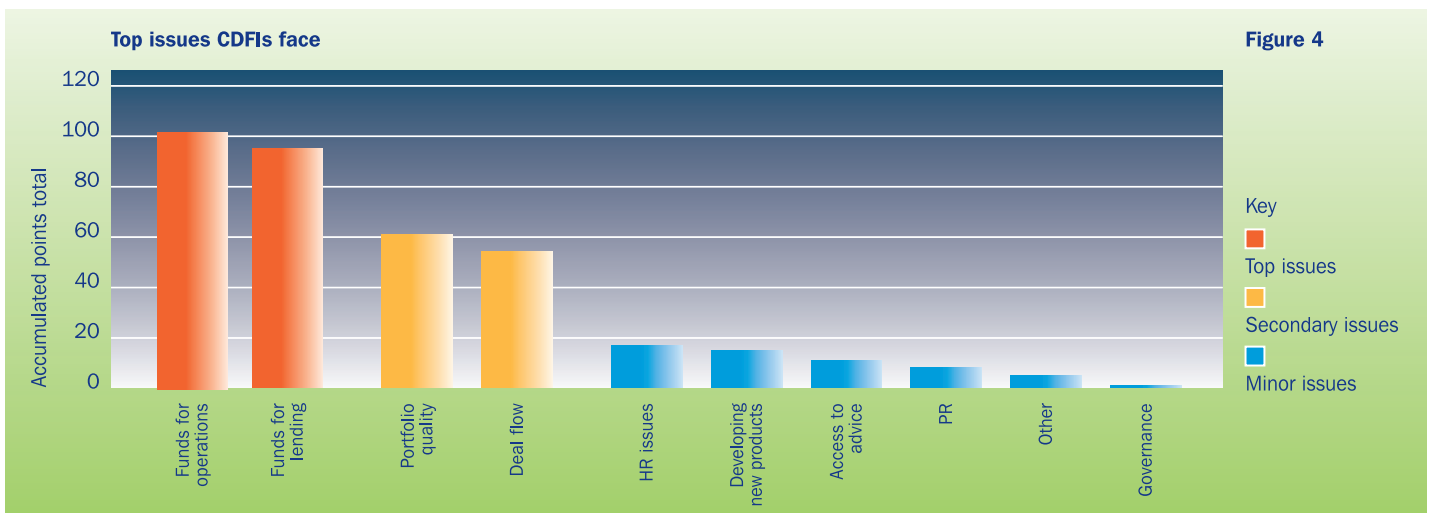


- credit being refused or withdrawn from customers previously deemed to be of mainstream lender calibre, and
- the need for stop-gap funding to cover revenue losses due to economic retraction.

Given that CDFIs appear to be applying the same loan fund policy standards as before the recession, it is evident that CDFIs simply do not have the capacity to meet demand rather than a risk aversion to providing larger amounts of financing to customers.

It is in the business market that this phenomenon of serving the right kind of customers, but not having enough capital to meet these customers' needs, is most apparent. The number of requests, as well as the amount requested, has increased more in the business sector than in the personal and social enterprise markets – not surprising given that recession hit small business foremost. Details of demand and supply by market sector can be found in the Appendix, Figures A.5 to A.7.

As shown in Figure 4, CDFIs cite funding – both for on-lending and for operations – as the most important challenge they face, well ahead of the related issues of improving portfolio quality and improving volume of deals. This mirrors the experience CDFIs reported in the difficulty in obtaining adequate funding and in increased default rates, as shown in Figure 2.



In their own words

CDFIs' experience of the recession

Respondents provided feedback on the impacts of the credit crunch and recession, the main issues being increased demand, shift in customer type and funding/income challenges.

Demand

"We experienced a tripling in demand for business loans. Although funding levels were increased, this was insufficient for the demand; therefore our lending criteria have been tightened, and increased security taken in the form of charges over assets, debentures, and personal guarantees. We also created a waiting list."

"Demand has picked up significantly since the lull of 2008."

"There is an increased demand for business loan funding but funds which should be available from central Government to help our clients via the local RDA have not become available."

Also see Figures 3a and 3b.

Customers

"We have observed a reduction in good applications despite our marketing efforts. While there is a steady stream of interest in our start-up services there seems to be a fear of actually borrowing any money."

"Overall the quality of applications and the average size of businesses seeking access to finance has increased. In some cases, this has been due to the inability or unwillingness of the banking sector to provide a similar level of finance at risk, which would have been the case previously."

"We have recently seen many applications at the top end of our range for 'distress lending' to save jobs, especially in manufacturing businesses which have suffered as a result of the fall-off in car production, and we have prioritised these cases. Our average loan size has therefore increased. We have also seen fewer applications from sole traders wishing to start-up. We have received applications from types of business we would not have seen before, and stable small-medium sized businesses with substantial bank overdrafts."

"The purpose of loans applied for has changed during the credit crunch as more people apply for debt related assistance and the impact of unemployment."

Also see Figure 9.

Income

"The decline in interest rates has had a major impact on our lending income. Almost all of our loan portfolio interest rates are linked to the base rate, and our cash reserves are invested in the money market, hence our earnings have suffered from the interest rate reductions."

"The decrease on income from investments has impacted us seriously."

"The fall in bank base rate has cut our investment income by 80%. It has also hit some of our historic variable interest loans where there were no collars on the rate being charged."

Also see Figure 2.

2.1 Impact of support for CDFIs

Prior to the launch in 2000 of a formal policy framework which codified and recognised the community development finance sector under an umbrella term – CDFI – and laid the foundation for the sector’s representative body – the **cdfa** – only a handful of such organisations existed.

Although the sector had been slowly growing, it was the recognition of the CDFI sector in tandem with dedicated governmental support and funding which created an environment for significant expansion (see Figure 5). With the advent of the **cdfa** and the launch of a dedicated CDFI Fund supporting business lending – the Phoenix Fund – the sector grew exponentially, until the fate of the Phoenix Fund became uncertain. The recent gradual decline in the number of CDFIs comes at a time when central governmental funding has retracted and been replaced with fragmented regional programmes, causing some CDFIs to cease trading and others to consolidate.

The Phoenix Fund was devised to increase the number and reach of CDFIs lending to businesses in disadvantaged communities, and was the major source of capital, investing over £42 million into CDFIs from 2000 to 2006. Thereafter, an additional £11 million was invested to varying degrees by the nine Regional Development Agencies (RDAs) in England, and terminated in 2008.

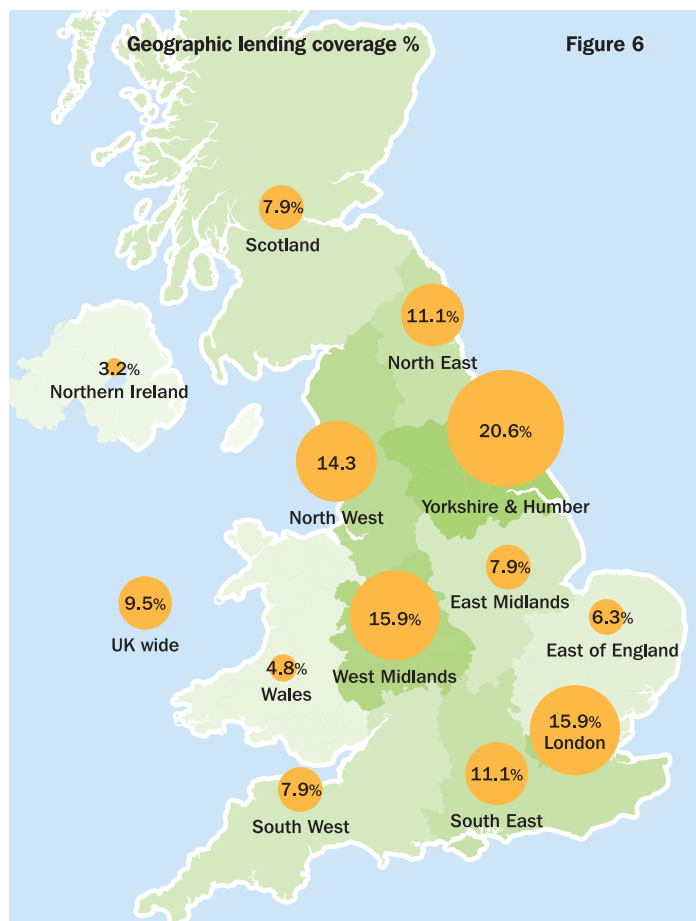
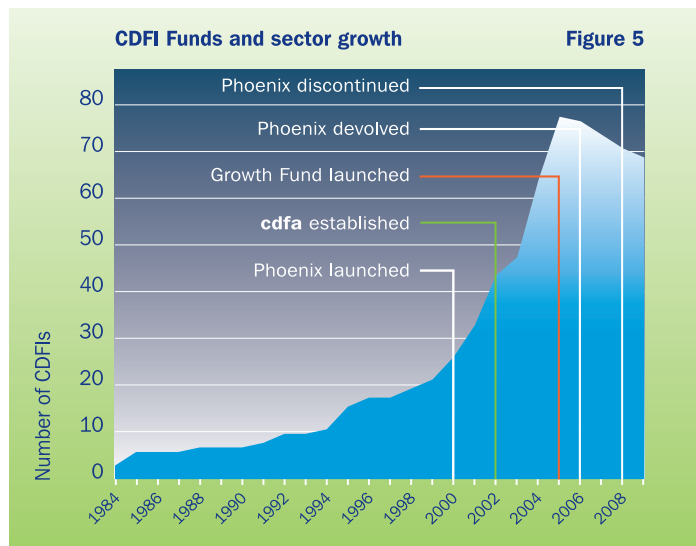
Since 2005, ten CDFIs have received over £10 million from the Department of Work and Pensions’ (DWP) Financial Inclusion Growth Fund. Designed to expand the reach of existing third sector personal lenders, commitment to continue the Fund to 2011 has been secured.

2.2 CDFI service coverage

Figure 6 shows where in the UK CDFIs provide service. The largest proportion of CDFIs, over one-third, serve Yorkshire and the Humber, followed by London, West Midlands and the North West, each of which are served by approximately one quarter of CDFIs (when including UK-wide CDFIs). However, the number of CDFIs serving an area does not necessarily indicate customer numbers or total loan values (details of which may be found in Figure 14). For example, while 13% of CDFIs serve Northern Ireland and 25% the West Midlands, CDFIs serving Northern Ireland provide 38% more in total loan value. Northern Ireland has one relatively large CDFI, the West Midlands more, smaller CDFIs.

As shown in Figure 7 overleaf, most CDFIs operate at a sub-regional level, with 60% serving local or countywide areas. This strategy ensures high quality community knowledge and flexibility in responding to local needs.

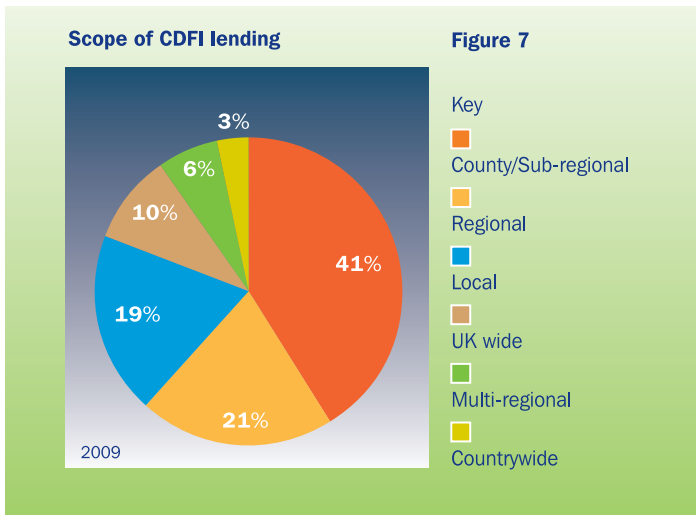
The 25 CDFIs operating at a larger geographic scope (regional, multi-regional, countrywide, UK-wide), maintain local presence through the 86 retail outlets they operate between them, in addition to employing field representatives and utilising telephone and email communications channels.



2.3 CDFI market sectors

CDFIs serve micro, small and medium businesses in disadvantaged communities, social enterprises and third sector organisations, and financially excluded individuals. Figure 8 overleaf shows both the proportion of CDFIs with the capability of serving each market and the proportion of CDFIs with customers in each market currently.

Many CDFIs serve primarily one market yet have the capability of serving others as well, under the right circumstances. For example, a CDFI focussing on micro-credit might also have the ability to service a small business loan if conditions are right.



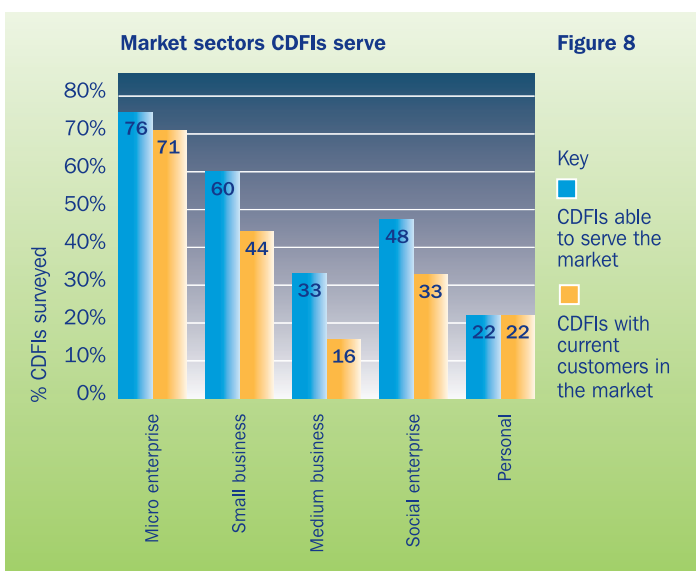
The difference between CDFIs' capability and their current customers (Figure 8), shows the willingness of CDFIs to serve multiple markets if and when they can. It is in the higher-end markets, such as medium business, where CDFIs may not always have the capacity to serve, despite their willingness.

Micro-credit is a mainstay of community development finance here as abroad. Three-quarters of CDFIs – not only business-lending CDFIs but also nearly half of personal-lending CDFIs – provide micro-credit.

Sixty percent of CDFIs are ready to serve small business, with 44% currently doing so. Medium businesses are often more established ventures and therefore less likely to be excluded by mainstream lenders, hence only one-third of CDFIs offer such service, with half of those currently serving such customers.

Nearly half of CDFIs are willing to provide financing to the social enterprise segment, with one-third currently serving customers.

Nearly a quarter of CDFIs offer credit to individuals, all of which currently serve such customers; CDFIs in this market tend to do so as a primary activity.



CDFI customer demographics

Figure 9 shows data on social demographics and other customer attributes for those CDFIs with the capacity to capture such detail. Although CDFIs continue to support new and informal businesses, such lending fell by 20% and 11% respectively on 2008, reflecting fewer new business starts and higher demand from established businesses struggling under current economic conditions.

CDFI target groups – such as single parents, Black, Asian and Minority Ethnic (BAME) communities, and women – continue to be a focus. The provision of service to urban versus rural communities approximates the distribution of the UK population.

