cdfa

INSIDE COMMUNITY FINANCE

THE CDFI INDUSTRY IN THE UK **2014**

About the CDFA

The Community Development Finance Association (CDFA) is the voice for providers of fair and affordable finance. We represent and support a national network of Community Development Finance Institutions (CDFIs).

Our mission is to support the development of a thriving and sustainable CDFI sector that provides finance for underserved communities, bringing wealth, wellbeing and economic prosperity to these areas. We provide support, funding and networking services to CDFIs, raise their profile with government and investors, and seek to create a positive environment for their continued growth and success.

www.cdfa.org.uk

About this publication

Inside Community Finance (ICF) is based on a survey conducted by the CDFA, which was completed by 54 CDFIs. The reporting period is 1st April 2013 to 31st March 2014. The survey has been conducted annually since 2003, and was previously known as *Inside Out*.

This report was written by Theodora Hadjimichael with contributions from Callum Anderson, Sam Collin, Jenna Cane, Ben Hughes, Sean Dennis, and Geoff Watson.

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Foreword

Economic Secretary to the Treasury

The UK economy is recovering from the most damaging financial crisis in generations. The economy is growing, the deficit is falling and there are record levels of people in work.

But the job is not yet done, and I am committed to ensuring that ambitious businesses can access the finance they need to grow; helping secure a strong UK economy. Community finance is playing a valuable part in contributing to this growth as businesses increasingly look to seek finance from alternative providers.

2014 has been a highly successful year for the community finance sector. This year, CDFIs lent £72 million to 13,230 microenterprises and SMEs, and 11,500 of these were new businesses. CDFIs also lent to 370 social enterprises and 42,000 individuals. Overall, the value of CDFI lending has grown by over 40% since last year.

This funding created 15,100 new jobs and safeguarded a further 3,700; strengthening local economies. This is an impressive achievement and demonstrates CDFIs' ability to change people's lives for the better and leave a real legacy for the next generation of Britons.

And this year, thanks to the CDFA's new Economic Impact Tool, the value added back to the local economy as a result of CDFI lending can now be measured more robustly. In 2014 CDFIs contributed £0.5 billion through the businesses and jobs that their finance enabled. This is alongside the real difference that CDFIs make through lending to social enterprises, and making personal loans on fairer terms to disadvantaged borrowers. The evidence clearly illustrates the ongoing importance of the sector in delivering alternative financial services to underserved markets.

I am delighted to see that the CDFI industry continues to go from strength to strength, supporting the UK economy by helping to generate growth, creating jobs and building wealth within its communities. I hope that it will build on this excellent work in the year ahead.

Andrea Leadsom

Andrea Leadsom MP

Introduction: Putting values into the economy

Ben Hughes

2014 has, without doubt, seen significantly increased interest in community finance, and in CDFIs in particular; building on themes of 2013, engagement with banks, iniquities of high cost credit provision and lack of diversity in the financial services industry really have dominated the media and political landscape.

The response? Numerous consultations held by HM Treasury, to stimulate growth of non-bank finance; action by Financial Conduct Authority (FCA) to curb the high cost credit market and the welcome move of Church of England, to become a champion of all things community finance.

There is no doubt that CDFIs have played a significant part in broadening diversity in the financial services industry. Last year 11% more customers were served than in 2013, lending £173 million in the process.

But lending is only part of what CDFIs do. The financial support and on-going relationship management that characterises CDFIs is what makes them stand out in an industry increasingly reliant on virtual, 'faceless' delivery models. Capturing the value of this, and quantifying it in monetary terms has always been an aspiration, and was one that we fulfilled this year; the Economic Impact Tool (EIT), developed over the past year, does just this – and enables all CDFIs, regardless of their lending market, to convert aggregate lending data into the kind of hardnosed economic analysis that even those furthest away from the sector will take seriously. It has quickly become a barometer of not only how the sector is performing, but also the impact on those communities unable to access mainstream finance, and to whom CDFI services are directed.

And that value is significant. Over £500 million added to the UK economy from SME lending alone, begins to show just how much of a difference their lending makes, and adds to the case for generating significantly more capital to on-lend – the lack of which remains one of the biggest constraints to growth.

These powerful and compelling figures enrich the argument for not only scaling up the CDFI industry, but also the general diversification of financial service providers. It is indisputable that CDFIs have a big role in serving underserved communities built on sustainable and entrepreneurial principles that increases the wealth and prosperity of Britons everywhere.

That's why, along with this year's ICF, we published our manifesto, *Just Finance*, which issued a call to action to the UK Government with a set of recommendations that if taken up would be real game changers for the sector.

With just a few months until the next General Election, there has never been a better time to come together and put the sector where it needs to be – at the heart of the financial services industry.

Ben Hughes
Chief Executive
of the CDFA

Chapter 1
Key findings

IN 2014 ...

CDFIs LENDING TO **BUSINESSES** ...

LENT **£72m** TO **13,230** BUSINESSES

CREATING **11,500** NEW BUSINESSES

CREATING AND PROTECTING **18,800** JOBS

=

ADDING **£0.5bn** TO THE UK ECONOMY

CDFIs LENDING TO **SOCIAL ENTERPRISES** ...

LENT **£78m** TO **370** SOCIAL ENTERPRISES

CREATING AND PROTECTING **2,140** JOBS

=

ADDING **£10m** TO THE UK ECONOMY

CDFIs LENDING TO **INDIVIDUALS** ...

LENT **£19m** TO **42,000** PEOPLE

SAVING **17,000** PEOPLE FROM HIGH-COST LENDERS

=

SAVING PEOPLE **£4m** IN INTEREST REPAYMENTS

CDFIs LENDING TO **HOMEOWNERS** ...

£4m

LENT **£4m**
TO **580**
HOMEOWNERS

432

ENABLING **432**
PEOPLE TO STAY
IN THEIR HOMES

=

£12m

ADDING **£12m**
TO THE UK
ECONOMY THROUGH
INDIVIDUALS BEING
ABLE TO STAY IN
THEIR HOMES

£2m

ADDING **£2m**
TO THE UK
ECONOMY THROUGH
BRINGING HOMES
UP TO DECENT
HOMES STANDARD

ALL CDFIs ...

£173m

LENT **£173m**
TO **56,200**
CUSTOMERS

REACHING
11%MORE
CUSTOMERS

=

£16m

ADDING **£16m**
TO THE UK ECONOMY
FROM INCREASED
FINANCIAL
CAPABILITY

Chapter 2
Defining the market gap

What is financial inclusion?

Financial inclusion is the ability for individuals, microbusinesses, small and medium sized enterprises (SMEs) and social enterprises to access the financial services necessary for their full and meaningful participation in the economy and society. Access to finance, referring not only to the provision of credit, but also access to a broader set of financial tools such as a bank account and financial capability, is a catalyst for economic growth. Those vulnerable to financial exclusion often include those with no or a poor credit history, low income consumers, young people who are not in employment or education, the elderly, disabled, and those from minority groups[1]. Segments of the enterprise market, including microbusinesses, SMEs and social enterprises seeking smaller amounts of finance for working capital or investment, are particularly likely to be unable to access their full financial needs from mainstream providers.

Causes of market failure

The gap in access to finance can be traced to the mismatch of information between supply and demand, lack of competition, and incentives for mainstream financial services providers that are not structured to meet the broad range of credit demands. These causes of longstanding market failure are evidenced in Figure 2.1 and begin to indicate how wide the gap in access to finance really is.

2.1 Market failures and evidence for financial exclusion

Market failure
Information gap

Supply
- Mainstream financial services providers do not gather sufficient information about the client and assess risk using primarily credit score[2].
- Currently individuals are unable to influence their credit score outside of traditional metrics, and new or early stage businesses are unable to demonstrate a track record.

Demand
- Consumers and enterprises do not pursue appropriate finance or recognise finance as an option, based on limited information in their networks or lack of financial education about options[3].

Evidence
Supply
- Up to 10% of RBS's declined SME clients were later found to be suitable for bank finance[4].
- Lack of transparency around lending practices, and limited, poor quality data provided by mainstream lenders[5].

Evidence
Demand
- In 2014 78% of SMEs chose not to seek finance, compared with 66% in 2012. 5% of SMEs did not apply because they were discouraged[6].
- 1.4 million people in the UK do not have a bank account and a further 4 million people are at the edge of banking[7].
- 7 million people, 11% of the population, use high cost credit[8].

Market failure
Lack of competition

- Lack of competition in financial services sector limits markets served and products available.

Evidence

- The four largest banks account for over 85% of Business Current Accounts (BCA) and 90% of business loans in the UK[9].
- The four largest banks account for over 77% of the UK personal current account market[10].

Market failure
Externality

- Regulatory requirements for risk-weighted assets for SME lending have negative externalities of excluding certain populations of consumers and enterprises.

Evidence

- Loan application rejections rates for small and medium sized enterprises (SMEs) soared from 5% in 2004 to over 20% in 2012[11] due to stricter credit policies.
- The UK had 17,637 bank branches in 1990, but only 9,500 in 2014 – a decline of 46% disadvantaging small businesses and vulnerable consumers[12].

Impact on the economy

The impact of these market failures on the economy and social wellbeing is unmistakable. For every consumer, microbusiness, SME, or social enterprise declined finance, the opportunity cost can be measured by the economic output and consumer spending forgone, and the economic ripples that these outcomes would have had on the overall economy. Financial exclusion is also expensive. Without a bank account, transaction costs are higher and more time consuming[13]. Finally, financial stress has significant health impacts, which affects both society and productivity[14]. Overall economic mobility is stunted as individuals and enterprises miss out on opportunities to invest, grow, innovate and stimulate growth in the economy. Indeed, the World Bank found a positive correlation between widespread use of financial services in a country and higher GDP[15].

