Community Development Financial Institutions (CDFIs)

- Private financial institutions focused on serving low-income communities
- Place-based with local accountability
- Primarily capitalized with debt: interest bearing loans or deposits
- Dominated by two models
  - Community Development Loan Funds
  - Community Development Credit Unions

Community Development Loan Funds (CDLFs)

- New model using capital from "social investors" to raise funds for community development lending.
- Several hundred exist nationally; about half have an economic development mission.
- Locally organized and controlled non-profit organizations
- Large share of capital (50 to 60%) from loans by individuals, churches, foundations and banks.
- Access to a larger and more diverse capital allows larger average size than RLFs: almost $10 million
- Risk profile is between that of banks and RLFs
- Spread between cost of funds and lending rates covers operating costs.
- Need more assets to fund operating costs vs. grant-based RLFs –average size close to $10 mm

CDLF Advantages

- Relatively simple to start-up since no bank charter needed
- Community control and responsiveness
- Flexibility in lending policies: no regulatory constraints
- Access to more funding than RLFs:
  - foundation and government grants
  - Institutional and individual loans
- Capacity to lend a large share of assets (70-90% vs. 50 to 60% for banks)
- Source of below-market debt for housing or non-profits by attracting below-market loans and subsidies

Financing Roles Suited to CDLFs

- Loan products must fit reliance on debt
  - Interest rates, amortization and loss must meet cash flow obligations to investors
- Short to medium term debt with moderate risk
- Predevelopment financing for real estate projects
- Construction and bridge financing for affordable housing, commercial real estate projects, and non-profit facilities
- Working capital and equipment financing for small businesses
- Working capital and equipment financing for non-profit organizations

Business vs. Housing Oriented CDLFs

- Housing CDLFs are 2X larger and utilize more debt capital than business funds
- Business CDLFs make more loans, smaller and have higher loss rates (7.2% vs. 2%) than housing lenders
- Business funds rely more on government funding (46% vs. 5%)
- Medium size business CDLFs ($2.5 to $8 mm) are strong performers with loss rates and high self-sufficiency

CDLF Challenges & Best Practices

- Defining target markets and products to match community needs, repay debt and reach scale
  - Trend toward serving expanded markets geographically and by customer
- Manage lending process to reduce loan losses
  - Sound underwriting standards and due diligence process
  - Expand technical assistance (Cascadia Loan Fund)
  - Fund expanded loss reserve
- Cultivate a stable and large investor base
  - Core set of lenders with low turnover of loans
  - Outreach and cultivation to expand investors: Boston Community Capital has over 300 sources
- Financial management of assets and liabilities

Community Development Credit Unions

- A membership organization supplying banking services and loans to members with a common affiliation ("field of membership")
- A financial cooperative--a member controlled institution based on one member-one vote governance
- An insured depository institution
- Serves low income individuals and communities
- 964 NCUA-designated credit unions with low-income memberships; total assets of $15 billion (2003)
- Credit union model adapted to serve low-income communities via the civil rights movement and war on poverty

CDCU Characteristics

- Provide banking, credit and development services (e.g. education, counseling, technical assistance)
- NCUA Definition: 50%+ of members have income below 80% of US median income or earn 80% of national average wage
- Average asset size of $16 million; 65% of assets in loans. ROA on .9%
- Lending focuses on consumer loans. Auto loans account for 43% of loan assets; home mortgages are 20%. Business loans capped at 12.5% of loan portfolio, which can be waived for LICUs.
- Average loan charge-offs of .71% in 2003

Development Roles of CDCUs: Banking Services to the Poor

- Provide an alternative to predatory and high-cost financial service firms
- Tailor services to unique needs of non-banked consumers
  - Convenient bundling of services
  - Wire transfers and affordable pay day loans
  - Partnerships to expand services and attract more members
- Financial literacy and asset development
  - Financial education and counseling
  - Credit building products and loans for low-income needs
  - Individual development accounts to promote savings

Development Roles of CDCUs: Small Business Lending

- CDCUs are more active small business lenders than conventional CUs
- Potential CDCU business credit roles:
  - Personal loans for business purposes
  - Small business loans to independent businesses with more emphasis on character lending
  - Specialized/niche business markets
    - Alternative business types
    - Minority or immigrant-owned enterprises
- Affiliate entity to supply high-risk debt, conduct training & technical assistance, develop new products & services

CDCU Challenges and Best Practice

- Building a large membership to start and sustain the credit union
  - Define a field of membership with capacity for several thousand members and several million dollars in deposits
  - Sponsor and partnerships to recruit members
- Creating a service model tailored to banking, credit and development needs of target market.
  - Market research to understand customer needs and obstacles
  - Partnerships & affiliates to expand & fund development services
  - Use partnerships to reach a larger membership, supply diverse financial services, raise capital and lower costs
  - Credit union service organizations to share costs
- Involve members in setting policies, delivering services and operations to advance the mission and reduce costs
- Non-member deposits to increase deposit base
- Cultivate capital sources for specialized lending roles

Self-Help and Opportunities Credit Unions

Self-Help Credit Union

- For what purposes was Self-Help Credit Union created?
- What are its primary lending activities and markets? How have these evolved over time?
- What are its primary sources of capital? How do these relate to and support its lending activities?
- What are the most important innovations and best practices from Self-Help's approach to development finance?

Opportunities Credit Union

- What are OCU's primary lending activities, services and markets? How do these compare to Self Help?
- What is unique about OCU's approach to development lending? What specific products and services have they developed to address the needs of their low-income market?
- Are there common strategies, lessons or best practices across the two credit unions?
- What does their experience relate to the economic development role of CDCUs?