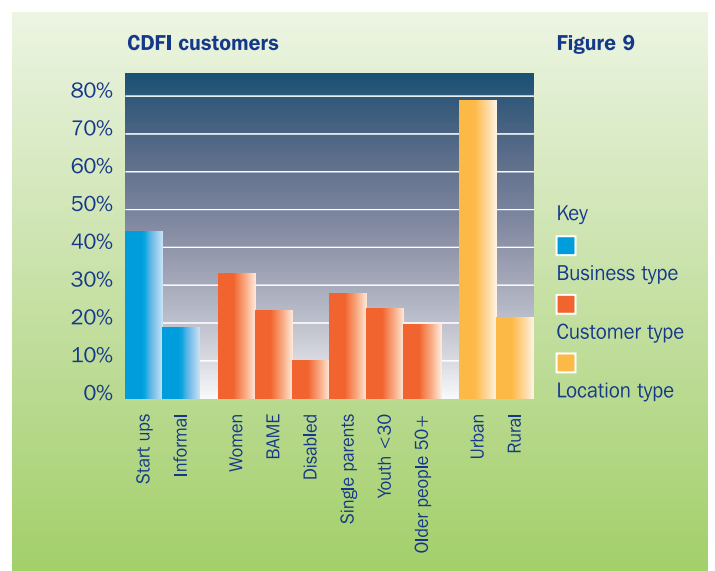
2.4 Partnerships

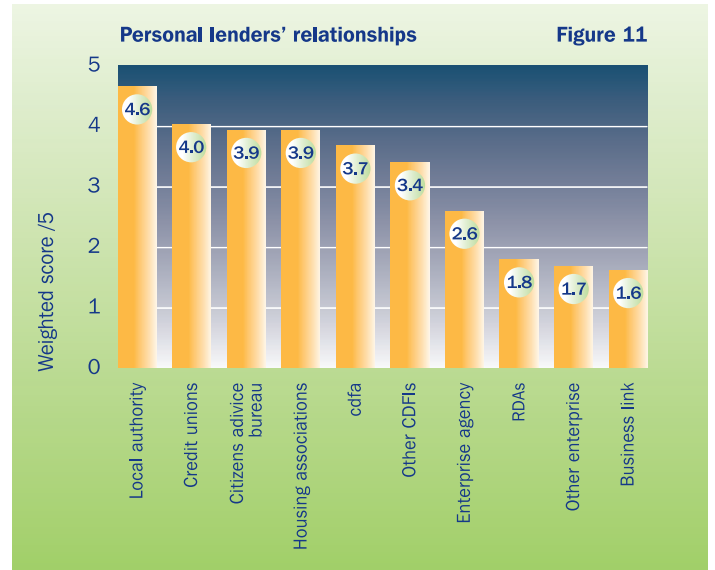
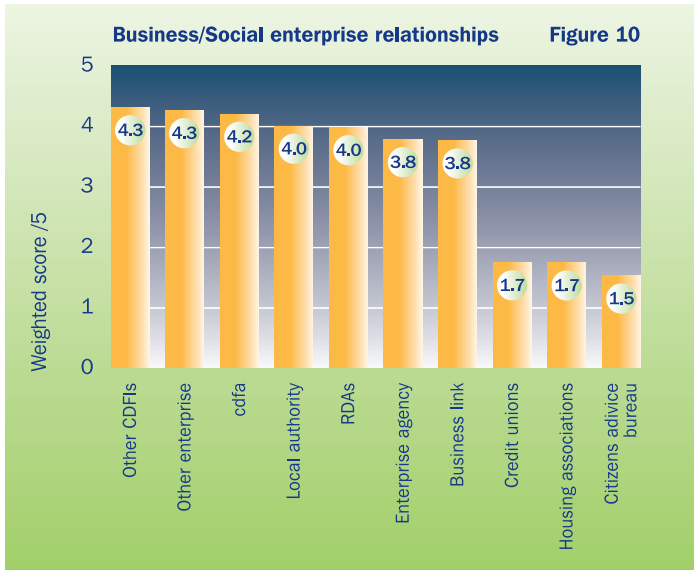
CDFIs collaborate with a range of other organisations for a variety of reasons including funding, project delivery and mutual support.

As shown in Figure 10, for business and social enterprise lenders widespread and fairly strong relationships exist with other CDFIs, other business-oriented organisations, the **cdfa**, local authorities and RDAs. Less developed relationships exist with Citizens Advice Bureaux, credit unions and housing associations – as expected, given that such organisations are traditionally more aligned with individual, not business, consumers.

Personal lenders have particularly strong and widespread relationships with local authorities and credit unions, as shown in Figure 11. Forty-six per cent of personal lenders also provide micro-credit (and of these, nearly half of their lending portfolio value is for that purpose), and these CDFIs have particularly strong relationships with enterprise agencies and other business-oriented organisations.

In general, however, a smaller proportion of personal lenders than business lenders have relationships with RDAs, given that RDAs are more likely to work with CDFIs around business support.





Sean Dennis
 Managing Director,
 Capitalise Business Support
 and **cdfa** board member

Sean Dennis, Managing Director of Hastings-based Capitalise Business Support, explains why reporting on social impacts is so important to his CDFI.

Social impact assessment: why bother? Well for us it is simple. We see this area of work as increasingly important in understanding our clients and the impact our support has on them, and also as a valuable tool to help raise future funding. As such we see this sort of monitoring as potentially crucial for the sector to help demonstrate its legitimacy and to help it develop and grow.

We are good at providing warm stories and we're even better at delivering hard economic facts. Having done this for years with varying success we kept thinking there must be some middle ground to connect the two ends of the spectrum. This led us to explore what was already out there, and we came across Jim McLoughlin, Head of the CUBIST Research and Consultancy Group at the University of Brighton, who had been working with Social enterprise London in developing a model called SIMPLE.

After securing funding from the **cdfa** Step Change programme, we set about testing whether this model could be applied to us. The journey has been long and even though we are only just starting to collect data and test systems that have been developed, it has undoubtedly been rewarding.

We have gained significant value from the work we've done. To start with, it has led us to redraw our mission statement in a way

that is much more meaningful to us. We already find it easy to produce statistics, such as since starting in 2004 40% of loans have been made to women, 25% to unemployed and over 10% to long-term employed.

This may not sound groundbreaking, but it confirms that we are achieving our mission and hitting the target groups that we set out to help.

We are still evaluating this data and are about to move onto the second phase of data collection. We will shortly finish a bespoke questionnaire and back office software system, which will allow us to capture and evaluate a range of impacts. These will range from soft skills development including confidence and self-esteem, through to business skills such as marketing, financial and operational control.

The next stage beyond this is to create a robust methodology to attribute a value to the work we do. This is not a strict Social Return On Investment process but having now presented at the **cdfa** Annual Conference, the International Social Innovation Research Conference at the University of Oxford Said Business School, to the New Economics Foundation and to leading organisations in the US, we feel we are not too far off achieving this potentially powerful tool.

I'm more than happy to answer queries from anyone who'd like to learn more about this work.

Case study

Measuring success: Capitalise Business Support

3.1 CDFI loan portfolio

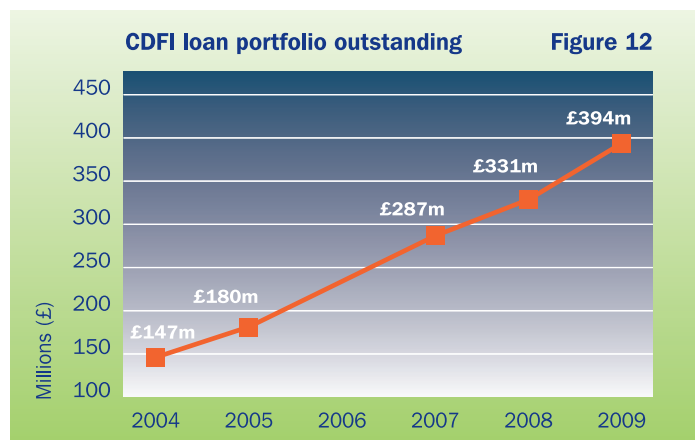
The CDFI sector continues to grow despite the slight decline in number of CDFIs, as evidenced by loan portfolio outstanding (Figure 12). The rate of growth has slowed slightly since the demise of the Phoenix Fund, with portfolio increase on previous years as follows:

- 2005/06 29%
- 2006/07 23%
- 2007/08 15%
- 2008/09 19%

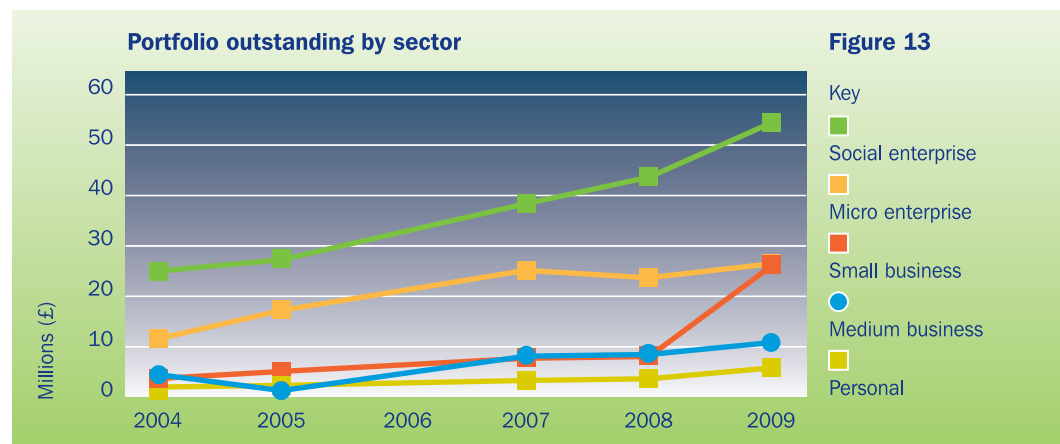
All markets experienced growth this year, as shown in Figure 13. The highest reported increase appears to be in the small business segment, but £12.4 million (or 72%) of the £18 million increase is attributable to improvements in reporting and

a new **cdfa** member operating predominantly in this segment. Adjusting for this, the small business portfolio has, nonetheless, grown by an impressive 28% between 2008 and 2009.

Social enterprise lending maintains the most consistent and considerable growth over time, and as many of the lenders operating in this space deal with comparatively large loans, this sector represents the lion's share of the overall portfolio.



A change in reporting period meant an 18-month gap in data collection between 2005 & 2007



Two large UK-wide CDFIs and one CDFI, for which breakdowns are unavailable, are excluded

The micro and medium business segments, as well as personal lending, continue a slow but steady growth. Despite levelling out recently, micro-credit maintains prominence. Personal lending represents the smallest proportion of overall portfolio outstanding, given the relatively low value of individual loans, coupled with the relatively small proportion of CDFIs active in this market. Likewise, lending to medium businesses is not a primary focus for most CDFIs, which engage much more with the smaller end of the enterprise spectrum.

Detail of total portfolio outstanding can be found in Figure A.3 in the Appendix.

3.2 Regional portfolio

Figure 6 showed that geographic scope of CDFI activity varies greatly across the UK. Figure 14 opposite shows another way of looking at regional scale – by aggregated number and value of loans outstanding. Not surprisingly, CDFIs with national scope produce the largest aggregated loan value portfolio but through a relatively small number of loans: it is at this level of operation where large projects tend to be supported. Regions with high numbers of loans tend to focus on

personal and micro lending. Regions enjoying strong support by RDAs, such as Yorkshire and the Humber, the North West and the West Midlands have high portfolio values, as does Northern Ireland, previously supported by the government. In Figures 15-17, regions reporting negligible or no data are not shown.

Business portfolio

With nearly £20 million outstanding, the North West accounts for one-third of the total business-lending portfolio of £60 million, with strong performance in all three business markets: micro, small and medium (see Figure 15). At nearly £12 million, Yorkshire and the Humber holds the next largest portfolio outstanding. The RDAs providing the most support are Yorkshire and the Humber, Northwest and West Midlands.

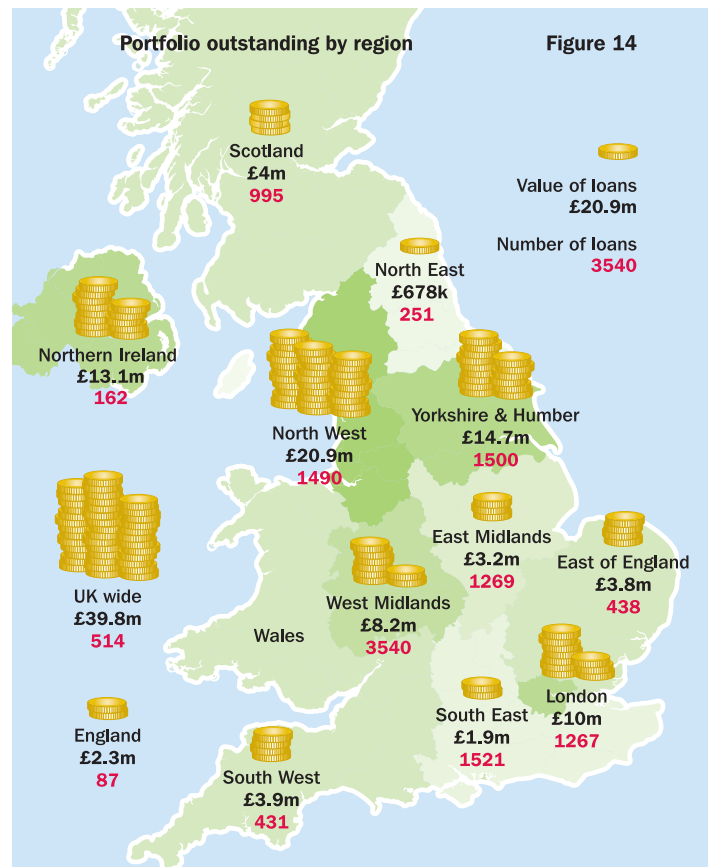
Micro enterprises are particularly well supported in London, the North West, the West Midlands and Yorkshire and the Humber, with between £3 and £6 million provided by CDFIs in each of these regions.

Small business lending portfolios are highest in Yorkshire and the Humber, UK-wide and in the North West, with between £5 and £7 million being lent there. The majority of the business portfolio is in the North West, securing its place as the largest business lender overall.

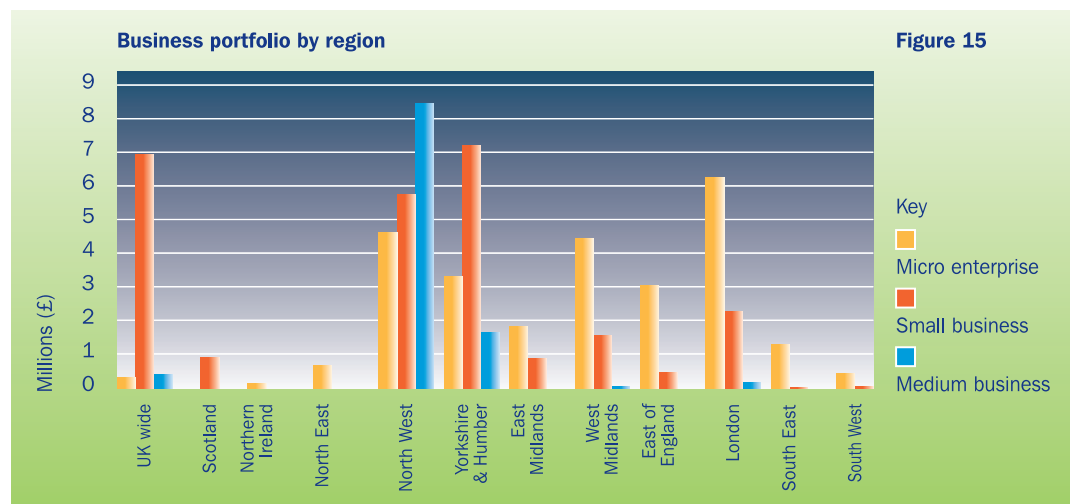
Social enterprise portfolio

CDFIs with UK-wide reach represent around 60% of the social enterprise portfolio, with nearly one-quarter in Northern Ireland (see Figure 16). As noted previously, social enterprise lenders with UK-wide coverage deal in higher value loan sizes than regional social lending CDFIs, hence their greater aggregated portfolio size.