The opportunity

Yet the evidence of the market gap and its impact on the economy and society indicates an enormous opportunity. Interventions, such as closer regulation of financial services providers[16], have taken place to address and correct some of the market failures that have led to this divisive gap. In addition to these reactive interventions, proactive measures must also take place, and Community Development Finance Institutions (CDFIs) have proved a successful approach to both filling the gap and changing behaviour. By doing so CDFIs are creating opportunities that did not previously exist, and are developing prosperous, sustainable, and resilient local economies, evidenced by the positive social outcomes and hundreds of millions of pounds added to the economy as a result of their financial products and services.

Chapter 3
What is a CDFI?

Community Development Finance Institutions (CDFIs) provide loans and support to individuals and enterprises unable to access finance from the mainstream financial services sector, enabling them to contribute to their local economy.

CDFIs are a diverse range of organisations that are unified by their commitment to providing financial products and services that are demand-driven, developed specifically for the needs of their individual market. All CDFIs share the mission of serving individuals, microbusinesses, SMEs, and/or social enterprises that are unable to fully access mainstream finance, thus enabling their participation in the economy where it was previously not possible. CDFIs do so through lending, but also crucially, through providing support such as advice, training and mentoring alongside the loans. The result of this combined offer is an inclusive financial service that brings previously excluded and higher risk individuals and enterprises up to a level where they are credit-worthy, able to service their debt, and so making an active contribution to their local economy.

Because unequal access to finance and financial exclusion permeates a community at different levels, most CDFIs specialise in lending to a specific market and tailor their products to certain segments of demand. Some CDFIs target for-profit SMEs and microbusinesses, while others focus on social enterprises and community-based organisations. CDFIs also lend to individuals, either for personal loans or for home repairs and improvements. An increasing number of CDFIs lend to multiple markets as demand for finance straddles multiple purposes.

Since the 2009 recession CDFIs have lent over £1 billion to their communities, creating and safeguarding over 66,000 jobs, 28,000 businesses, thousands of social enterprises, and saving 150,000 individuals from becoming trapped in a cycle of indebtedness with high cost credit providers.

Since the 2009 recession CDFIs have lent over **£1bn** to their communities.

3.1 CDFI characteristics

Snapshot of an average **CDFI**

Loan fund
12 FTE staff
£2.5m Net assets
£750k Turnover
Not for profit

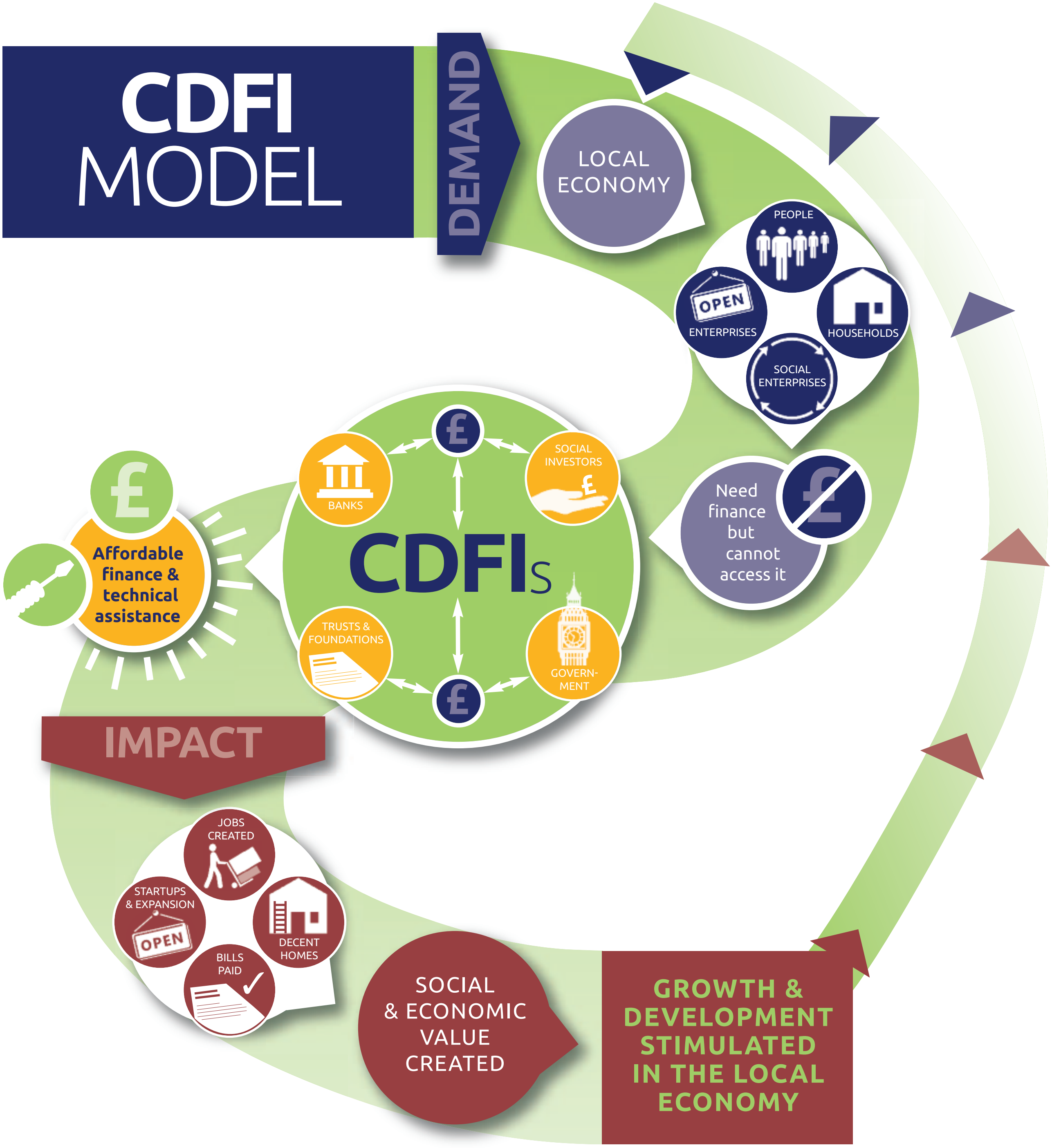
	Enterprise	Social Enterprise	Personal	Home Improvement
Average loan size	Start up: **£5,700** Existing micro: **£21,600** Existing SME: **£46,900**	**£46,000**	**£450**	**£7,300**
Average interest rate	13% APR	8% APR	67% APR	8% APR
Average term	3 ½ years	5 ½ years	11 months	6 years
Customer profile	Microenterprise or SME likely turned down by bank	Social enterprise operating in a disadvantaged area	Finance used for debt management and short-term cash flow needs	Finance used for home repairs for thermal comfort and energy efficiency

CDFI theory of change

CDFIs are specialist organisations that fill the market gap that mainstream financial institutions are unable to serve, thus creating positive social and economic outcomes through their responsible lending and support activities. Because of their social mission, CDFIs have a different risk appetite to other lenders. Whilst CDFI customers may be considered higher risk and un-creditworthy by other financial institutions, the CDFI model essentially "de-risks" the client by taking a holistic approach to their credit needs, which has been described as a traditional or pre-credit scoring approach. So whilst CDFIs use credit checks as part of their assessment process, they focus on understanding the individual or business, rather than relying solely on a standardised credit scoring system.

They do this in a variety of ways, using multiple pieces of information about the individual or enterprise such as data captured from application forms, financial statements, face to face and telephone interviews, visiting the business premises, assessing business plans, budgets, and forecasts. The CDFI's focus is on understanding the individual or business with an emphasis on determining the customer's viability. Over the course of the application process, CDFIs will provide both formal and informal technical assistance support, such as financial training, mentoring and advice, to help the client develop their business or personal financial position prior to applying for finance. It is this capacity building and technical assistance process that reduces the risk of the investment, and makes the finance successful. The CDFI approach of determining demand and the barriers to accessing finance, enables them to develop demand-driven products that can be more appropriate; this results in positive outcomes, such as growth and lower levels of debt and exclusion, ultimately making the individual or enterprise better off. The CDFI model is illustrated in Figure 3.2.

3.2 CDFI model



The impact of a CDFI's intervention can be measured as the value added compared to the status quo, in other words, the additionality of the investment. The financial and technical assistance that CDFIs offer not only provides individuals, microbusinesses, SMEs, and social enterprises with economic opportunity, but transforms the risk perception of them, ultimately changing behaviour and integrating them more fully into mainstream financial services.

Chapter 4
CDFI lending 2014

CDFIs lent **£173m** in 2014 – **41%** more than in 2013.

Overall CDFI lending activity

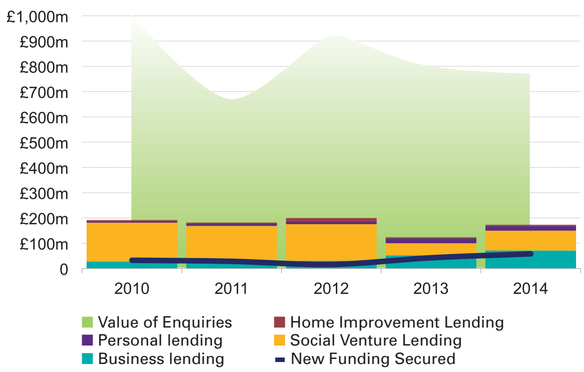
In 2014 CDFIs continued to expand their reach to provide credit and support services to individuals and enterprises in the local economy for whom access to finance was a major barrier to participating in mainstream society and the economy. CDFIs lent a total of £173 million to people, households, and social and for-profit enterprises during 2014, compared to £123 million in 2013 – an increase of 41%. This increase was partly financed by £59 million in new capital secured during the year. Using loan book value as a measure of the size of the sector, CDFIs reported a loan book value of £136 million at the start of the year and £216 million at the end of the year, a 59% increase. Cash available to on-lend at the end of the year was £239 million.