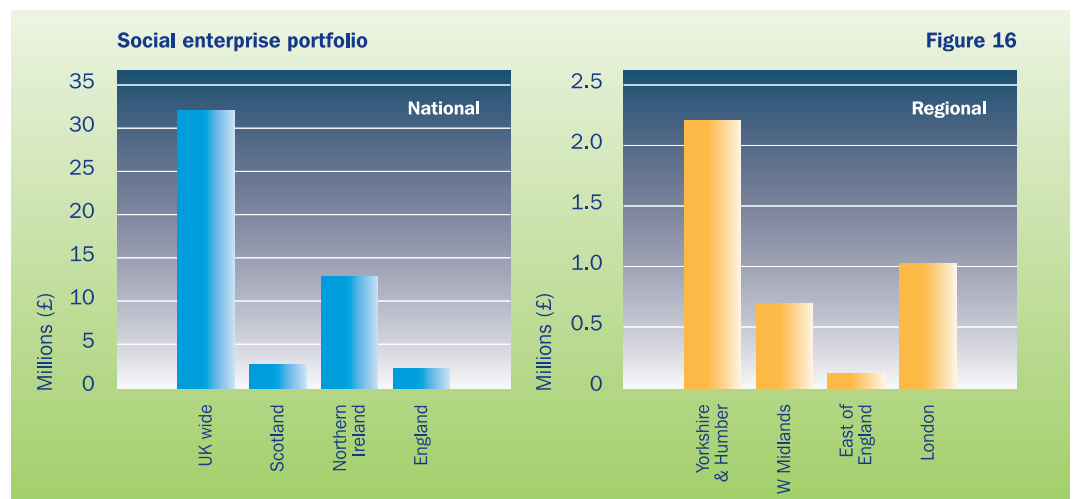
At the regional level, nearly half of the social enterprise portfolio, just over £2 million, is in Yorkshire and the Humber, with London and West Midlands making up most of the remainder.



Two large UK-wide CDFIs are excluded from this graph to allow for comparison



Two large UK-wide CDFIs are excluded from this graph to allow for comparison



One large CDFI has been removed from this graph to allow for comparison

Personal portfolio

Personal lending is particularly strong in the North West, with 35% of the total portfolio share, and West Midlands with 20% (see Figure 17). Although there may be many variables at work with regards to regional variation, the Department for Work and Pensions' (DWP) Growth Fund may account for a significant proportion. Three CDFIs in the North West and two in West Midlands benefit from this Fund – designed to increase the availability of affordable personal loans via third sector lenders such as CDFIs – while other regions in the country have either one or no CDFI in receipt of Growth Funding.

3.3 Loans disbursed

Overall, CDFIs lent out 50% more by value than in 2008, and disbursed one-third more by number of loans (Figure 18).

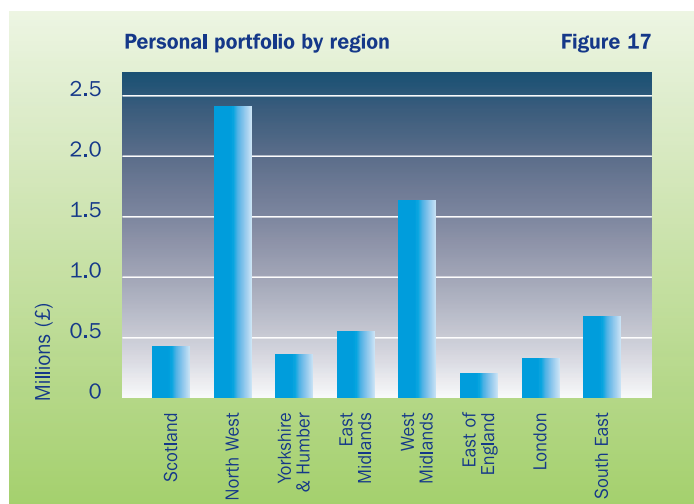
Although it appears that small business lending increased five-fold, half of this increase is attributable to one new small business lending member and improved reporting by another. Taking that into account, small business lending nonetheless tripled. The value of medium, social and personal lending each increased by roughly a third. In medium business lending, the number of loans disbursed doubled, meaning more, smaller loans were disbursed. Slightly fewer, larger value loans went to social enterprises, and personal lending is maintaining relative parity in loan number and loan size.

See Appendix Figure A.4 for trend analysis of loans disbursed by sector, 2004-2009.

Loan conversion rates

CDFIs serve risky, underserved markets with due diligence, making careful business decisions while providing invaluable service to financially excluded individuals, social enterprises and businesses in deprived communities. An examination of loan conversion rates – that is, the proportion of loan applications that result in loans disbursed – demonstrates not only the degree to which CDFIs are making sound decisions but also their capacity to meet demand. Figure 19 opposite, shows value of loan applications and loans disbursed.

Generally speaking, prior to the credit crisis the CDFI sector had the capital and organisational capacity to finance nearly



half or more of loan applications, depending on market segment (see Figure 20 opposite).

This year, loan conversion rates amongst business lending CDFIs are lower than in previous years due to the unprecedented increase in demand from businesses hit by the credit crunch and recession. CDFIs stepped up to serve this surge in demand by providing more loans of a greater total value, but were unable to meet the same rate of demand as in previous years. While some CDFIs report tightening their risk management regime, many simply do not have the funds to responsibly meet demand.

For example, in the medium business market, the conversion rate has fallen by 56% on last year, but the total value lent has increased by almost a third. In the small business market sector, conversion rates are half what they had been last year, yet the value lent has increased five-fold.

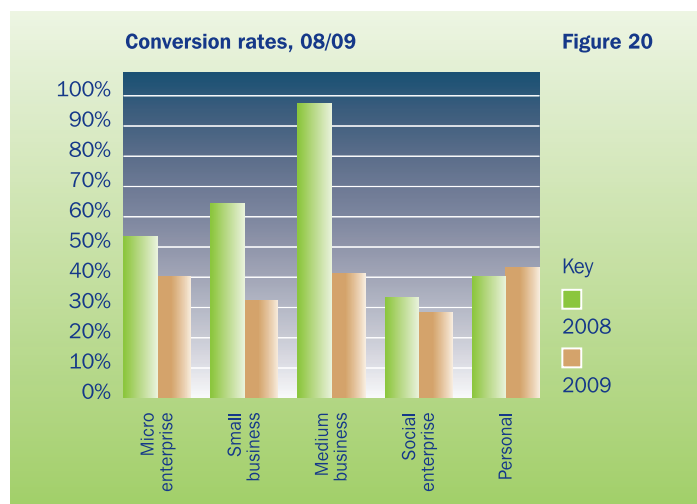
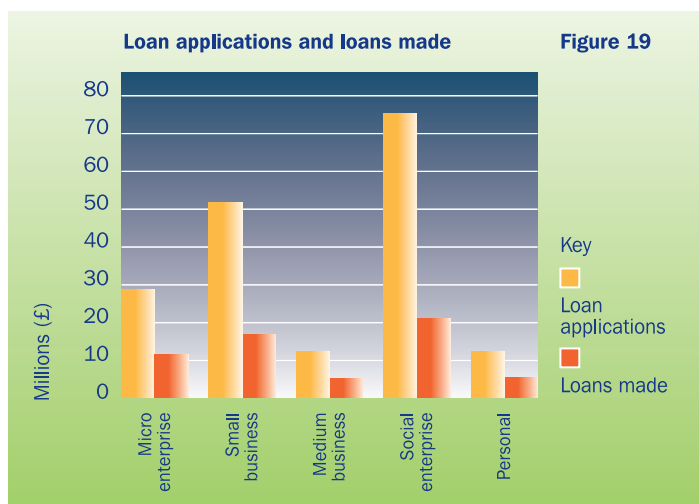
The relative stability of the personal lending conversion rates over time can likely be attributed to the nature of personal lending: high volume, low value lending of short duration allowing for flexible and responsive reaction to market conditions.

In addition, many applicants for personal loans are experiencing worklessness and in receipt of benefits, providing them with relatively stable circumstances. However, as the unemployment rate rises, there may be an influx in demand by those recently made redundant and requiring affordable credit.

Figure 18 Loans disbursed, 07/08 and 08/09

Sector	2008		2009	
	Value	Number	Value	Number
Micro enterprise	£10,097,595	1,020	£11,422,572	1,081
Small business	£3,108,490	99	£16,533,110	569
Medium business	£3,850,000	15	£4,925,119	30
Social enterprise	£55,219,388	411	£72,468,579	392
Personal	£3,875,208	6,869	£5,215,773	8,794
Total*	£76,150,681	8,414	£113,134,045	10,937

*Total includes one CDFI for which market breakdowns were not available



Two large UK-wide CDFIs, and one CDFI for which market breakdowns are unavailable, are excluded

Although the conversion rate for social enterprise loans has remained consistently and relatively low, this is due more to an excess of unsuitable applications rather than lack of CDFI capacity, where supply of funding for investment-ready projects is understood to be relatively ample. Social enterprise lenders are often best placed to raise significant private sector investment using a sustainable model. The lack of change in conversion rates since the advent of the recession could be because social enterprises and third sector organisations won't be significantly affected unless or until cuts in public expenditure are made.

The lack of investment-readiness of many social enterprise applications is due a variety of reasons: the funding structure of these organisations, with many having insufficient reserves, dependant on short-term, ad hoc public sector funding; organisations in crisis, frantic for finance after having exhausted all other funding avenues; poor understanding of the sector by mainstream lenders, driving them to CDFIs; the ability of each CDFI to cater to the huge diversity of organisations defined as 'social enterprises'; the often complex and multi-faceted funding streams social enterprises may attempt to bundle together; and lack of investment-readiness of many smaller social enterprises and charities which cannot access credit elsewhere.

Increased customer demand is not without its costs. It stretches CDFIs' resources due to larger numbers of customer enquiries, processing of more applications, due diligence demands and so forth. Surges in demand can overwhelm CDFIs, thereby conflating CDFIs' costs without providing any income.

Average loan size

Figure 21 shows the average size of loans disbursed in 2008/09 using two different calculations, both of which demonstrate that CDFIs are responsive to the markets they serve. The 'CDFI average' data was calculated within specific market segments by totalling the average loan size of CDFIs working within each market, and then dividing that total by the number of CDFIs working in each market, shown in the first column.

Markets	CDFI average	CDFI sector portfolio
Micro enterprise	£10,353	£10,567
Small business	£27,919	£29,056
Medium business	£95,533	£164,171
Social enterprise	£78,796	£184,869
Personal	£606	£593

They signify the lending behaviour of a 'typical' CDFI operating in a specific market. The 'CDFI portfolio average' is calculated by adding the value of loans made by all CDFIs and then dividing by the number of loans for each market segment. This reveals what lending is like across the entire market segment without reference to the size of individual CDFIs.

Comparing the two provides insight as to how the CDFI sector functions with regards to different market segments. For example, in markets where the two values are similar, such as in micro, this means that most CDFIs serving the markets are acting similarly – whether CDFI lending volume is low or high. A gap between the two values reveals a wide range in how CDFIs support those market segments, and that the needs of those borrowers are very diverse. CDFIs serving the smaller sized markets – personal, micro and small business – are a relatively cohesive group in terms of the sizes of loans provided.

At the larger end of the market spectrum – medium business and social enterprise – CDFIs are more disparate, mirroring wider variation in the size and type of loan provided to these segments. As larger, established enterprises, medium businesses have a wide range of needs requiring a variety of financing levels – from marketing to gap financing and building refurbishment. Social enterprise lenders fall into two distinct groups: large, national lenders operating at the high end, financing building purchase and the like, and local lenders catering to smaller social enterprise operations.

3.4 Loans committed

At the end of the reporting period CDFIs had £105 million of loans committed. Of this value, 97% are to the social enterprise/charity market. Much of this amount is simply loans which have been agreed but not yet disbursed or drawn down; these figures will appear in next year's report as "loans disbursed."

Loans committed also includes financing for large projects with relatively long terms reserved for borrowers but not yet drawn. A certain proportion of this capital – as much as 60% – may not end up being required by borrowers, who often find that the formal launch of a project attracts other funding streams, including grants and donations, to cover costs. Without the commitment of CDFI financing, many of these projects would remain unrealised.

Funds committed but not yet drawn represent a proportion of CDFI capital which may not ultimately be used but is unavailable to lend to others. CDFIs serving this market need to maintain high rates of capital reserves and therefore require compensatory capital if they are to finance other such projects. See Appendix Figure A.8 for details on Loans Committed 08/09.

Change Matters

Change Matters is the **cdfa**'s performance framework tool which provides an independent professional assessment of the Finance, Business and Impact domains for a CDFI. The process began in 2005 and has developed 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 and assess their own performance relative to the broader sector.

The *Change Matters* reports include short term, medium term and long term recommendations. The **cdfa** is aware that some recommendations would be easier than others to implement, but the objective report by the assessors provides a logical series of steps to take to improve performance.

Based on the trend of assessment reports from 2008 to 2009, key areas for CDFIs to develop towards best working practice include:

- Delinquency management
- Accounts and management information systems
- Loan analysis & portfolio quality
- Risk management
- Reserves policies
- Business planning and KPIs
- Measuring and reporting SROI and demonstrating impact
- Governance
- Marketing
- Social impact

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. This not only fits the mission of the **cdfa**, but has inspired new thinking of ways to disseminate this across the sector via the **cdfa**'s website. 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 vs re-scheduling, and define earned income sources.

A particular challenge for *Change Matters* reporting in 2009 was to assess the CDFIs objectively against the performance framework within a larger backdrop of a swiftly changing economic environment and changing profiles of CDFIs. That is why a key element of *Change Matters* is to carry out regular performance framework visits, so that progress can be measured and the report's analysis and recommendations will continue to be relevant to the CDFI.

4.1 Loan purpose

Figures 22, 23 and 24 show loan purposes by value across the entire CDFI portfolio outstanding. Further detail is shown in the Appendix, Figures A.9-A.11.

Business loan purpose

The majority of the value of lending for business purposes is for gap financing. For many businesses this type of finance is critical. Mainstream financiers are frequently unwilling or unable to meet all of a business’s credit needs, and CDFIs bridge the gap. Gap financing also includes stop-gap funding to cover cash flow problems and seasonal fluctuations in income.

Loans are often provided as part of a joint finance package between a CDFI and a high street bank, and are low-risk yet crucial to survival.

While gap financing tends to be provided by larger CDFIs, smaller institutions are more likely to provide loans for working capital and equipment purchase. Many businesses, with no other source of credit, depend on these loans to survive and thrive, demonstrating CDFIs’ utility as ‘lenders of last resort’.

Social enterprise loan purpose

Social enterprises and third sector organisations are extremely diverse, and this diversity is reflected in the CDFIs that serve them. So although half of the aggregated CDFI sector lending portfolio is for property purchase, this type of loan represents only 10% of the ‘typical’ social enterprise lending CDFI’s loan purpose. As with business lending, most CDFIs provide social enterprise loans for working capital, gap financing, and equipment purchase.

Personal loan purpose

The predominant reasons for personal loans are as expected – consumption and home improvement. Given the diverse needs of personal loan customers, it is also unsurprising that reasons outside of our survey choices make up the third category: ‘Other’, which includes loans for holidays, rent payments and family essentials such as school uniforms.

As we have seen with average deal size, personal lending CDFIs tend to be a more cohesive group. Therefore the aggregated personal lending purposes shown here broadly reflect the focus of the ‘typical’ personal lending CDFI as well.

4.2 Interest rates

Interest rates may not reflect the total cost to customers, but they do indicate risk. So although average interest rates for micro and small business loans are level at 11.8%, rates for micro enterprises can reach as high as 25%, while 19% is the maximum for small businesses. Nonetheless, CDFIs deliver competitive rates and a vital lifeline to those whom banks

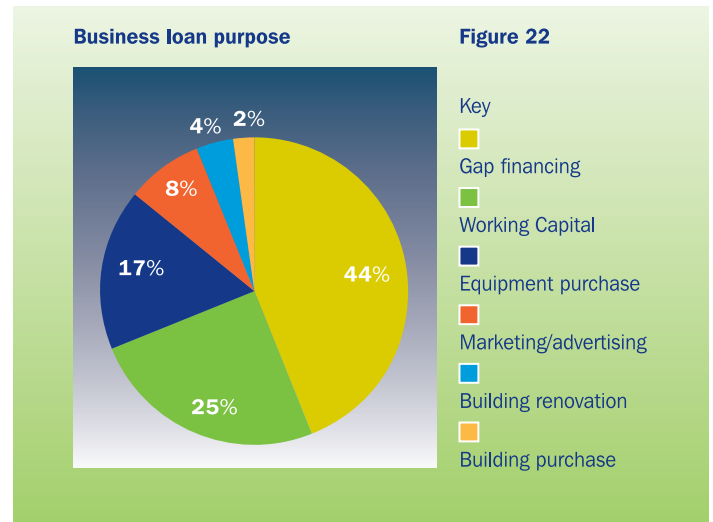


Figure 22

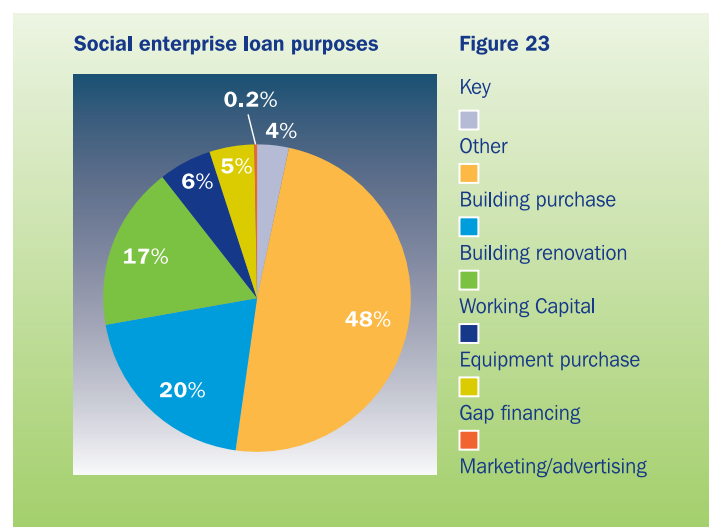


Figure 23

One large lender has been removed from this graph to allow for comparison

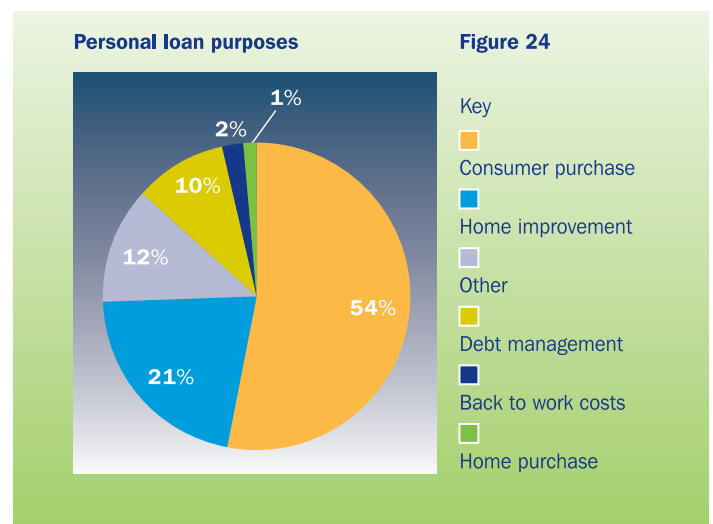


Figure 24

refuse. Providing business loans at around 11%, and personal loans at around 25%, means that businesses in disadvantaged communities and financially excluded individuals can access fair and affordable finance – finance that would not otherwise be available to them (see Figure 25 overleaf).

Interest rates charged

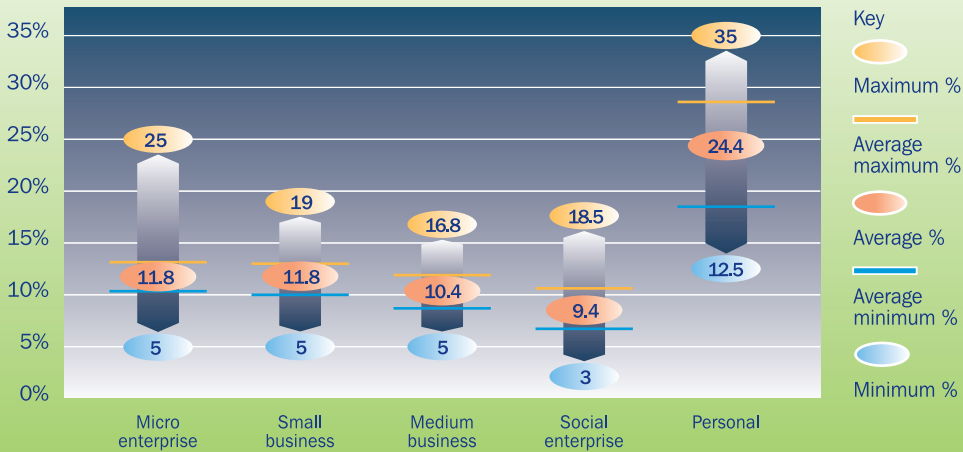


Figure 25

4.4 Delinquencies and defaults

Portfolio at Risk (PAR) refers to the outstanding balance of all loans that have an amount overdue by 30 days or more, and reflects the true risk of delinquencies. Figure 27 shows PAR 30+ by sector, with the average rate around 25%, comparable to last year (22%). The overall average CDFI default, or write-off, rate of 13% is also similar to previous years.

4.3 Loan security

Figure 26 shows security on loans based on the aggregated CDFI portfolio. Given the diverse nature of the different market segments CDFIs serve, the range of security type is not surprising. Nearly one third of CDFI lending is unsecured, although the proportion of this is decreasing. Collateral for personal and smaller size loans is not normally required, but for larger loans security is more often required. See Figure A.12 for further details.

Security type, by portfolio value

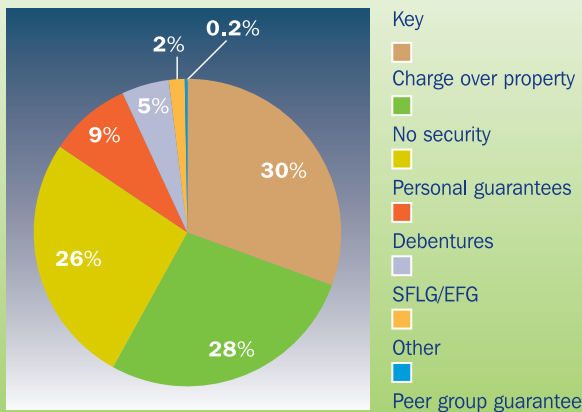


Figure 26

One large lender has been removed from this graph to allow for comparison

Given that only half of the reporting period fell within the recession, these figures are unlikely to represent the current situation. Since the time of the survey, many **cdfa** members are reporting a rise in delinquencies and write-offs. Should the recession translate into more write-offs, CDFIs face serious challenges with regards to managing their funds and, in some cases, their viability.

CDFIs catering predominately to medium businesses – often established enterprises with relatively more diversified debt liabilities – have the lowest write-off rates.

Social enterprise is the most diverse market, with high value loans to large, resilient social enterprises and third sector organisations offsetting the riskiness of loans to smaller start-up social enterprises, thereby delivering a low write-off rate.

As in the wider economy, small businesses, including micro enterprises, have been particularly hard hit by the recession and credit crunch, but the fullness of this may not be yet apparent. Higher default rates may have only begun to appear at the latter end of the reporting period. The relatively high personal lending write-off rate reflects the high risk of this high-volume, low-value market.

PAR and write-offs

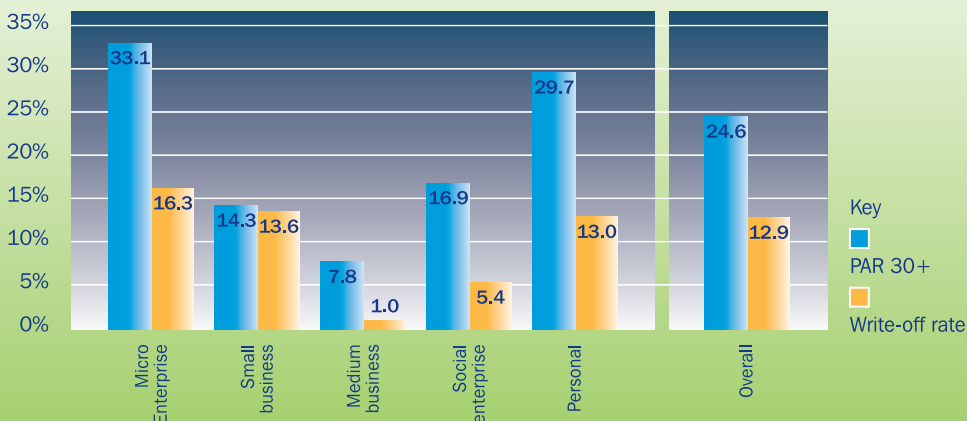


Figure 27

Inside Out data suggests that default rates can be affected by the provision of advisory services.

Some CDFIs provide finance only, while others provide finance and advisory services.

Those providing advice have an average default rate 3% lower than those who do not, despite the fact that many CDFI customers will receive

advice elsewhere. This helps establish the value of delivering finance alongside customised advice.

Some CDFI customers require support in order to build the kind of financial capacity required to become competent and responsible borrowers. Although advisory services helps ensure success, providing such services are resource intensive.

However, passing all of the costs borne on to borrowers would impinge upon CDFIs ability to provide affordable finance and in achieving their mission, highlighting the need for dedicated funding streams for advisory services. See Section 6 for more detail on the support services that CDFIs provide.

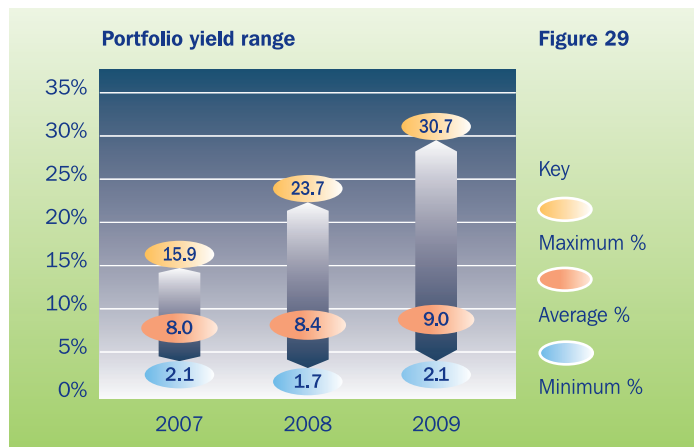
4.5 Deployment

Deployment ratios show the percentage of total loan fund assets that are outstanding or committed. This ratio varies enormously between CDFIs as it is affected by large repayments, sudden injections of capital and the age of the CDFI, with younger CDFIs having had less time to build up their loan book and establish themselves in their market place.

The **cdfa**'s performance framework, *Change Matters* sets a best practice benchmark for deployment at 60 to 80 per cent. As Figure 28 shows, CDFIs have moved into and remain in this range – a demonstration of the sector's maturity and adherence to diligent business practices.

In the current economic climate, when banks have been asked to shore up reserves and increase liquidity, it is particularly prudent that CDFIs should not over-deploy. Operating in a risky arena dictates the need for caution with regards to CDFIs ensuring that they do not over-extend themselves, and during these uncertain times, maintaining deployment nearer 60% is ever more appropriate.

Indeed, in September 2009, the Financial Services Authority announced that it would impose higher capital requirements against riskier trading activities. While this relates to the mainstream financial markets, the argument applies to community development activities as well.

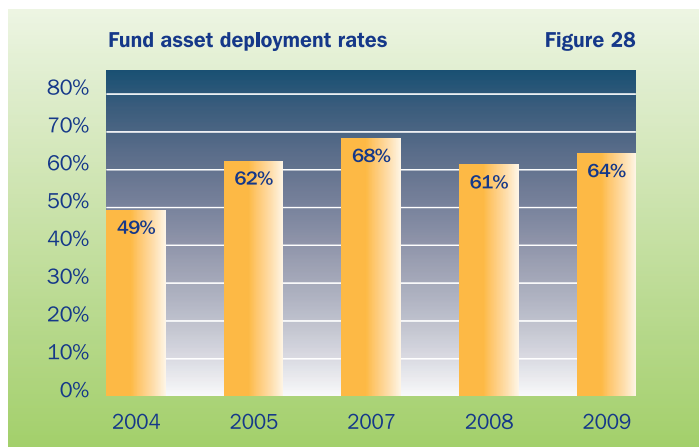


It is important that the CDFI sector shows that it is not vulnerable, especially now in a period of financial flux.

4.6 Portfolio yield

Portfolio yield (Figure 29) captures the interest and fees a CDFI earns over the twelve-month period as a percentage of average portfolio outstanding. This ratio gives an insight into the relative productivity of CDFI portfolios, and shows the portfolio's capacity to generate income. Personal lending CDFIs hold the highest average portfolio yield – 12.3% – mirroring the higher deployment rates and interest charged on personal loans. Although average portfolio yield is increasing only slightly over time, the upper range is rising at a faster rate, and, as more CDFIs improve their performance the average portfolio yield is expected to rise.

One method of increasing portfolio yield is to increase rates and fee charges; however, this approach runs counter to the ethos of the CDFI sector and would undermine the provision of fair and affordable finance.



5.1 CDFI loan fund assets

The aggregated CDFI loan fund size (Figure 30) – comprising loans outstanding, loans committed and funds available for lending – continues to grow. The sharp increase this year is due to a burgeoning portfolio and a recovery of funds available and loans committed, both of which had reported drops in value in 2008. In addition to these funds, CDFIs manage an additional £73 million on behalf of others, not included here (see Figure 38 for details).

As discussed in Section 4 and shown in Figure 31, the breakdown of the CDFI Loan Fund shows safe and sound fund management. Over 60% of funds are loans outstanding or committed, with the remainder serving as reserve – especially important during turbulent economic times.

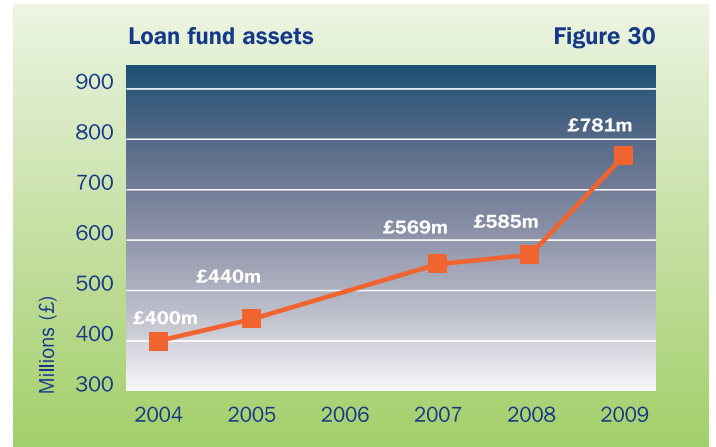
CDFI fund sizes

Figure 32 below, shows the CDFI loan fund size is stabilising, with the average fund size increasing slightly from £3.6 million in 2008 to £4.1 million 2009. This does not include funds under management on behalf of other parties.