The upward trajectory of growth in lending and new funding secured to lend is evidenced in Figure 4.1; however challenges remain in meeting the demand for finance as demonstrated by the high level of enquiries for CDFI loans – nearly £0.8 billion in 2014 – and the gap described in Chapter 2.

CDFIs lending to for-profit businesses and social enterprises experienced particularly strong growth in lending, serving 42% and 21% more customers, respectively. Both lending to individuals and homeowners stabilised, with similar levels of lending and support to 2013. Yet this is not due to lack of demand, but rather a constraint in supply of funding to these CDFIs to on-lend (see Chapter 5). New funding programmes and a number of policy tools have enabled the enterprise lending sector to scale rapidly in recent years, to meet demand from underserved businesses. Increased investment into other CDFI markets, including social enterprise, individual, and homeowner would catalyse similarly dramatic growth and effective delivery of products and services to markets underserved by mainstream providers.

The access to finance and financial upskilling that CDFIs provide, enables the various participants in the local economy – people and enterprises – to engage in, and grow the economy, and access opportunities that previously were not attainable. The value of this additionality, or increased economic activity, can now be measured by the CDFA's Economic Impact Tool (EIT), which monetises the overall value added of the outcomes generated through CDFI lending and support services[17]. This additional economic value not only drives local growth and reinvestment, but is also a cost savings to the Exchequer. A summary of overall CDFI lending and the value added to the UK's GDP in 2014 as a result of this activity can be seen in Figure 4.2.

4.1 Demand and supply



4.2 CDFI lending and economic impact in 2014

In 2014 54 CDFIs lent **£173m** to

13,230 For-profit microenterprises and SMEs	**370** Social enterprises	**41,938** Individuals	**584** Homeowners	And provided financial literacy and technical assistance to over **56,000** customers

ADDING…

£502m from businesses and jobs created and saved	**£10m** from social enterprises and jobs created and saved	**£4m** from savings[18]	**£2m** from home repairs and £12 million from enabling people to stay in their homes	**£16m** from increased financial capability and skills upgraded

…TO THE ECONOMY

CDFI lending and support activities to individual markets and their outcomes and impacts are described in the following four sections.

Further information on CDFI lending can be found in the Appendix.

Chapter 4.1
CDFI lending to businesses 2014

4.3 CDFI lending to businesses and its economic impact in 2014

In 2014 CDFIs lent **£71.6m** to **13,230** businesses

AND AS A RESULT ...

11,482 New businesses created	**641** Businesses safeguarded	**15,146** New jobs created	**3,701** Jobs safeguarded	Client turnover increased by **£66.2m**	Enabled businesses to leverage a further **£40m** of finance

... ADDING BACK TO THE ECONOMY ...

£226m from businesses created by unemployed people on benefits	**£42m** from businesses created by employed people	**£89m** from jobs created	**£145m** from jobs safeguarded	**£4m** from clients mentored

£0.502bn ADDED TO THE ECONOMY FROM LENDING TO BUSINESSES

Market characteristics

Microbusinesses and SMEs are large drivers of economic growth and employment. In 2013, SMEs accounted for 60% of private sector employment, and 50% of all private sector turnover[19]. However this economic engine may be slowing down as a result of difficulty in accessing capital. Despite some recent improvements in the economy, SMEs are accessing less finance, with fewer firms taking on new finance over the past year, and more – 78% – choosing to not seek finance at all[20]. A further 5% of SMEs did not seek finance because they were discouraged[21]. These trends indicate that the current supply of capital to SMEs is a barrier, stifling the potential for growth and innovation.

A particular gap in access to finance for businesses is among small firms, with limited borrowing history, track record, and no quality security. This segment reports higher rates of discouragement, and lower rates of success when applying for finance (less than 50% are successful)[22]. Small and micro businesses are also less likely to have a credit history, further impeding their ability to fully access mainstream finance. However it is these small and micro enterprises that provide vital goods and services to local communities, such as local retailers, IT providers, hair salons, and building contractors.

CDFI lending to businesses

CDFIs specialise in serving this small and micro segment of the market that cannot access its full financial needs from mainstream financial institutions. In 2014 34 CDFIs lent a record £72 million to over 13,000 businesses. Demand for finance from CDFIs remained high, with 28,000 enquiries, totalling over £250 million. In addition, CDFIs lent a further £42 million to 6,200 businesses on behalf of other business service providers who did not have credit licences and outsourced their lending to CDFIs. The majority (73%) of CDFI customers were microbusinesses, with fewer than 9 employees.

The core of the CDFI enterprise lending market is existing micro and small enterprises that are commercially viable but cannot access some or all of the finance they need for working capital or investment because of their size, or lack of security. The CDFI approach of determining the viability of a business, taking a flexible stance on security requirements, and having a different risk appetite than banks, positions CDFIs as crucial local providers of finance for micro and small businesses. CDFIs also frequently co-finance these businesses with banks, de-risking the deal for the bank. CDFIs lent £46 million to existing for-profit enterprises in 2014, including £26 million to 1,200 microenterprises and £20 million to 430 SMEs. Lending to this segment of the market increased nearly 30% since 2013, with average loan sizes to both microenterprises and SMEs also increasing.

In 2014 a driver of CDFI lending to small and micro enterprises was the CDFA's Regional Growth Fund programme, a public-private match fund for businesses that were previously declined by banks (see Chapter 5).

In total CDFIs lending to enterprises secured £53 million in new funding this year, an increase of over 70% since 2013.

In addition to the core market of established businesses, CDFIs are also significant suppliers of finance to the smaller micro and start up segments of the market, being instrumental delivery partners for the New Enterprise Allowance (NEA) and The Start Up Loans (SUL) schemes. Both of these schemes help people become self-employed by creating the capacity to manage a business alongside the provision of finance. As local delivery mechanisms, CDFIs have been well positioned to serve this higher risk segment of the market which would not otherwise occur to this scale without the intervention of these important government programmes. In 2014 CDFIs lent £10 million to 8,900 individuals through NEA and £15 million to 2,700 entrepreneurs through SUL.

Value back into the economy

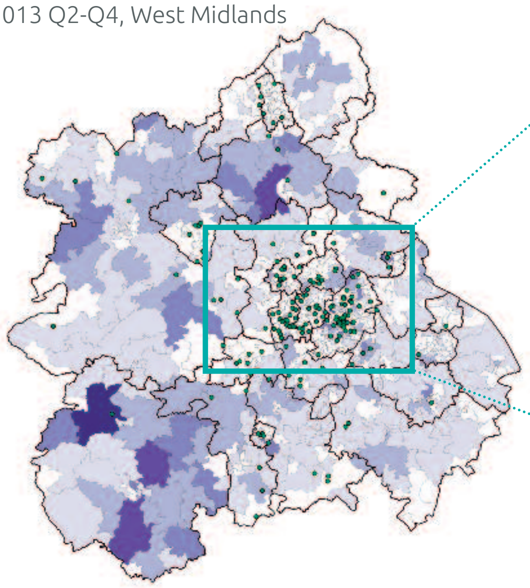
As a result of this lending and increased financial capability, over 12,000 businesses were created and safeguarded, and nearly 19,000 jobs were created and saved. The economic benefits of these outcomes to society and the economy are substantial, as an additional £0.502 billion was added to UK GDP as a result. This shows the value CDFI business loans add to the UK economy by both safeguarding existing jobs as well as creating new jobs, reducing local unemployment. For every £1 lent by CDFIs to businesses, £7 is added to the economy.

CASE STUDY

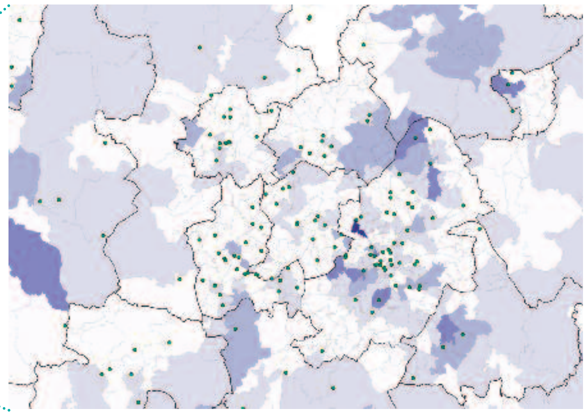
Andy Savery has created a successful and growing commercial truck body building business thanks to a CDFI loan. Andy secured the loan from ART (Aston Reinvestment Trust) to acquire an existing business that had run into financial difficulties. The loan, made with funding from the CDFA's Regional Growth Fund programme, enabled Andy to develop a flourishing business and save local jobs. M6 Motor Bodies in Birmingham has doubled its staff from eight to 16 and increased the number of vehicles in its workshop from three to 18 in just seven months as a result of the loan from ART.

CDFI enterprise lending data has been mapped with bank SME lending data and geographies of deprivation in the West Midlands region (using CDFI postcode lending data, the British Bankers' Association's (BBA) voluntary bank lending data, and the 2010 English Indices of Multiple Deprivation). Figures 4.4 and 4.5 demonstrate that CDFI loans are made in areas where there are higher levels of deprivation, and less bank lending. Particularly in the region surrounding Birmingham CDFIs are clearly lending to disadvantaged and underserved segments of the enterprise market, filling gaps in access to finance.