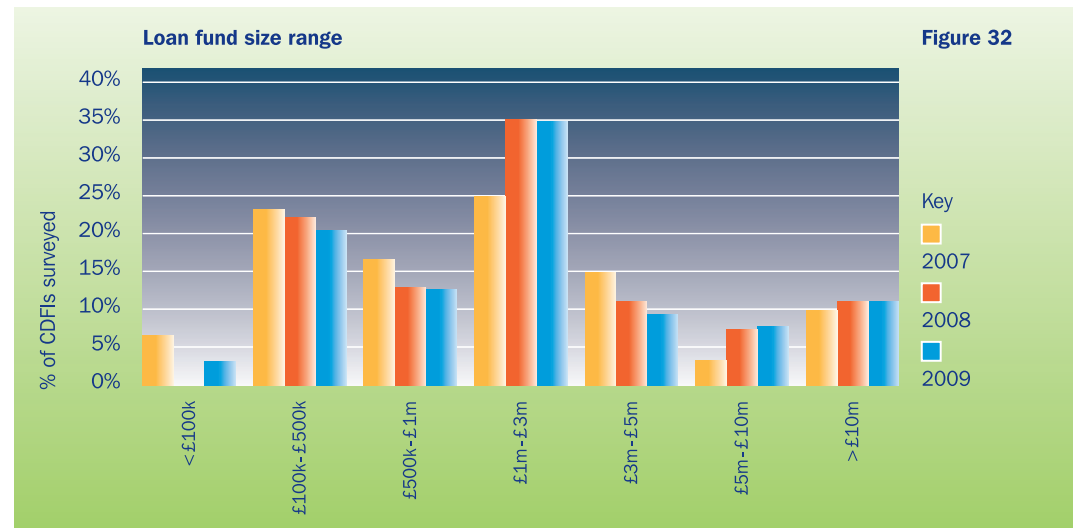
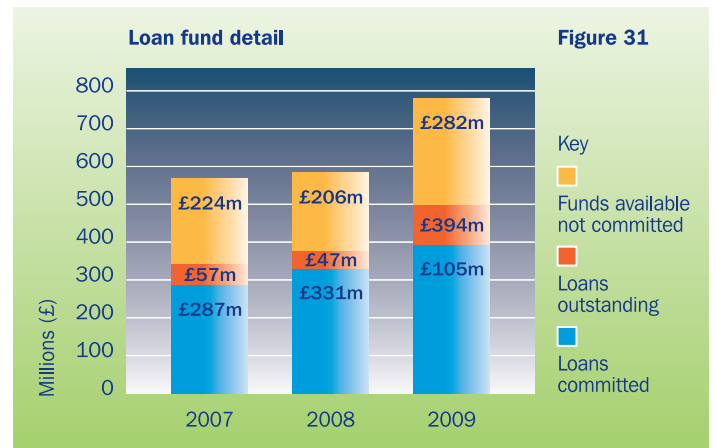
5.2 Income

The proportion of grant versus earned and investment income is often seen as an important sustainability benchmark

(Figure 33 overleaf). Just under half of total income is raised through endowments (from sources such as government, trusts and foundations, corporate social responsibility programmes and so on) and contracts from statutory bodies (such as the DWP, RDAs and local authorities). Over a quarter was raised by investment: commercial loans, private investment and withdrawable shares, and the



A change in reporting period meant an 18-month gap in data collection between 2005 & 2007



remaining quarter from earned income from interest and fees. For the first time, less than half of reported income is from grants and contracts, as shown in Figure 34. Despite this, grants still remain crucial to the CDFI sector.

While earned income remains relatively static, as CDFIs become more established and build relationships with commercial lenders and private investors, income from investment increases. Investment-ready CDFIs which are successful in raising private investment tend to be well-established; operating at scale; able to demonstrate robust business practices; able to offer additional sources of security to investors; and, perhaps most importantly, can offset risk with public grant investment.

Earned income

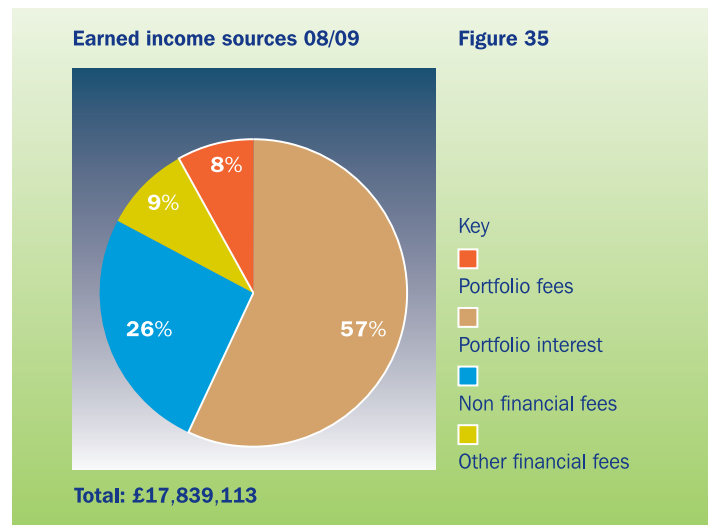
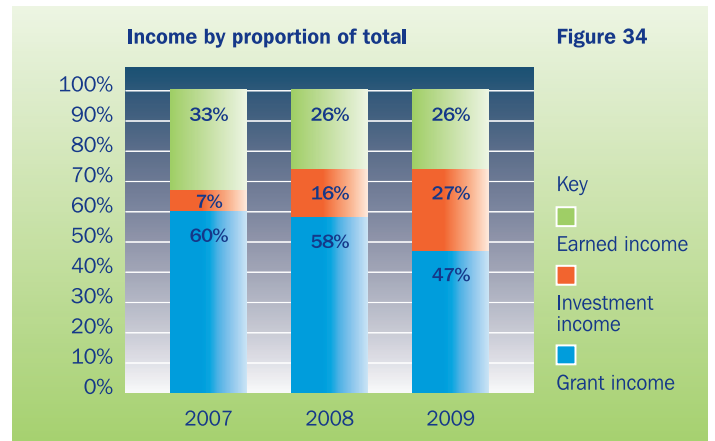
A closer look at earned income (Figure 35) reveals that the majority (65%) is from interest and fees charged on loans. Nearly 10% comes from fees for other financial services and products, such as fund management fees. Nonetheless, fully one quarter of earned income comes from non-financial services (such as training, business support or financial literacy programmes), showing recognition of the importance of a diversified income strategy.

External income

CDFIs access external sources of income from many sources in the form of investments and grant funding. While virtually all external income for operations was from grants, for on-lending purposes 60% was from investments and 40% from grants. Of the £51 million raised last year from external sources, roughly 90% was for on-lending. Raising revenue for operations and capital for on-lending are the top two challenges CDFIs currently face. (see Figure 4).

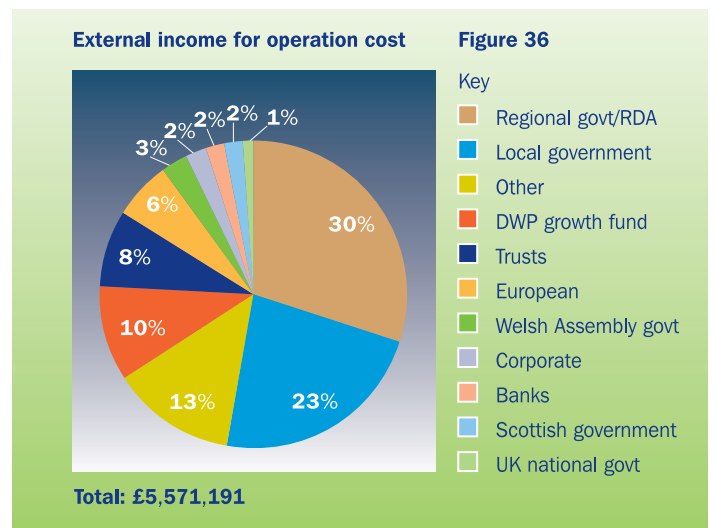
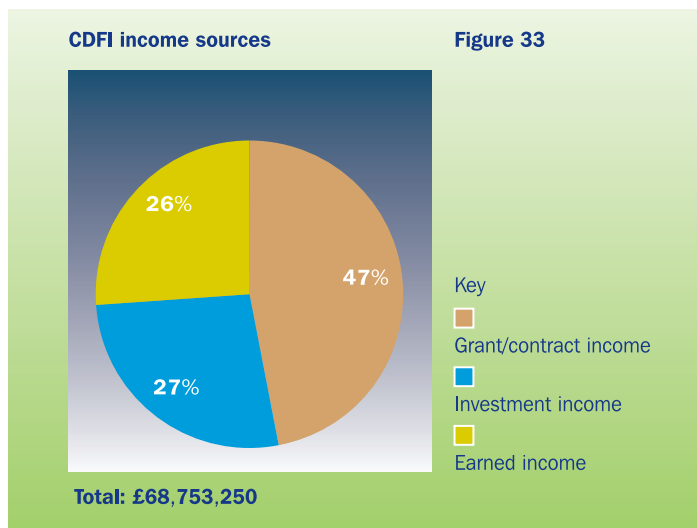
External income for operations

Many funders only support 'projects' rather than core or running costs. Nonetheless, the **cdfa** and CDFIs have been largely successful in convincing funders – in particular RDAs and local authorities – of the need to provide such support. The DWP



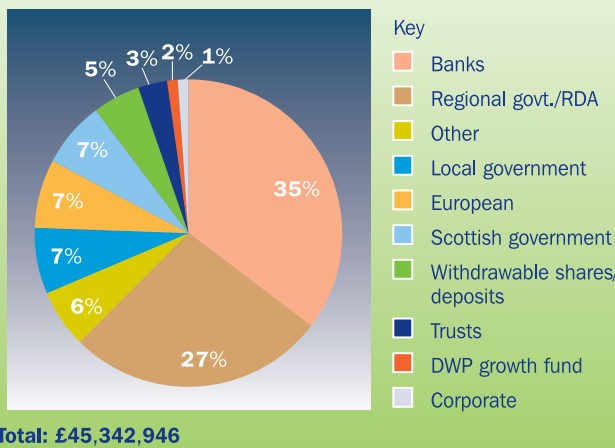
Growth Fund provides an exemplary model, linking up capital for on-lending with revenue to cover associated costs.

As shown in Figure 36, although RDAs remain the largest contributors to CDFI running costs, the proportion – as well as actual amount – continues to fall compared with previous years. £2.3m (or 43% of the total) was provided by RDAs in 2007, £2.1m (36%) in 2008, and £1.7m (30%) this year. The bulk of the difference is being made up in the 'other' category – most of which comprise individual charitable donations, fundraising activities and loans.



External income for on-lending

Figure 37



External income for on-lending

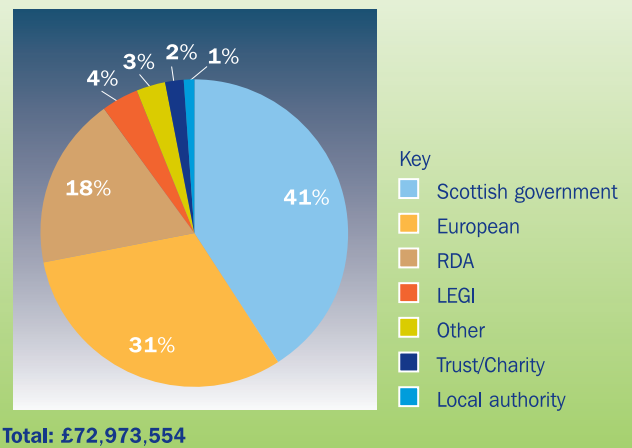
As shown in Figure 37, banks were the largest source of external income for on-lending, providing 35% of the £45 million total. One-fifth of CDFIs received such capital from banks, 93% as investments and the remainder as grants. As with any bank customer, CDFIs are subject to commercially-based risk assessment, and it is those CDFIs either large and diverse enough, able to leverage grant funding, or using a government guarantee scheme (EFG), that are considered investment-ready.

Although RDAs provide around a quarter of total on-lending funding, the majority of this is from the three RDAs with policies supporting CDFI activity. All such capital is in the form of grants, and is an important foundation from which CDFIs can leverage commercial investment.

In addition, CDFIs are adept at accessing capital from a range of other, mostly governmental, sources, in particular from Europe, the Scottish government and local authorities. Half of local funding was raised from the Local Economic Growth Initiative (LEGI) programme.

Sources of funds under management

Figure 38



Community Investment Tax Relief (CITR)

Last year £6.5 million of investment was raised using CITR, bringing the total raised since 2003 to £58 million. Only 14% of respondents reported using CITR last year, and 80% of the investment raised was by three large social enterprise lenders having the structure and capacity to use the scheme to its potential.

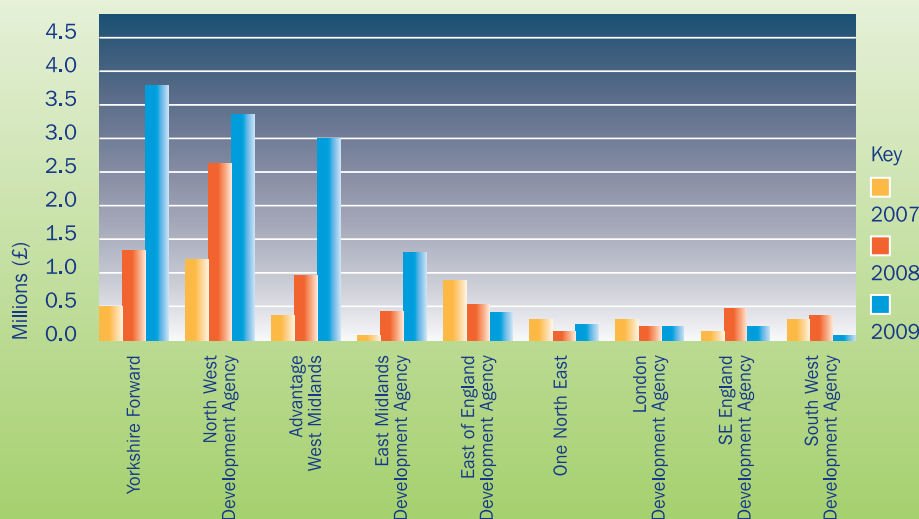
Although CITR has demonstrated its efficacy as an investment tool, certain obstacles preventing greater take-up need to be addressed before it can become a vehicle as a major source of private capital for deprived communities and underserved markets.

5.3 Funds under management

As fund managers, 16% of CDFIs are currently entrusted with £73 million from a range of mostly governmental sources (Figure 38). While most of the fund programmes are for business lending, the highest value of such programmes goes to social enterprise lenders. Much of the nearly four-fold increase reported this year is due to a new Scottish Government Fund and reporting by a new **cdfa** member.

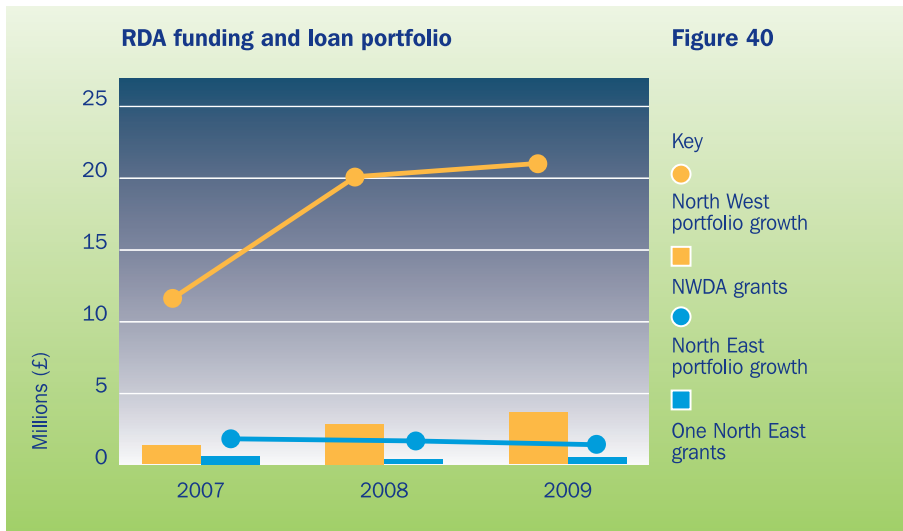
RDA funding 07-09

Figure 39



5.4 RDA funding

With the scaling down of the Phoenix Fund in 2006, £11 million was made available to RDAs specifically for the community finance sector. Since then, each RDA has devised its own strategy to support businesses in disadvantaged areas as well as to combat financial exclusion, with great variation between RDAs' approaches to supporting CDFIs to meet these goals.



Yorkshire Forward, the North West Development Agency (NWDA) and Advantage West Midlands are the biggest supporters of CDFIs, with the East Midlands Development Agency in a secondary tier, and the remainder far less supportive, as shown in Figure 39.

CDFIs in regions with strongly supportive RDAs tend to have the largest loan portfolios. Although RDAs provide less than one-third of total CDFI funding for on-lending, the kind of support they provide can position CDFIs such that they are more attractive to other funders, by leveraging RDA support. Without this foundation of support, CDFIs can face barriers to development.

Figure 40 compares the situation in two regions, the North West and North East, showing the amount of RDA funding versus the total regional CDFI loan portfolio. While NWDA provided 14 times as much funding to CDFIs as did One North East (ONE) in 2008/09, the regional portfolio of CDFIs in the North West was 30 times larger. Broadly speaking it is in those regions where RDAs are most supportive – Yorkshire & the Humber, North West and West Midlands – where some of the largest CDFI portfolios are found.

6.1 Support services

As shown in Figure 41, CDFIs provide a variety of support services. These services not only help meet the goals of community development finance but, as shown in Section 4, can help ensure the success of CDFIs by helping to build 'better' borrowers.

Different types of support require different levels of resourcing. At the lower-cost end, mutual referral arrangements with relevant partners such as Business Links, CABx and, for example, the nationwide referral service the **cdfa** is establishing with Barclays, provide low-cost solutions.

Other support services are much more resource intensive but can be highly effective. One-to-one mentoring is provided by nearly three-quarters of respondents and has been particularly successful. Training, provided by nearly half of members, reaps results but is costly to provide. CDFIs may charge nominal fees or provide the service free of charge to help ensure inclusiveness. These services are particularly subject to budgetary constraints and, therefore, vulnerable during periods of revenue contraction.

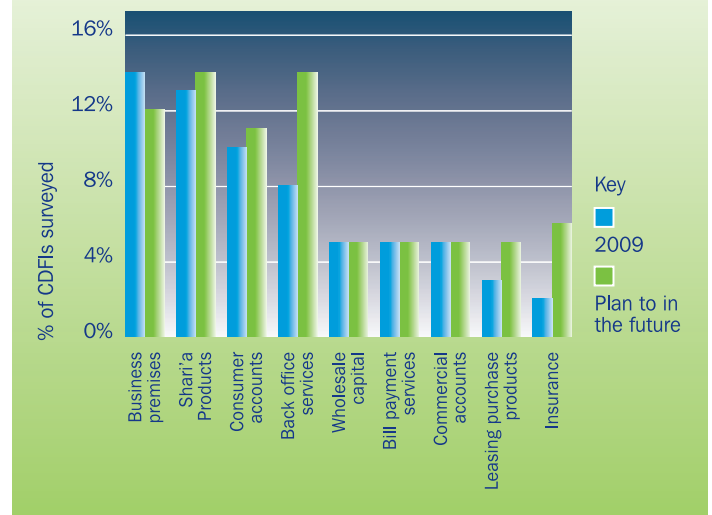
CDFIs also provide a range of products and services, as shown in Figure 42, the most popular of which are customer-oriented: business premises for clients, Shari'a (Islamic) products and Consumer Savings accounts, facilities or access; all clearly linked to CDFIs' mission.

Figure 41 Customer support methods used

Support services	% CDFIs surveyed
Referrals	86%
Email/phone support	81%
Informal advice during loan process	78%
One-to-one mentoring	70%
Training	44%
Brokerage/co-financing services	44%
Peer mentoring	25%

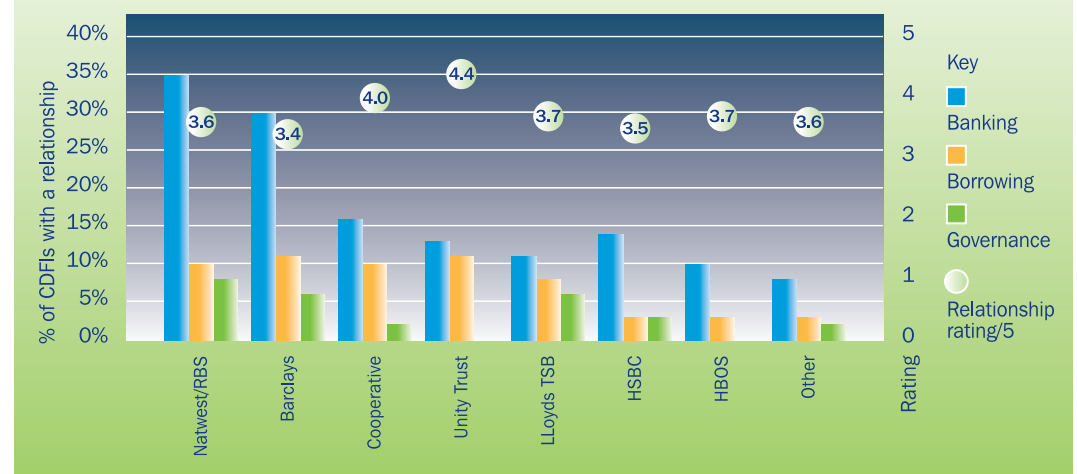
Products and services provision

Figure 42



Bank relations, number and rating

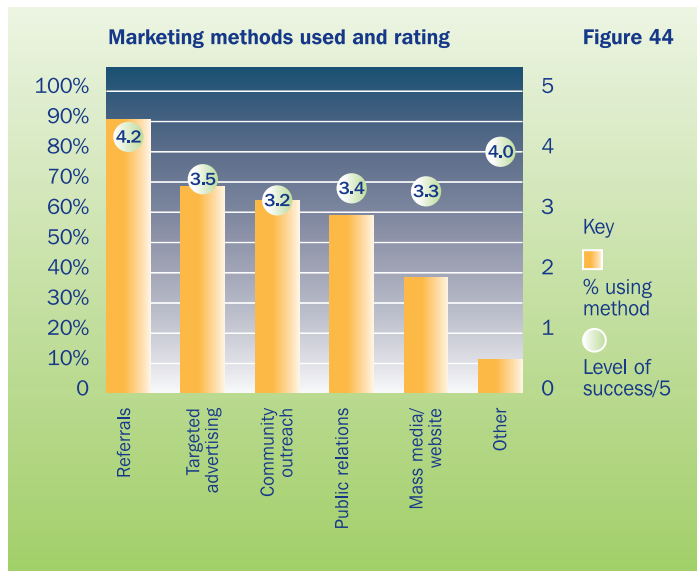
Figure 43



CDFIs also support each other by providing back-office services and wholesale capital. While these three areas are projected to maintain their prominence, insurance provision is projected as an important product in future.

6.2 CDFI-bank relations

CDFIs rightly see banks as natural allies, with many developing their account-holding relationship into further involvement in the form of loans or participation in governance (Figure 43). Ethical banks, such as the Cooperative and Unity Trust, as well as high street banks with a stated interest in community development, such as RBS and Barclays, are particularly strong in providing commercial loans to CDFIs. The ethical banks are reported as having the strongest relationships with CDFIs, although relationships with all banks have been rated quite highly this year.



6.3 Marketing methods

Most CDFIs operate on very tight budgets, so it is not surprising that the one method employed by virtually all CDFIs is utilising referral systems (Figure 44). This method is also rated as the most effective marketing activity.

A majority of respondents reported using targeted advertising, community outreach and PR strategies, all of which were rated as reasonably successful.

6.4 Human resources

The number of staff employed by CDFIs increases in tandem with the growth of the sector: respondents this year reported a collective staff of 494, up from 338 in 2007. Given the hugely diverse nature of the CDFI sector, it is not surprising that staff composition varies accordingly. Most CDFIs operate within the 'micro-enterprise' category, with 78% having less than ten staff. Roughly half of respondents have fewer than five full-time employees, and over three-quarters have fewer than ten full-time employees. Of the CDFIs with local/sub-regional scope, 80% have less than five staff.

But perhaps more surprisingly, of the CDFIs operating at a regional or national scale, 64% have a staff size of 10 or less. This demonstrates that CDFIs run relatively lean, efficient operations.

Figure 45 Numbers of staff (FTE)

CDFI FTE staff numbers	% CDFIs surveyed
< 4.9	53%
5.0 – 9.9	25%
10.0 – 19.9	13%
20.0 >	8%

Over 80% of CDFIs have dedicated Loan Officer(s), the role with the highest staff level. Approximately 40% of respondents reported using volunteers. While most use just a few volunteers at a time, a minority of respondents use 10 or more.

Twenty per cent of CDFIs are not immediately managed by a chief executive, and are instead managed directly by the Board or are part of a larger group structure, reporting to a group chief executive. Eighty-six per cent of those with no immediate chief executive have fewer than five full-time employees.

Working in the CDFI sector

Personal accounts

We asked a selection of CDFI employees how they joined the sector, what challenges they face in their role, and why they find the job rewarding.



“The rewarding part is seeing the difference we make”

Elaine Rimmer
*Chief Executive,
Lancashire Community Finance*

I was previously a manager with a national bank. As a result of their reorganisation, I took a redundancy package and was looking for work closer to home in Preston. Then I saw a job advert for a new CDFI that was being established. They needed someone to take it through to implementation, and to manage it from there on. It appealed to me not only because of my personal circumstances, as it was based in Preston, but also because it matched my skill set. I was aware of financial exclusion issues from my work with the bank and wanted to make a difference. I looked more closely at the CDFI sector – **cdfa** had just been established at the time – and decided it was right for me.

The most challenging part of the job, I'd say, is the politics: the postcode lottery of funding, and the fact that the statutory agencies we deal with don't always understand what we do. But the rewarding part is seeing the difference we make. As opposed to a large organisation where the impact of what you are doing might be felt hundreds of miles away, here there's an immediate impact. We may not change people's lives overnight but we can really empower them. I also take satisfaction from our success, and the fact that we've exceeded the targets that were set for us in our original business plan.



“I consider it a privilege to be part of the CDFI sector”

Eric Munro
*Current Board Member, Business Finance
Solutions, DSL and Scotcash.
Director, Community Banking,
Royal Bank of Scotland*

I've always had an interest in regeneration and the eradication of poverty. I was very aware that one of the main challenges was access to appropriate finance. There were a number of 'soft loan' funds in the 1990's for businesses that couldn't access finance, which were a kind of forerunner to CDFIs.

I used to sit on the panel of some of these loan funds as I had a personal interest in that area.

Developing Strathclyde Ltd, an enterprise lender CDFI based in Glasgow, grew out of one of those loan funds and I joined its Board. From there I went on to join the Boards of a number of other CDFIs.

Coming from the mainstream banking sector, it was an opportunity for me to use the skills I had in a different way. The geographic and market diversity of the CDFIs gave me a deeper understanding of the issues and an insight into possible solutions.

It is very rewarding, although sometimes it can be frustrating when I consider how much more we could achieve if we all worked in collaboration pulling in the same direction at the same time – the private sector, the public sector and the CDFI sector. But then I think of what we've already achieved. Despite some bumps in the road we've come a really long way in a relatively short period of time, and I find that very satisfying. I believe that we are at a crossroads and it is vital that the various stakeholders work together to ensure that lessons from the past are learned and that a stronger and more sustainable CDFI sector emerges.

I get tremendous fulfilment from working with passionate people who against the odds are every day making a real difference to the lives of ordinary people. I consider it a privilege to be involved with the CDFI sector.

“It appealed to me because it was about serving communities”

Mark Howland
*Marketing Manager,
Charity Bank*

Having completed a degree in marketing, I took a placement at Investors in Society, which went on to become Charity Bank. I wanted to use the skills I'd learnt on my degree in the charitable sector – not just making more money for rich people.

It appealed to me because it was about serving communities. I feel that in the UK we are not one big community, but lots of small isolated ones and I think our work can help to address that.

It gets frustrating sometimes that the sector as a whole does not have a more recognisable brand. There is only so much we can do to spread the message on a limited budget. But I find it rewarding when I meet with the organisations we're supporting. It gives great satisfaction to see at first hand how Charity Bank's support is helping to change lives.

7

Appendix

Summary of data

Structure and Workplace

Company structure	% of respondents surveyed
Community interest company	3%
Company limited by guarantee	65%
Company limited by shares	16%
Industrial and provident society	29%
Public limited company	5%
Other	8%

Charitable status	
Registered charity	29%
Exempt charity	6%
None	67%

Loan management systems	
Anchor	16%
Loan Man	14%
Street Serve	19%
Bespoke	27%
Other	25%

Human resources	Number (FTEs)
Chief executives	42
Operation managers	43
Lending officers	141
Money advice officers	45
Administrators	145
Other	78
Total CDFI employment (FTEs)	494
Volunteers	128

Lending coverage and customers

Key markets	CDFIs able to serve	CDFIs with current customers
Micro enterprise	76%	71%
Small business	60%	44%
Medium business	33%	16%
Social enterprise	48%	33%
Personal	22%	22%

Geographic lending coverage	% of respondents surveyed
UK wide	10%
Scotland	8%
Northern Ireland	3%
Wales	5%
North East	11%
North West	14%
Yorkshire and Humber	21%
East Midlands	8%
West Midlands	16%
East of England	6%
London	16%
South East	11%
South West	8%

Scope of lending coverage	
UK-wide	10%
England, Northern Ireland, Scotland or Wales	3%
Multi-regional	6%
Regional	21%
County/Sub regional	41%
Local	19%

Types of CDFI customers	
Start-up businesses	44%
Informal businesses	19%
Women/female-led businesses	33%
BAME-led business	23%
Disabled	10%
Lone parent households	28%
<30 years	24%
50> Years	20%
Urban-based business/individual	79%
Rural-based business/individual	21%

Summary of data

Lending Structures

Average interest rates (%)

Micro enterprise	11.8%
Small business	11.8%
Medium business	10.4%
Social enterprise	9.4%
Personal	24.4%

% of CDFIs who charge fees

Arrangement fees	43%
Administration fees	48%
Late payment fees	21%
Any fee charging	71%

% of CDFIs whose interest rate varies depending on

Longer loan term	10%
Repeat customer	33%
Larger loan	17%
Pricing for risk	38%
Co-financing with other lenders	10%

% of CDFIs taking the following security

	% of overall CDFI portfolios*	CDFI average
Charge over property	31%	7%
Debentures	9%	10%
SFLG/EFG	5%	5%
Personal guarantee	26%	21%
Peer group guarantees	0.2%	2%
No security	28%	52%
Other	2%	4%