4.4 CDFI enterprise lending and bank SME lending; 2013 Q2-Q4, West Midlands



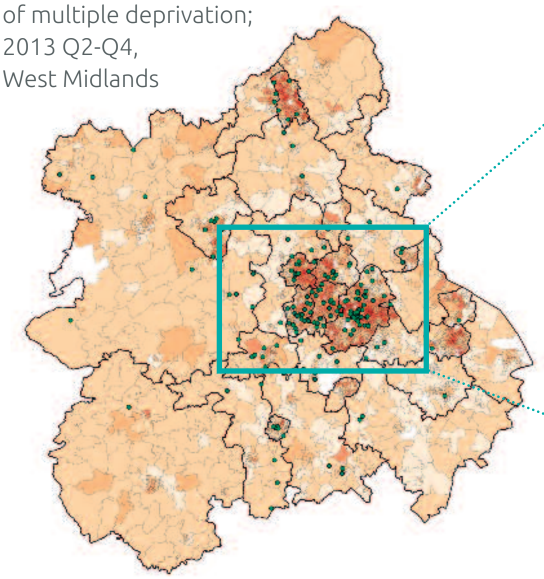
4.4.1 CDFI enterprise lending and bank SME Lending; Birmingham



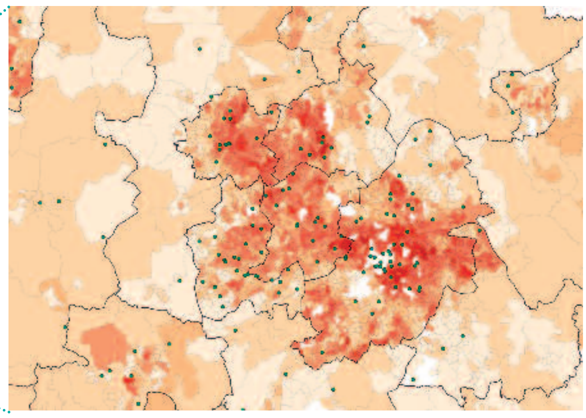
● Location of CDFI Lending

Value of Bank Lending
- No Data
- £0 - £30m
- £30 - £60m
- £60 - £90m
- £90 - £120m
- £120 - £150m
- £150 - £180m

4.5 CDFI enterprise lending and indices of multiple deprivation; 2013 Q2-Q4, West Midlands



4.5.1 CDFI enterprise lending and indices of multiple deprivation; Birmingham



● Location of CDFI Lending

Index of Multiple Deprivation
- No Data
- 0 - 10
- 10 - 20
- 20 - 30
- 30 - 40
- 40 - 50
- 50 - 60
- 60 - 70
- 70 - 80

Chapter 4.2
CDFI lending to social enterprises 2014

4.6 CDFI lending to social enterprises and its economic impact in 2014

In 2014 CDFIs lent **£78.4m** to **370** social enterprises

AND AS A RESULT ...

38	**322**	**346**	**1,794**
Social enterprises created	Social enterprises safeguarded	Jobs created	Jobs safeguarded

... ADDING BACK TO THE ECONOMY ...

£404k	**£9.8m**	**£78k**
from social enterprises created	from social enterprises safeguarded	from clients mentored

£10.2m ADDED TO THE ECONOMY FROM LENDING TO SOCIAL ENTERPRISES

Market characteristics

Social enterprises are businesses that trade to tackle and prevent social problems, improve communities, people's life chances, or the environment. They provide goods and services in the open market, but reinvest their profits back into the business or the local community. They can be set up as charities, community and voluntary organisations, and other not-for-private-profit ventures. Social enterprises tackle social issues where there has been underinvestment or market failure; they are concentrated in areas of high deprivation as they work on issues of greatest social need within a community, such as employment and training, homelessness, and youth development[23].

The social enterprise sector has been growing rapidly in the UK, and developing in terms of its demand for finance. Whilst the majority of social enterprises still seek grants when applying for external funding[24], the supply of grant funding has been declining since the recession, with more traditional grant sources – such as government – providing support through contracts for services instead[25]. Grant funding is also becoming more targeted, such as through the Investment and Contract Readiness Fund (ICRF), a new £10 million fund, managed by The Social Investment Business, on behalf of the Office for Civil Society, for capacity building to enable social enterprises to secure investment and compete for public service contracts. As a result of this shift in funding, access to finance is cited as the biggest barrier to starting up and achieving sustainable growth by social enterprises, and nearly half of social enterprises reported applying for finance in 2012[26] - demonstrating their ambition to grow and the demand for their services.

CDFIs and Social Banks lent **£78m** to social enterprises in 2014.

As it is a relatively young sector, there is limited standardised information across social enterprises, and social enterprises' demand for finance is primarily served by small non-mainstream bank providers such as CDFIs, Social Investment Finance Intermediaries (SIFIs), Social Banks, individual investors, Social Impact Bonds, and crowdfunders.

CDFI lending to social enterprises

CDFIs are social enterprises themselves, and are therefore uniquely positioned to serve the social sector's demand for finance. Their expertise in the non-profit operating environment, such as understanding the challenges of running a social enterprise, and the resources and tools available for social enterprises, make them specialist providers in helping new and established social enterprises grow, as they transition from grant to debt finance.

The CDFA survey measures both CDFI and Social Bank lending to social enterprises, as their markets are similar. However, CDFIs typically serve the demand for smaller deals – below £250,000 without quality security or credit history, a segment of the market with the strongest demand, but that is underserved by most other social investors[27].

In 2014 11 CDFIs lent £12 million to 261 social enterprises – similar to 2013 levels. Social banks lent £66.4 million to 109 social enterprises, an 89% rise in the value of loans disbursed by social banks since 2013. This increase represents social banks returning to historic lending levels, after a period of repositioning due to changes in regulation in 2013.

Demand for finance also remained strong, with over 2,000 enquiries from social enterprises for £465 million, as growing organisations needed the finance and technical assistance to expand their services. The majority (93%) of CDFIs' social enterprise customers had been declined by a bank and 94% were located in a disadvantaged area. Roughly one third of the social entrepreneurs to whom CDFIs lent were under 30 years old, another third were elderly, and 20% had a disability.

Social enterprise lending CDFIs raised approximately £4 million in new funding in 2014, a slight decrease from the previous year. This means that the remaining capital for lending came from CDFIs' own funds or from previous funding received.

The introduction and expansion of the Social Investment Tax Relief (SITR), a new scheme launched in 2014 to attract significant new private investment into the social economy, is an important step to increasing investment into social enterprises, and particularly into CDFIs that can provide the appropriate financial products and services for social enterprises to grow and tackle difficult social problems. In addition, new programmes such as Power to Change and Big Potential will strengthen the capacity of community enterprises and help build a stronger base for longer term, more substantial investment from the likes of Big Society Capital and those commercial investors increasingly interested in social investment.

CASE STUDY

Collage Arts is an inspiring arts development and training charity, set up over 30 years ago in North London by Manoj Ambasna. The charity is an incubator for 200 creative businesses, which collectively employs over 500 people in one of England's most deprived wards. Collage Arts also takes on over 100 creative apprentices every year, supporting disadvantaged and unemployed young people to attain employment skills and qualifications, and build aspirations. Last year, 77% of apprentices completing the courses went on to university or full time employment. Collage Arts received a loan of £100,000 from Big Issue Invest to develop and grow its training programme and provide working capital for its core incubator service. The loan has secured the future for the social enterprise, and the young people it supports.

Value back into the economy

CDFI finance and technical assistance to social enterprises had a significant impact on the UK economy in 2014. As a result of their lending and technical assistance, 38 social enterprises were created and 332 safeguarded, creating 350 jobs and protecting a further 1,800. This added £10.2 million to the UK's GDP. However, not captured in this economic impact is the value of the enabling effect that CDFIs have on society. By providing finance and support to social enterprises addressing societal issues where there is market failure, CDFIs are enabling these issues to be tackled at greater scale and more effectively, thus decreasing cost to the government.

Chapter 4.3
CDFI lending to individuals 2014

4.7 CDFI lending to individuals and its economic impact in 2014

In 2014 CDFIs lent **£18.9m** to **41,938** people

Helped **17,000** people avoid using a high cost credit provider	Provided financial literacy support to **8,100** people	Helped **4,200** people open a bank account	Helped **1,800** people pay bills and **9,000** people manage existing debts	Helped **10,000** people manage household expenses and **6,000** cover short term one-off expenses

... ADDING BACK TO THE ECONOMY ...

£4m from loan repayment savings	**£12m** from individuals mentored

Market characteristics

Individuals need to access financial products such as current and savings accounts, mortgages, and other loans, to manage daily expenditures, finance one-off purchases, and plan for their longer term financial security. In the UK, the macro-economic backdrop of unemployment/underemployment, welfare reforms[28], and increased cost of living against wage stagnation all erode individuals' financial stability, and resilience in being able to cope with unexpected expenditures. The University of Birmingham's Annual Financial Inclusion Monitoring Report found that one third of individuals in the UK could not find £200 to cover a one-off expense. Half of this population reported needing to borrow to meet this expense[29].

Furthering the stress of not having a cushion to meet financial shocks is the inability to access a bank account, which makes every transaction more costly and time consuming, and makes it more difficult for an individual to access mainstream services, and to fully integrate into society. Without a bank account or a credit score, individuals struggle to access products and services such as renting a flat, getting a mobile phone contract, or being paid for work, not to mention the difficulties of paying bills. An estimated 1.4 million adults do not have a bank account, and a further 4 million incur regular fees on their bank accounts, pushing them to the edge of mainstream banking[30]. Individuals hit hardest by these trends may be forced to take on debt to make ends meet, creating what is often a downward spiral of further financial distress and over-indebtedness.