*one large lender is removed from this analysis

Lending Activity

Loan applications April 2008-March 2009

	Value	Number
Micro	£28,517,733	2,320
Small	£51,405,334	1,144
Medium	£12,056,369	76
Social enterprise	£254,959,534	816
Personal	£12,236,116	14,544
Total*	£360,986,225	18,994

Value of loans made (disbursed) April 2008-March 2009

	Value	Number
Micro	£11,422,572	1,081
Small	£16,533,110	569
Medium	£4,925,119	30
Social enterprise	£72,468,579	392
Personal	£5,215,773	8,794
Total*	£113,134,045	10,937

Value of loans committed as of 31st March 2009

	Value	Number
Micro	£854,300	71
Small	£1,509,850	51
Medium	£741,250	9
Social enterprise	£102,183,877	342
Personal	£90,546	12
Total*	£105,448,223	490

Value of CDFIs' outstanding portfolios

	Value	Number
Micro	£26,435,109	3,608
Small	£26,086,552	1,014
Medium	£10,762,384	78
Social enterprise	£271,528,044	1,522
Personal	£5,812,581	7,693
Total*	£393,981,355	14,198

Portfolio outstanding breakdown by regions – see page 27

Average loan size by total portfolio

Micro	£10,567
Small	£29,056
Medium	£164,171
Social enterprise	£184,869
Personal	£593

Average loan size by CDFI sector portfolio

Micro	£10,353
Small	£27,919
Medium	£95,533
Social enterprise	£78,796
Personal	£606

Loan Purposes

Business loan purposes

	% of overall CDFI portfolio	CDFI average
Building purchase	2%	1%
Building renovation	4%	6%
Working capital	25%	38%
Equipment purchase	17%	28%
Marketing/advertising	8%	9%
Gap financing	44%	18%

Social enterprise loan purposes

Building purchase	49%	10%
Building renovation	20%	7%
Working capital	17%	34%
Equipment purchase	6%	16%
Marketing/advertising	0.2%	3%
Gap financing	5%	21%
Other	3%	9%

Personal loan purposes

Purchases	53%	43%
Back to work costs	2%	3%
Training and education	0%	0%
Debt management	10%	16%
Home improvements	22%	28%
Home purchase	1%	1%
Other	12%	9%

Capitalisation

Total CDFI fund assets £781,171,260

Money available not committed £281,741,682

Money held not on balance £15,842,641

CDFI earned income

Portfolio interest	£10,333,194
Portfolio fees	£1,410,757
Other fees for financial products	£1,539,846
Fees for non-financial profits	£4,555,315
Total	£17,839,113

External CDFI funding

	Operational costs	On-lending capital
Regional government or RDA	£1,732,094	£12,337,865
Local government	£1,267,427	£3,241,017
Other	£712,528	£2,685,597
DWP Growth Fund	£560,915	£1,098,704
Trusts	£462,326	£1,184,065
European	£316,311	£3,197,583
Welsh Assembly government	£150,000	£0
Corporate	£116,006	£300,000
Banks	£113,584	£15,979,165
Scottish government	£95,500	£3,000,000
UK central government	£45,000	£0
Withdrawable shares/deposits	£0	£2,318,950
Total	£5,571,691	£45,342,946

* Totals include CDFIs for whom a breakdown of loans per market were not available

CDFI Funds Under Management

Central government	£30,000,000
European	£22,300,000
RDA	£13,539,389
LEGI	£2,950,000
Trust/charity	£1,568,864
Local authority	£627,000
Other	£1,988,301
Total	£72,973,554

Performance

Portfolio at risk (30 days+)

Micro enterprise	33.1%
Small business	14.3%
Medium business	7.8%
Social enterprise	16.9%
Personal	29.7%
All sectors	24.6%

Write-off rate

Micro enterprise	16.3%
Small business	13.6%
Medium business	1%
Social enterprise	5.4%
Personal	13.0%
All sectors	12.9%

Deployment ratio

	64.0%
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Portfolio Yield

	9.0%
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Portfolio outstanding breakdown by regions

	Micro	Small	Medium	Social	Personal
UK wide	£325,000	£6,917,000	£415,000	£249,292,682	£0
Northern Ireland	£148,051	£0	£0	£13,016,664	£0
Scotland	£0	£935,197	£0	£2,770,000	£375,465
England/Wales	£0	£0	£0	£2,352,027	£5,000
North East	£678,577	£0	£0	£0	£0
North West	£4,613,670	£5,736,713	£8,447,000	£0	£2,133,204
Yorkshire and Humber	£3,322,485	£7,195,381	£1,653,500	£2,211,465	£313,593
East Midlands	£1,850,451	£887,815	£0	£0	£486,455
West Midlands	£4,439,063	£1,570,490	£65,955	£699,097	£1,445,509
East of England	£3,063,721	£473,000	£0	£125,696	£173,028
London	£6,245,644	£2,287,458	£180,929	£1,033,253	£287,889
South East	£1,300,267	£33,897	£0	£11,278	£592,438
South West*	£448,180	£49,601	£0	£15,882	£0

* Excludes one CDFI for which a market breakdown was not available

CDFI services

% of CDFIs offering support

Business support training courses/seminar	44%
One-to-one mentoring/advice	70%
Peer mentoring	25%
Informal advice by email/phone	81%
Informal advice during loan processing	78%
Referral/signposting other providers	86%
Brokerage/co-financing services	44%

% of CDFIs offering other services

Back office services	8%
Wholesale capital	5%
Islamic products (Shar'ia)	13%
Leasing purchase products	3%
Business units/other business accommodation	14%
Insurance	2%
Consumer accounts	10%
Bill payment services	5%
Commercial bank accounts	5%

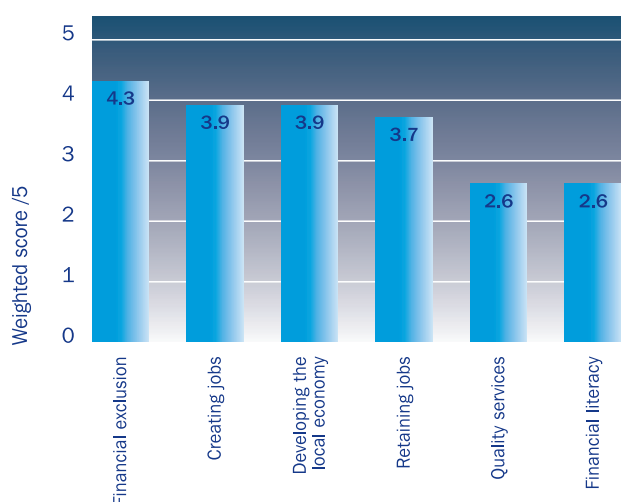
Impacts

	2009
Total value of loans made	£113,134,045
Individuals financed	8,794
Businesses financed	2,143
Jobs sustained	4,762
Jobs created	5,055
Training places provided	1,274
Total funds levered	£126,460,145

Additional figures

What drives CDFI lending?

Figure A.1



CDFI retail outlets

Figure A.2

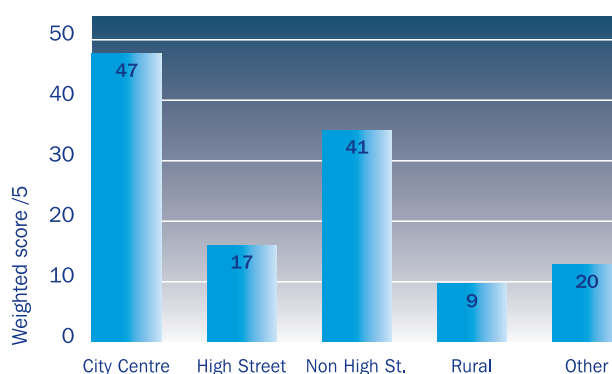


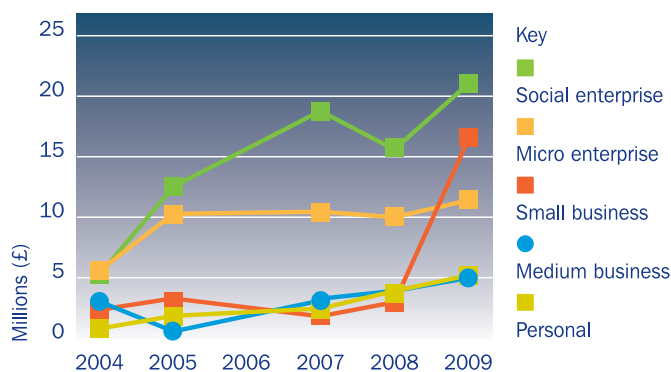
Figure A.3 Portfolio outstanding

Sector	2008		2009	
	Value	Number	Value	Number
Micro ent.	£23,562,630	3,498	£26,435,109	3,608
Small bus.	£8,093,921	398	£26,086,552	1,014
Medium bus.	£8,420,335	25	£10,762,384	78
Social ent.	£230,003,773	1,346	£271,528,044	1,522
Personal	£3,606,263	7,709	£5,812,581	7,693
Total*	£330,808,945	12,976	£393,981,355	14,198

*Total includes CDFIs for which market breakdowns were unavailable

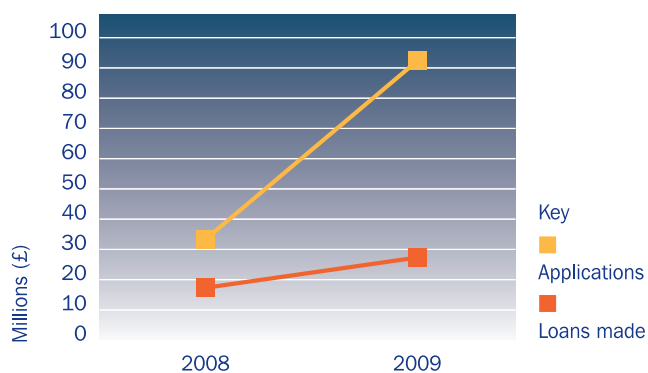
Value of loans made (disbursed)

Figure A.4



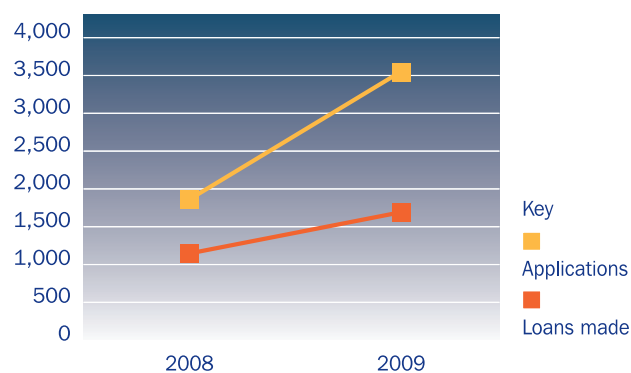
Business loan demand by value

Figure A.5a



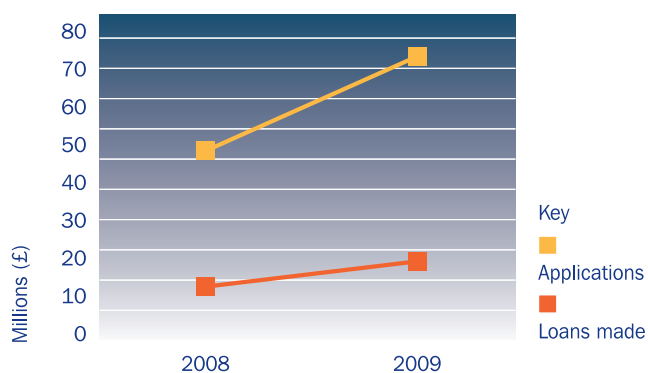
Business loan demand by number

Figure A.5b



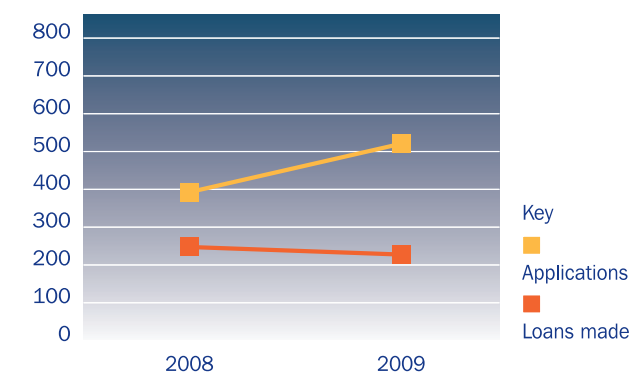
Social enterprise loan demand by value

Figure A.6a



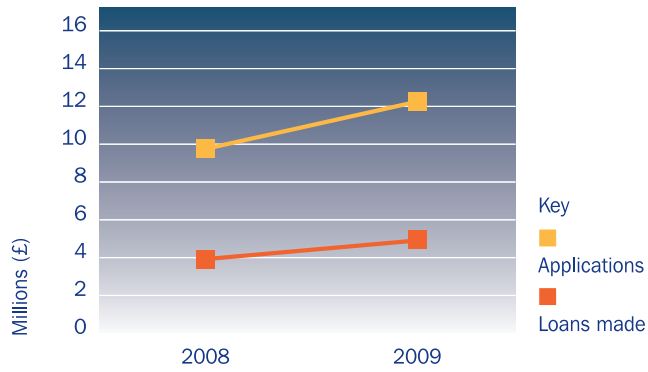
Social enterprise loan demand by number

Figure A.6b



Personal loan demand by value

Figure A7a



Personal loan demand by number

Figure A7b

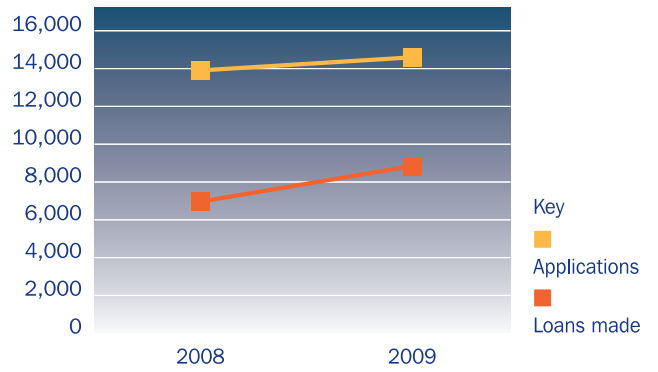


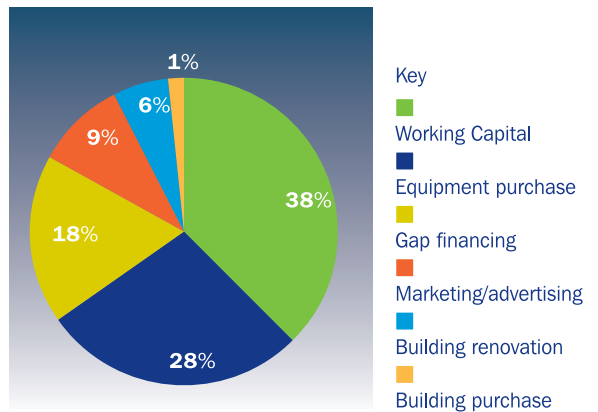
Figure A.8 Loans committed, not drawn down

Sector	2009	
	Value	Number
Micro enterprise	£854,300	71
Small business	£1,509,850	51
Medium business	£741,250	9
Social enterprise	£102,183,877	342
Personal	£90,546	12
Total*	£105,448,223	490