For these individuals, the inability to access affordable mainstream finance – or to be financially excluded – has detrimental effects on their participation in the economy, society, and their community, and ultimately on their social and economic mobility. For instance, research has shown that moving from low to average financial capability improves psychological wellbeing by about 6%[31].

The alternatives that exist for accessing finance for unbanked and underbanked individuals are local options such as CDFIs, credit unions, and high cost short term lenders, such as payday lenders, home credit, and pawn shops. In reality credit union regulation can prevent them from providing gap-filling finance to the most vulnerable customers due to their higher level of risk[32]. High cost lenders offer a unique product, but often without reference to affordability and customers' ability to repay, therefore trapping individuals in a cycle of over-indebtedness. In addition, the Financial Conduct Authority's (FCA) forthcoming price cap, intended to protect consumers, could potentially exclude further hundreds of thousands of individuals from accessing credit to meet one-off expenses or daily cash flow needs, so alternatives need to be capitalised and equipped to serve this new gap in the market.

CDFI lending to individuals

CDFIs have a mission to serve those experiencing financial exclusion, and have specialised products and services to meet their demand for credit. In 2014 12 personal lending CDFIs lent £19 million to 42,000 individuals. These levels of lending were similar to 2013, although demand increased over 25%, with 87,000 individuals seeking £44 million in finance. In 2014, 70% of CDFI customers came from a household with annual income of less than £15,000. Furthermore, 41% of those who received a CDFI personal loan had used a high cost credit provider such as a payday lender or a loan shark in the previous twelve months; 60% were on state benefits, 54% were unemployed and 45% lived in social housing.

CDFIs helped **17,000** people avoid high cost credit providers.

In order to serve this population of vulnerable consumers, CDFIs have developed products and services that enable the customer to take control of their financial wellbeing and become financially secure. CDFIs provide a holistic approach, serving customers with no or poor credit history due to an event in the past, offer affordable and flexible products that take into account an individual's ability to repay, and build the customer's financial capability through financial literacy training and budgeting advice. Personal lending CDFIs are relationship-based, typically operating out of multiple branches, and often have partnerships with local credit unions and banks, so that as part of their services CDFIs help their customers set up accounts with these providers, thus enabling them to become more integrated into mainstream financial services. By accessing finance through a CDFI, consumers build up their financial resilience and reduce their financial risk, which has positive impacts on other aspects of their lives and enables them to participate more fully in the economy.

In 2014 CDFIs lending to individuals secured over £2 million in new funding, a drop from £9 million in 2013, and used existing funding to finance the remainder of their lending. This lack of new capital to on-lend coming into the personal lending sector is a significant barrier to CDFIs, preventing them from meeting the growing need in this segment of the market that only they are positioned to meet responsibly. An injection of capital into this CDFI sector, as the enterprise lending sector has seen over the past several years, would lead to similar levels of strong growth and organisational scale in the personal lending market. This would enable CDFIs greater market penetration, thus decreasing levels of high debt and reliance on benefits, and improving social wellbeing.

CASE STUDY

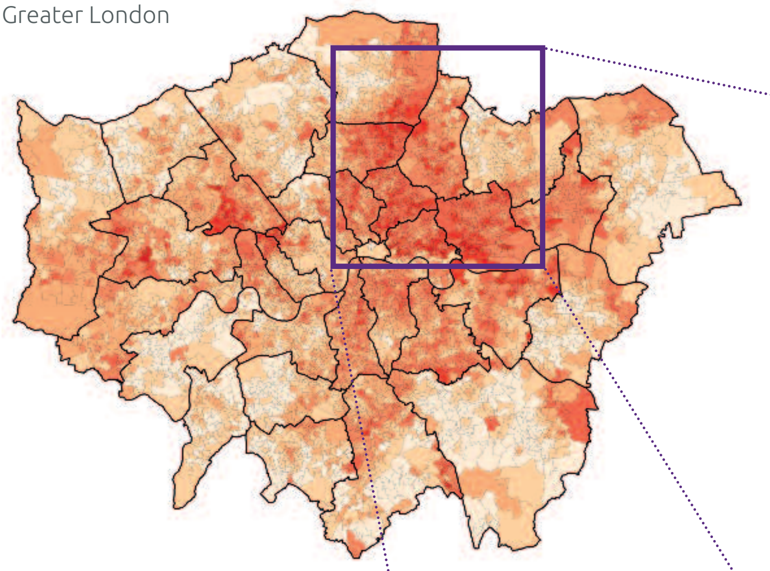
A Glasgow based couple, David and Moira, both have disabilities and needed to access finance to improve their accessibility. David has heart problems and Moira is an amputee so both are very restricted in their mobility. Things worsened when Moira unfortunately had to have her second leg amputated and given David's heart problems, he was unable to lift her in and out of her wheelchair into their car. They found an opportunity to get a Motability car, specially adapted to allow the wheelchair to be pushed up a ramp into it. The couple saved £245, but were unable to find the money needed for the deposit of £995 within the required timescale. So they approached local CDFI, Scotcash, which gave them a loan of £750, on affordable terms. Scotcash also helped David and Moira to set up a credit union savings account and now £5 of their weekly repayments go into savings, which can be withdrawn at any time to meet unexpected expenditure. The new car is now making a major difference in David and Moira's lives.

Value back into the economy

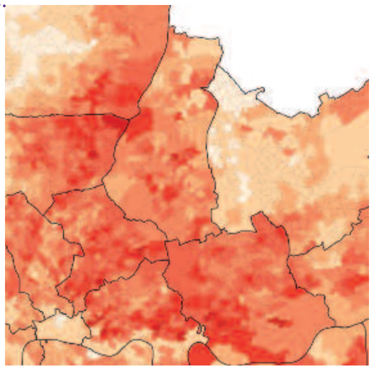
By providing affordable and flexible credit alongside financial capacity building, CDFIs helped over 17,000 individuals avoid using a high cost credit provider, over 4,000 people open bank accounts, 9,000 people manage existing debts and bills, and 10,000 people manage their household expenses. CDFIs also helped 6,000 people meet unexpected short term expenditures, such as car repairs, and seasonal spending such as Christmas gifts. These activities added £4 million to the UK GDP in 2014, through the integration of these individuals into mainstream society, and increasing their consumer surplus.

CDFI personal lending data has been mapped with bank personal lending and geographies of deprivation in the Greater London region (using CDFI postcode lending data, the BBA's voluntary bank lending data, and the 2010 English Indices of Multiple Deprivation). Figure 4.8 demonstrates that CDFI loans are made in areas where there are higher levels of deprivation, and less bank lending. Particularly in the boroughs of Tower Hamlets, Newham, Hackney, Haringey and Enfield, CDFIs are clearly lending to underserved individuals, filling gaps in access to finance.

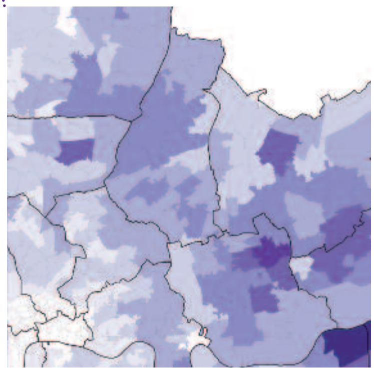
4.8 Indices of multiple deprivation; Greater London



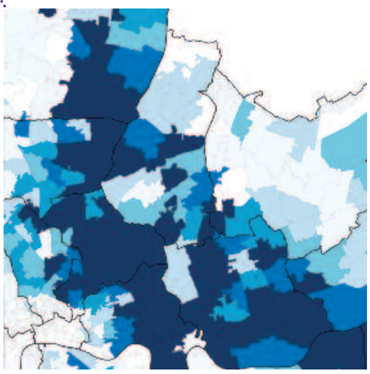
4.8.1 Indices of multiple deprivation; East London



4.8.2 Bank personal lending, 2013 Q2-Q4; East London



4.8.3 CDFI lending, 2013 Q2-Q4; East London



Chapter 4.4
CDFI lending to homeowners 2014

4.9 CDFI lending to homeowners and its economic impact in 2014

In 2014 CDFIs lent **£4.3m** to **584** homeowners

AND AS A RESULT ...

432 People were able to stay in their homes	**304** Homes were brought up to Decent Homes Standard	The lives of homeowners who were elderly **(81%)**, low income **(69%)**, disabled **(5%)**, were improved

... ADDING BACK TO THE ECONOMY ...

£12m from individuals being able to stay in their homes	**£2m** from bringing homes up to Decent Homes Standard	**£169k** from homeowners advised

Market characteristics

Homeowners need to access finance to undertake essential repairs, adaptations and improvements to their homes. Of the 23 million dwellings in England, 65% are owner-occupied, and of those 4.6 million are occupied by elderly homeowners (over 65 years old), and 2.3 million are homeowners with annual incomes below £15,000[33]. Whilst the majority of homeowners can access finance through mainstream suppliers such as banks, vulnerable homeowners, such as those who are low income or on a fixed income, elderly or disabled, or whose assets are not adequate security, are often excluded from the mainstream.

An indication of demand for finance in this market is the number of homes that do not meet the Government's Decent Homes Standard[34], which sets standards for home quality and energy efficiency. As nearly 80% of all dwellings in England were built over 30 years ago, and 20% were built a century ago[35], a large proportion of the housing stock is at risk of being in poor condition. In 2009 about 30% of all homes in the UK were classified as not Decent Standard[36], and owner-occupied homes accounted for the majority of non-decent homes[37]. Poor housing conditions reduce a homeowner's quality of life, and lead to negative health impacts[38].