*Total includes one CDFI for which a market breakdown was not unavailable

Loan purposes - by average CDFI loan

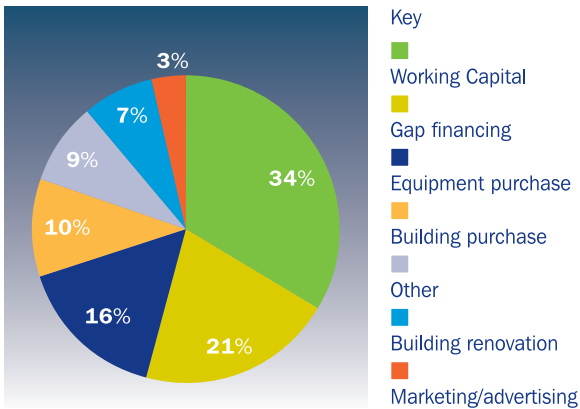
Figure A.9



Business

Loan purposes - by average CDFI loan

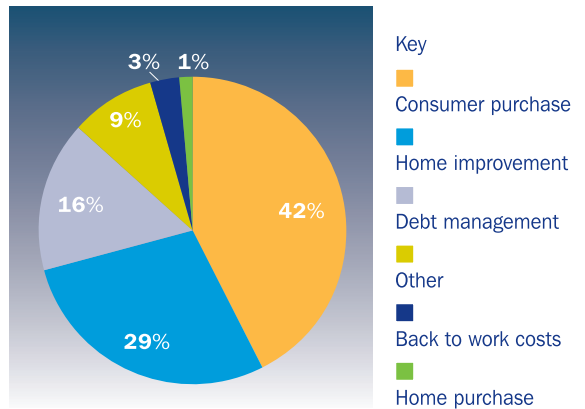
Figure A.10



Social enterprise

Loan purposes - by average CDFI loan

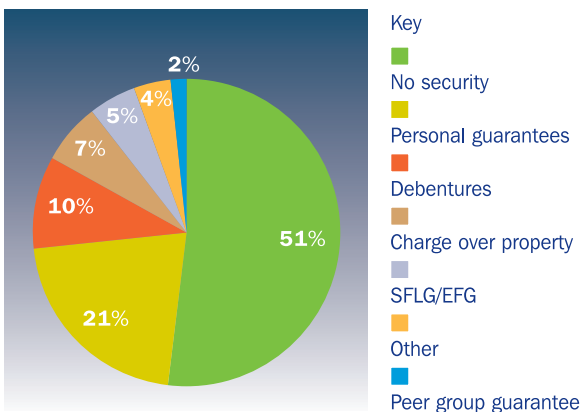
Figure A.11



Personal

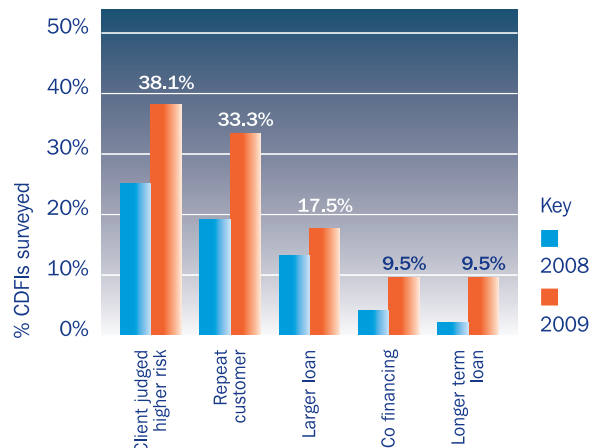
Security by average CDFI loan

Figure A.12



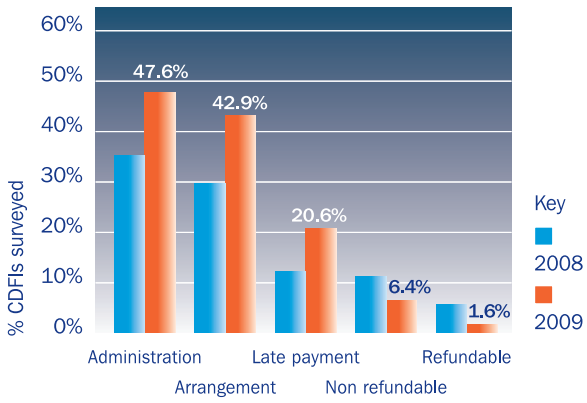
CDFIs adjusting interest rates

Figure A.13



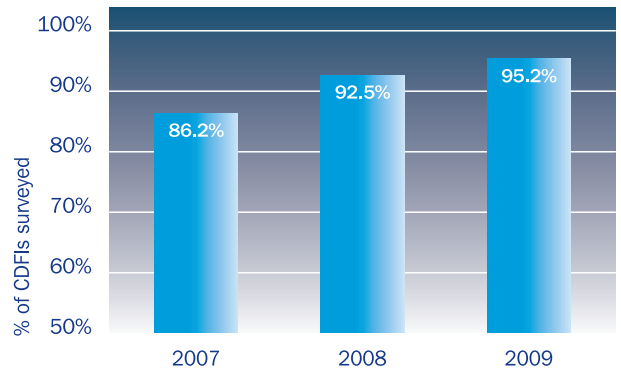
CDFI fee charging, by type

Figure A.14



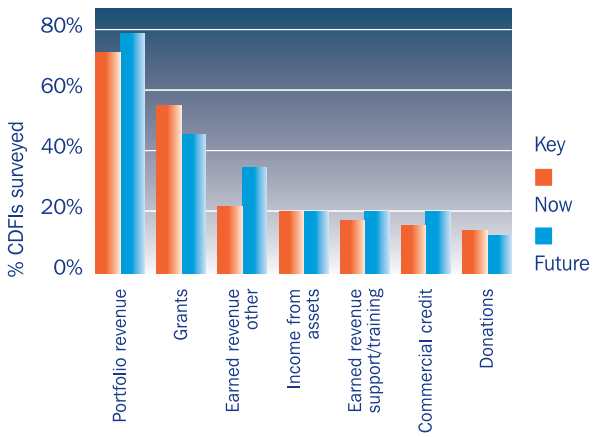
% of CDFIs with advisory boards

Figure A.15



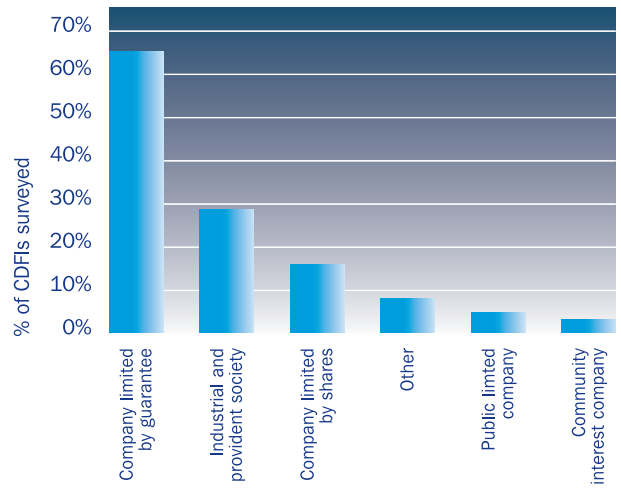
Anticipated revenue sources

Figure A.16



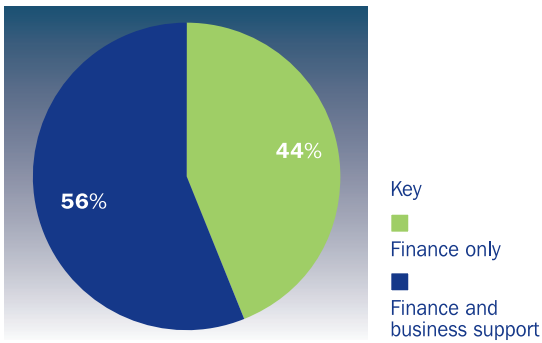
CDFI company structures

Figure A.17



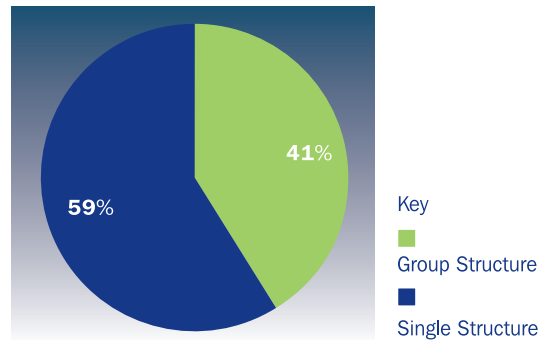
CDFI services offered

Figure A.18



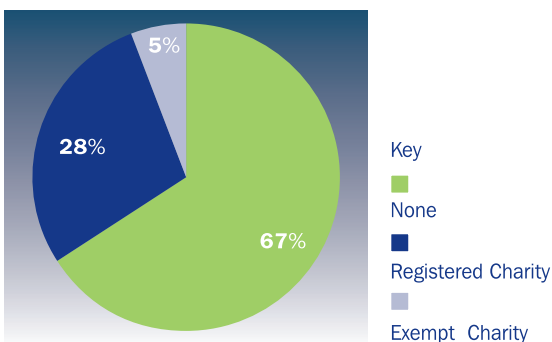
Group structure

Figure A.19



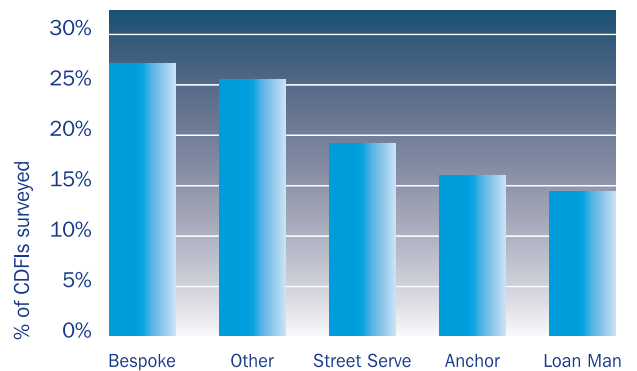
CDFI Charitable status

Figure A.20



Loan management systems

Figure A.21



Glossary

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.

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/third sector 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 Community Development Finance Institutions (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.

Department for Work and Pensions (DWP)

The UK government department responsible for the financial inclusion programme. The department administers the Growth Fund.

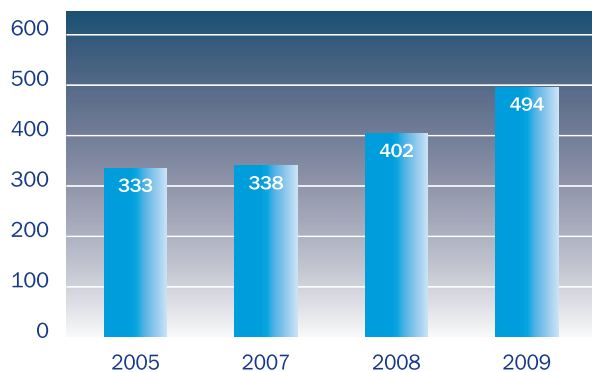
Deployment ratio

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: (Loans/equity investments outstanding + loans/equity investments committed) / total fund size.

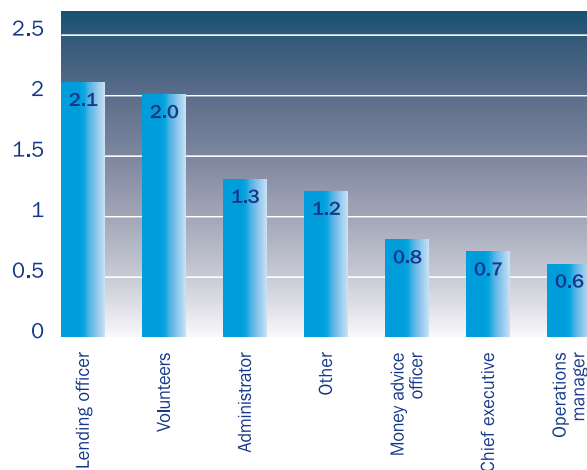
Total CDFI staff numbers (FTEs)

Figure A.22



Average number of FTE

Figure A.23



Glossary

Enterprise Finance Guarantee (EFG) scheme

An interim government guaranteed lending scheme replacing SFLG intended to help smaller businesses, which may be struggling to secure finance by facilitating bank loans of between £1,000 and £1 million. 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: (Loans outstanding + loans committed + funds available for on lending).*

Gap financing

This includes temporary borrowing to provide needed funds between the termination of one loan and the beginning of permanent financing. Gap financing also includes stop gap funding to cover cash flow problems and seasonal fluctuations in income.

The Growth Fund

A £36 million financial inclusion fund, administered by the Department of Work and Pensions, to increase the availability of affordable personal loans via third sector lenders such as CDFIs.

Home improvement loans

A consumer loan taken out to finance alterations, remodeling, or structural renovations to an existing dwelling. These loans are generally short-term, but may be for longer periods.

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 regions. Between 2000 and 2006 the fund invested over £42 million into the CDFI sector. A further £11 million has been invested in CDFIs to varying degrees by the nine RDAs. The Phoenix Fund was closed 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 30 days overdue. 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: outstanding balance of loans over 30 days overdue / gross loan portfolio.*

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: (Total interest + fee income received) / average gross loan portfolio.*

Regional Development Agencies (RDAs)

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

Small Firms Loan Guarantee (SFLG) scheme

Former government loan guarantee scheme in effect from December 2005 until its replacement by EFG in January 2009.

Security

Secured loans are backed by a pledge of collateral, as opposed to an unsecured loan, backed only by the integrity of the borrower.

Working capital

Working capital includes the accessible resources needed to support the day-to-day operations of an organisation. Working capital is commonly in the form of cash and short-term assets.

Write-offs

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: Net loan losses (i.e. net of any recoveries) / Average gross loan portfolio.*

Survey respondents

Representing 93% of active members

ABI Associates- Faith in Business
Acorn Fund
Aspire Micro Finance
Aston Reinvestment Trust
Bees Knees
Big Issue Invest
Black Country Reinvestment Society
Bridges Ventures
Bristol Enterprise Development Fund
Business Enterprise Fund
Business Finance North West
Business Finance Solutions
Capitalise Business Support
Charity Bank
Community Money
Co-operative and Community Finance
Coventry and Warwickshire Reinvestment Trust
Croydon Enterprise
Cumbria Community Asset and Reinvestment Trust
Development Strathclyde
Donbac
East Lancashire Moneyline
East London Small Business Centre
Enterprise Loans East Midlands
Finance South Yorkshire
Five Lamps
Foundation East
Fredericks Foundation
GLE oneLondon
Gloucestershire Development Loan Fund
Goole Development Trust
HBV Enterprise
Impetus
Innovative Finance (Hastings Trust)
Isle of Wight Lottery
Key Fund Yorkshire
Lancashire Community Finance
Leicestershire Moneyline
London Rebuilding Society
MCF Loans

Merseyside Special Investment Fund
Moneyline Yorkshire
Norfolk & Waveney Enterprise Services
North London Enterprise Credit Union
North Staffordshire Risk Capital Fund
PRIME
Project North East
Robert Owen Community Banking Fund
Scotcash
Sirius
Social Investment Scotland
South Coast Moneyline
South West Investment Group
Spirit of Enterprise Loan Fund
Street NE
Street UK
The Social Enterprise Loan Fund
Triodos Bank
UK Steel Enterprise
Ulster Community Investment Trust
WEETU - Full Circle Fund
Wessex Reinvestment Trust
West Yorkshire Enterprise Agency

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Inside Out – The State of Community Development Finance

is the Community Development Finance Association's (**cdfa**) annual report on the UK community development finance sector. **Inside Out** is the only publication to provide data and commentary on what's really happening in the sector.

Some of the highlights include:

- The latest figures on the changing distribution of CDFIs and the markets they serve
- Analysis of sector and individual business strategies and performance
- Information on the range of financial products and other services
- What the future holds

The **cdfa** is the UK trade association for Community Development Finance Institutions (CDFIs). Community development finance delivers innovative financial products primarily aimed at entrepreneurs in disadvantaged areas, but also addressing personal debt in poorer communities.