Vulnerable populations, such as the elderly, those with low incomes, and minorities, are at higher risk for living in homes that are below Decent Home Standard[39]. In fact 40% of elderly people, and over one quarter of households in poverty live in non-decent homes[40]. These populations also face difficulty accessing finance to make repairs to bring their homes up to standard, and therefore are at risk of remaining in poor quality housing. Homeowners making home repairs can access finance from local providers such as CDFIs, credit unions, local authorities, charities, and equity release lenders.

CDFIs helped **432** people stay in their homes in 2014.

CDFI lending to homeowners

Six CDFIs specialise in lending to low income and disadvantaged people who need finance for home-related problems, such as repairs and energy efficiency upgrades. CDFI lending for home repairs ranges from working with individual homeowners to undertake essential repairs, to refurbishing an entire block of empty homes, bringing them up to Decent Standard. These CDFIs typically partner with local authorities to deliver funds to local residents for home improvement purposes. In 2014 CDFIs lent over £4 million to 580 homeowners, which was similar to 2013 levels of lending. However, enquiries for finance for home repairs and energy efficiency upgrades decreased roughly 30% since last year due to factors such as local authority cuts in service and warmer weather conditions; CDFIs however, report that latent demand remains at high levels. The majority of households that CDFIs served were homeowners (96%); 92% claimed some form of state benefits, 81% of customers were over the age of 65, and 69% were low income.

In 2014, CDFIs lending to homeowners secured under £1 million in new funding, primarily from local authorities. Whilst a small sector compared to other CDFI lending markets, there is widespread need to serve homeowners who are at risk of living in substandard housing, or being displaced due to housing conditions, as demonstrated by the aging housing stock and disadvantaged residents who need to make essential repairs. CDFIs are a vital delivery mechanism for reaching these residents, improving their lives and making them overall better off as a result of their improved housing conditions.

CASE STUDY

Mrs. Ingham previously struggled to heat her home, had a leaky roof and poor insulation, but knew she couldn't afford to pay for the cost of repairs. She eventually contacted South Somerset District Council for help and learned about their partnership with a local CDFI, Wessex Resolutions. Wessex helped Mrs. Ingham to work out what would be affordable, and provided a low-cost loan of £12,000 for a new boiler, new roof slates, insulation and a new window. After the work was completed Mrs. Ingham said that it had made an amazing difference to her quality of life, as she now has a warm and comfortable home, and no longer has to worry about the cost of home repairs.

Value back into the economy

CDFI home improvement loans and technical support had a significant impact on clients' living standards. CDFIs' activities in 2014 enabled 432 homeowners to stay in their homes as a result of repairs, and brought 304 homes up to Decent Home Standard. These improvements resulted in £12 million added to the UK economy from improved home conditions and £2 million from people able to stay in their homes. For every £1 lent by CDFIs to homeowners, at least £3 was added to the economy.

Chapter 5
CDFI model – how do they do it?

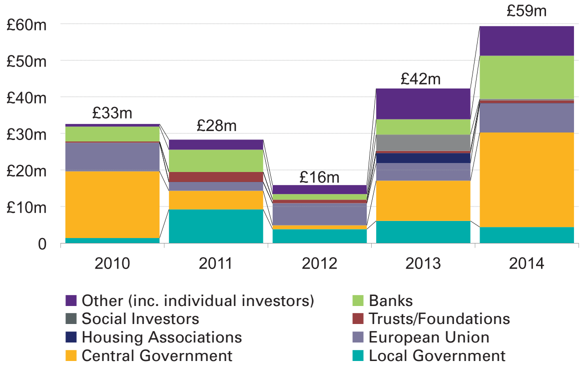
CDFIs are typically not deposit-taking financial institutions, so they need to raise their capital for on-lending. This funding is secured from a variety of sources – loans from commercial and social lenders, grants from the government, trusts and foundations, equity from shareholders, and funds they manage on behalf of third parties. They receive income from lending through interest and fees, and portfolio management charges, with many raising revenue grants, often for delivery of support services such as technical assistance activities.

Sources of funding

CDFIs raise their capital to on-lend from a range of sources. A challenge for CDFIs when structuring funding is assessing whether and how the terms of the funding might impact on their mission of providing access to affordable finance. For example, the cost of capital influences the rates that CDFIs charge their own clients, and the maturity of a CDFI's bank loan affects its own loan terms with clients to ensure they are able to repay the bank loan, both challenges that CDFIs must factor into their products.

In 2014, CDFIs secured £59 million in new funding. As Figure 5.1 demonstrates, this funding was a mix of bank and social loans, and grants from local, central, and European governments. Overall, the composition of CDFI funding continues to diversify as the funding landscape shifts. Once very grant oriented, CDFIs are now more commercial in their approach to securing investment. This transformation and diversification has enabled CDFIs to offer more flexible lending parameters, in terms of their geographic coverage and clients served. However, commercial funding poses new challenges of maintaining operational sustainability, meeting stretching security and covenant requirements and achieving scale given the added cost of capital.

5.1 New funding secured to lend, 2010-2014



Policy tools for attracting new funding

Community Investment Tax Relief (CITR) is a tax relief for corporate, institutional, and individual investors investing in CDFIs for on-lending to businesses and social enterprises located in deprived communities. In 2014 there were 27 accredited CDFIs. Investors receive a relief of 25% of their total investment over five years, or 5% per annum. Through CITR, CDFIs have secured over £100 million in new funding since 2002, primarily through bank loans to CDFIs. This has facilitated more than £100 million of onward lending. CITR is an essential tool for attracting new capital to on-lend for CDFIs, however it is currently only available to CDFIs lending to for-profit and social enterprises. Broadening CITR to become available to all CDFIs, and aligning its benefits with those of the Social Investment Tax Relief (SITR), would ensure that this critical scheme remains competitive and continues to attract new private investment into the sector.

In 2014 CDFIs secured **£59m** in new funding, an increase of over **40%** from 2013.

First loss

CDFIs operate in markets where there is greater risk of non-repayment. The CDFI model seeks to de-risk the investment by providing technical assistance that improves the borrower's creditworthiness and ability to repay. By number, 85% of all CDFI loans are unsecured[41], meaning that the private investors and lenders that make up an increasing source of CDFI funding, need assurance that their investment will be repaid. So as non-profit mission-driven lenders, the concept of a first loss facility that absorbs losses when the customer is unable to repay, is important to consider when structuring funding for CDFIs.

Among CDFIs there are essentially two approaches to ensuring first loss cover:

- External funding is secured to absorb losses, such as grant funding either from foundations or government, or policy guarantee schemes, which guarantee a portion of losses within a lender's portfolio. Such guarantee schemes have been established because of the social and economic benefits that exist from providing finance to harder-to-reach, excluded markets.
- Bad debt losses are covered by the CDFI's loan loss reserves, and the cost of risk is priced into the interest rate charged to borrowers.

Policy guarantee schemes

An existing loan guarantee scheme is the Enterprise Finance Guarantee (EFG), which covers a net of 15% of loans in a lender's EFG portfolio[42]. EFG can also be used as a wholesale guarantee, covering 15% of a bank's investment into a CDFI. These two mechanisms together can provide the investor essentially a 30% cover. As the majority of CDFI loans are unsecured, EFG is a useful tool in minimising risk when lending to higher risk SME markets. Whilst effective, this tool is only available to CDFIs lending to for-profit and social enterprises, not the broader CDFI lending market. Additionally, as it is impossible to determine the final risk profile and repayment term until the loan portfolio has fully matured, it has resulted in minimal use of the wholesale mechanism by banks.

CASE STUDY

Regional Growth Fund

A current and effective example of a fund structured to both leverage in private investment and provide first loss cover is the CDFA's Regional Growth Fund (RGF) programme. This fund, targeted at for-profit and social enterprises across England that cannot access bank finance, is a £60 million public-private match fund between the Department for Business Innovation and Skills (BIS) and the Co-operative and Unity Trust Banks. The 50% grant match from BIS provides the first loss cover, but also serves the important function of lowering the cost of the bank loan, as the total cost is spread over a larger sum. Through the RGF programme, CDFIs have accessed bank loans at an average of 4% over base, yet when taking into account the grant match, the average cost is 2% over base. Some banks participating in the programme have invested in CDFIs through CITR. In addition to claiming the tax relief through CITR, banks often offset the cost of their capital to CDFIs when making a return. This further lowers the cost of funding for CDFIs, allowing them to allocate more resources to lending and operations. The repayments on the RGF grant are recycled to make further loans, and build CDFIs' balance sheets, leveraging in further commercial funding to on-lend.

The RGF programme has proved highly successful. In 2014, CDFIs lent over £10 million to 400 new and growing social and for-profit enterprises, creating and saving nearly 1,400 jobs, which added an estimated £74 million to local economies across the country. Because the government grant leveraged a private match, the average cost to the government per job during the year was £3,700, which is only 10% of the average cost per job for the entire RGF programme[43].

Future of CDFI funding

Funding impacts on both the growth of the CDFI sector, and its sustainability. The funding landscape for the sector is expected to continue to diversify, with increased funding from commercial, social, and individual lenders and investors. Despite diminishing grant funding from local sources, strategic government programmes such as policy guarantees, tax reliefs, and funds such as the Regional Growth Fund can help put the sector on a level playing field when serving the higher risk market segments; these programmes can reduce risk and leverage significant private investment into CDFIs, so that the social returns that they generate are high – at a low cost to the government.

Future sources of CDFI funding are likely to include new entrants such as the British Business Bank, which was established by the government to stimulate growth in alternative sources of enterprise finance. Challenger banks, crowdfunders, and peer to peer lenders are other potential sources being explored; Local Enterprise Partnerships (LEPs) too, offer an important source of investment and strategic positioning, at a time when further devolution for both European and government backed economic initiatives looks likely. Existing sources can also play a wider, sectoral role. For example mainstream banks have funding relationships with a limited number of CDFIs, but there is potential for them to provide capital for a consortium or sector-wide CDFI fund. Similarly, Big Society Capital's (BSC) £600 million, intended to grow the social investment market, has been inaccessible for the majority of CDFIs due to the fund's structure and pricing, however there is still potential for BSC to underpin a larger sector-wide CDFI fund if these issues are addressed. Local options such as Community Share Issue, Housing Associations, and other partnerships with local providers can offer different forms of capital to tackle a wide range of social issues. Finally, trusts and foundations have the potential to provide capacity-building support to CDFIs even if they cannot provide capital to on-lend at scale.

CASE STUDY

Community shares

Community share sales in local enterprises and organisations are serving a growing and valuable purpose. CDFIs are part of a wider intermediary base that are often involved in providing business support and finance to enterprises undertaking community share offers. The financing of viable and sustainable local buildings, pubs, shops, renewable energy schemes and many other ventures gives community members a real and meaningful stake in a local asset. Members who own shares become investors, customers and contributors in the running of the enterprise.

> Constraint in supply of funding remains a major barrier to scaling the CDFI sector.

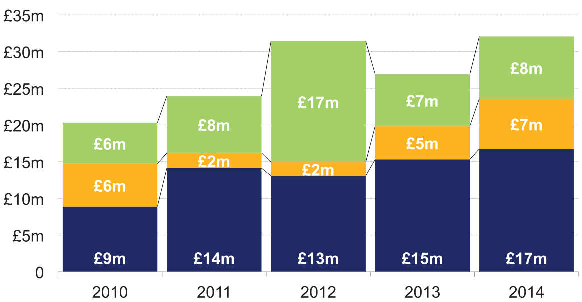
CDFIs have experienced organic growth from securing funding individually, but what has also proven tremendously successful is the economies of scale of a consortium of CDFIs, such as the CDFA RGF scheme. This demonstrates the need for a long-term sector-wide CDFI Fund, available to all CDFIs across markets.

Sources of income

The CDFI model of being a unique specialist provider is highly effective, but comes at a cost both in terms of the technical assistant support provided and the higher levels of risk, both of which make it more difficult for CDFIs to achieve full sustainability and raise capital.

As with the shift towards more commercial forms of capital for on-lending, grants to cover operating costs have also declined. This shift has coincided with a period of strong growth for CDFIs, where scale and higher volumes of lending have enabled CDFIs to become more self-sufficient, covering their operating, funding, and risk costs with income raised through interest and fees from lending and support activities, and fees from managing funds on behalf of third parties. As evidenced in Figure 5.2, there has been a notable increase in the proportion of earned income, such as interest and fees, over other income, such as revenue and capital grants, since 2010. Whilst this shift is positive in terms of the sector's scalability and the signal it sends to investors, the technical assistance CDFIs provide, which is instrumental in the development of a customer's financial capability and their ability to realise their economic potential, is typically funded through revenue grants. In the progression to operational self-sufficiency, CDFIs have experienced a tension in providing affordable finance and high quality support services.

5.2 Earned and other income



	2010	2011	2012	2013	2014
TOTAL EARNED INCOME	69%	78%	81%	80%	83%
TOTAL OTHER INCOME	31%	22%	19%	20%	17%

■ Earned Income – Other
■ Earned Income – Interest and fees from managing funds
■ Earned Income – Interest and fees from lending

CDFIs are uniquely positioned to serve the gap in access to finance described in Chapter 2 with their demand-driven approach. Their ability to serve local markets not only demonstrates the need for greater supply – funding into the sector – to meet the demand, but also the need for the infrastructure to scale. In order for CDFIs to continue to increase their volume of lending and geographic reach, investments infrastructure are necessary, from which greater efficiencies and economies of scale will follow.

Portfolio performance

CDFIs have been scaling up to meet the demand for finance, targeting markets underserved by mainstream financial institutions. Due to discrete market characteristics, data on portfolio at risk (PAR – 90 days or more in arrears) and write-offs over the years presents a mixed picture of portfolio quality. Overall CDFIs are aligned or outperforming industry benchmarks on portfolio performance.

- In the **micro and SME market**, CDFIs reported a portfolio at risk of 7.7% and write-offs of 4.7% of their portfolio in the year. This was a notable decrease over the previous year, primarily driven by the injection of new capital so diluting their portfolios. Taking this into account, the average PAR and write-off rates for the micro and SME market over the past three years are 16% and 9%, respectively. As a benchmark, the Enterprise Finance Guarantee scheme, which is typically used when lending to riskier SME markets where business owners do not have security or credit history, had a default rate of 28% after its first three years[44], well above CDFIs' bad debt rate. The average default rate for SME loans with banks is 4%[45].
- **Social enterprise** lending CDFIs typically lend to organisations that are established, and are transitioning from grant finance to debt finance. As these enterprises have a track record, they are less likely to default on their debt. In addition, as social enterprise loans tend to be larger – c£46,000 – some CDFI loans (25%) are secured against property or assets, or government guarantees. In 2014 CDFIs lending to social enterprises reported a PAR of 2.8% and a write-off rate of 2.6%. Compared to other social investment funds that have write-off rates of 4-6%[46], social enterprise lending CDFIs outperform these portfolios.
- CDFIs **lending to individuals** reported a PAR of 17.8% and a write-off rate of 11.2%. Using credit unions and payday lenders as benchmarks, personal lending CDFI portfolios appear to be at greater risk, however the CDFI model and target market are different from the benchmarks'. Credit unions, which can be restricted from serving low-income, excluded customers because of their interest rate cap have a PAR of 6-9%[47]. Payday lenders tend to have default rates under 10%[48], but have rollover rates of 28%[49]. Rollover rates are indicative that a client is having difficulty repaying. When rolling over a loan, payday lenders extend the loan term and charge the client an additional fee.
- CDFIs **lending to homeowners** reported a PAR of 0.6% and a write-off rate of 0.1%. Compared to bank mortgage lenders who had a repossession rate of 0.7% at the end of FY 2014[50], CDFIs lending to households had similar portfolio performance.

5.3 Portfolio performance

		2012	2013	2014
MICRO & SME	PAR	19.2%	20.4%	7.7%
	Write-offs	14.3%	7.6%	4.7%
SOCIAL ENTERPRISE	PAR	5.5%	1.4%	2.8%
	Write-offs	0.9%	0.6%	2.6%
PERSONAL	PAR	18.4%	12.0%	17.8%
	Write-offs	6.0%	7.7%	11.2%
HOME IMPROVEMENT	PAR	0.1%	0.2%	0.6%
	Write-offs	<0.1%	<0.1%	0.1%

Chapter 6
CDFIs in the broader financial services sector

The gap in access to finance described in Chapter 2 is attributable to a lack of information about the market and awareness of community finance, as well as a lack of competition. On the demand side, there is very little public awareness and understanding of non-bank finance, as well as low levels of financial capability that would inform better financial decisions[51]. For example, 25% of small business owners finance their operations with personal credit cards and mortgages[52] instead of securing a business loan, which makes them financially vulnerable by putting their personal assets at risk. On the supply side, mainstream financial institutions are not incentivised or required to serve markets that may be less profitable in terms of the products and services they use. This perception has reduced innovation and diversity in products and services available to meet the broader population's demand for credit.

CDFIs are serving a unique segment of the market, and are the only ones doing so responsibly.

Need for integration

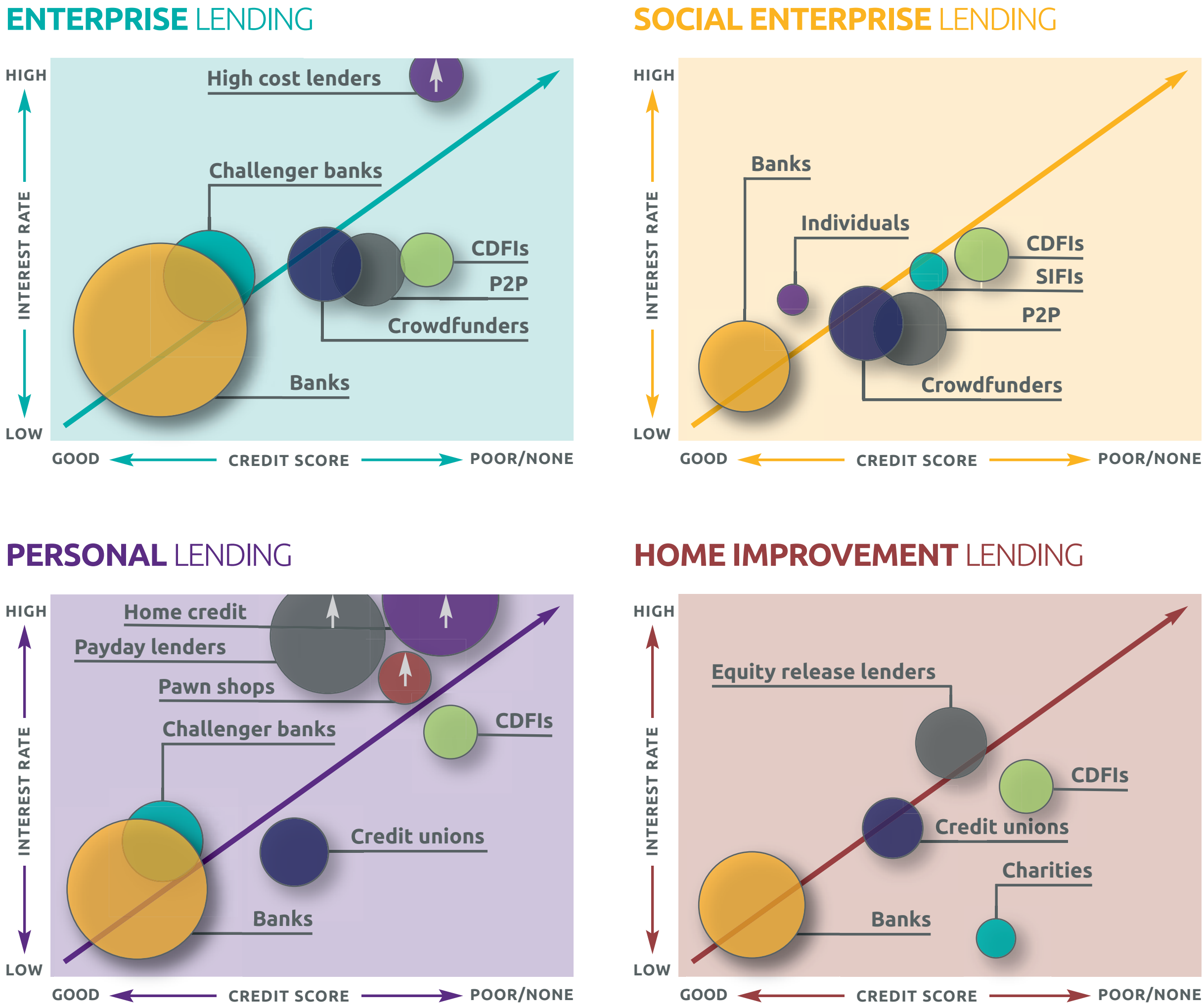
Appropriate products and services that are tailored to demand can be transformational for a person's or household's wellbeing, and businesses' and social enterprises' future growth and contribution to the economy. For these products and services to be available to a broader population, and for the subsequent economic and social potential to be realised, barriers to information and incentives to invest – such as tax and legislation – must be addressed to ensure better integration of the financial services sector.

Figure 6.1 illustrates the position of the credit providers in each market: for-profit enterprise, social enterprise, consumer, and homeowner. As demonstrated by CDFI lending maps in Chapter 4, CDFIs serve a segment of the market that mainstream and other non-bank providers are unable to support. Using credit score as a proxy for perceived risk, and interest rate as an indicator of fairness, CDFIs are serving these markets responsibly. However, as CDFIs are often the only affordable providers in these market segments, it is clear that the undersupply of capital is constraining CDFIs from meeting the full demand for finance.

In addition to fragmentation in access to finance, relationships between finance providers are also variable. There are some co-financing relationships between banks and CDFIs as well as referral relationships, one-off partnerships between banks and peer to peer lenders, and banks and credit unions. However, these models are undeveloped and there are gaps in geographic coverage, therefore failing to unlock the significant economic potential that can be achieved in creating economies of scale and leveraging each provider's capabilities.

Potential links that can integrate the sector are widespread formalised referral, direct financing, co-financing deals, mentoring, and training relationships between providers. A more integrated financial services sector would reduce information asymmetries through the increased knowledge of other forms of finance in the market. Consumers and enterprises would have more options from which to choose in the marketplace, driving competition for appropriate and fair products. This would enable the broader population to climb the credit ladder, accessing products that are specific to their demands. As a result there would be lower levels of financial instability, enabling the creation of wealth and reinvestment in the local economy, stimulating a feedback loop for further demand for finance.

6.1 Map of the financial services providers in each market



Note: Size of providers illustrative based on loans outstanding

Role of government

Whilst some formalised partnerships can take place organically, widespread integration is most effectively driven by public policy. The government's legislation on the mandatory referral of declined SME customers from banks to alternative providers is a welcome move towards creating a more integrated network of finance providers for the benefit of all enterprises, yet in its current form it is restricted to businesses. Given the significant economic and social benefits generated by individuals and enterprises accessing finance appropriate for their needs, and the longstanding market failure in accessing this finance, broader action by government on access to finance policy is needed, to support CDFIs and other non-bank providers in filling the gap.

For example, the Community Reinvestment Act (CRA) has proved to be a highly effective model of linking mainstream banks and CDFIs in the United States. Enacted in 1977, the CRA requires banks to lend to traditionally less profitable markets, including capitalising community lenders such as CDFIs and credit unions, to lend to underserved and excluded markets. Similar broad legislation in the UK would accelerate the positive steps that have been made in incentivising sustained and strategic relationships between all finance providers, creating a more efficient and competitive market.

Conclusion

2014 proved to be an exciting year for the CDFI industry in the UK. The for-profit and social enterprise markets have seen significant growth, both in terms of number of customers served and in the total value of loans disbursed. This upward trajectory of CDFI lending clearly illustrates the sector's capacity to serve the unmet demand for credit.

With the right support, CDFIs have proven they can flourish and unlock the potential of local economies across the UK. The maps in Chapter 4 directly comparing CDFI and bank lending, alongside English indices of multiple deprivation, as well as Figure 6.1 mapping the position of financial services providers, crystallise the fact that CDFIs are a key player in filling in the gaps in access to finance.

The introduction of the CDFA's Economic Impact Tool, measuring the value added back to local economies from CDFI lending and support activities, shows that in 2014 CDFIs contributed hundreds of millions of pounds to the UK GDP that otherwise would not have been generated, bringing wealth, social wellbeing, and prosperity to underserved areas.

Although the vast majority of CDFIs anticipate significant further growth over the coming years, there are still barriers to scaling up the CDFI industry; a shortage of capital prevents many from increasing the level of lending and support they can conduct, which restricts growth and subsequently their ability to bring wealth and prosperity to households and communities.

There is still so much more that can be done to support the continued growth of the CDFI sector. With the 2015 General Election just around the corner, a significant window of opportunity is open for the main political parties to commit to renewing their efforts in promoting and supporting the sector.

In May 2014, the CDFA published its manifesto, *Just Finance*, which set out the steps that need to be taken by the next UK government to facilitate the continued growth of the CDFI industry. Its recommendations include:

- **A £150 million fund to capitalise CDFIs so that they can expand, replicate and sustain the community finance sector in the long term;**
- **The Financial Conduct Authority and the Bank of England to take a leadership role in ensuring growth of the non-bank sector, to better meet the needs of those that are financially excluded;**
- **Better quality and more professional systems and standardisations of community finance infrastructure.**

If the next UK government begins to implement these asks then in the years that lie ahead, the CDFI industry will be well placed to flourish even more for the benefit of communities and local economies across the UK.

CDFI participants

Acorn Fund
Adage Credit
ART Business Loans
Big Issue Invest (BII)
BCRS Business Loans
Business Enterprise Fund
Business Finance Solutions
Charity Bank
Community Land and Finance C.I.C.
Co-operative and Community Finance
Coventry and Warwickshire Reinvestment Trust
Croydon Business Venture Limited
DSL Business Finance
East London Small Business Centre
Enterprise Answers
Enterprise Loans East Midlands
Enterprise Northern Ireland
Entrust
EV Business Loans Limited
Fair Finance
Finance for Enterprise
Financing Enterprise Ltd
Five Lamps
Foundation East Ltd
Fredericks Foundation
GLE oneLondon
Goole Development Trust
HBV Enterprise
Impetus
IW Lottery
Key Fund
Lancashire Community Finance
Let's Do Business Finance
MCF Loans (Midlands Community Finance)
Merseyside Special Investment Fund (MSIF)
Moneyline
Moneyline Yorkshire IPS Ltd
My Home Finance Limited
Northern Pinetree Trust
Purple Shoots Business Lending Ltd
Robert Owen Community Banking Fund Ltd
Royal Bank of Scotland Micro Finance Funds
Scotcash C.I.C.
Sirius
Social Investment Scotland
South West Investment Group (SWIG)
Street UK
The Social Enterprise Loan Fund (TSELF)
Third Sector Finance C.I.C.
Triodos Bank
Ulster Community Investment Trust Ltd
WCVA
Wessex Home Improvement Loans
West Yorkshire Enterprise Agency Limited

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APPENDIX

CDFI loan disbursals, by number and value

TOTAL CDFI lending, 2010-2014

	2010	2011	2012	2013	2014
Total number of loans disbursed	19,100	23,100	33,400	50,700	56,200
Total value of loans disbursed	£200m	£191m	£200m	£123m	£173m

Loans to **enterprises: microbusinesses and SMEs**, 2010-2014

	2010	2011	2012	2013	2014
Total number of start up/micro loans disbursed	1,165	1,240	2,318	8,992	12,791
Total number of SME loans disbursed	345	260	290	311	430
Total number of loans disbursed	**1,510**	**1,500**	**2,608**	**9,303**	**13,230**
Total value of start up/micro loans disbursed	£12m	£13m	£17m	£38m	£52m
Total value of SME loans disbursed	£16m	£10m	£13m	£14m	£20m
Total value of loans disbursed	**£28m**	**£23m**	**£30m**	**£52m**	**£72m**

Loans to **social enterprises**, by CDFIs and Social Banks, 2010-2014

	2010	2011	2012	2013	2014
Total number of loans disbursed by CDFIs only	134	123	177	204	261
Total value of loans disbursed by CDFIs only	£5m	£6m	£10m	£13m	£12m
Total number of loans disbursed by social banks	378	269	170	102	109
Total value of loans disbursed by social banks	£148m	£140m	£135m	£35m	£66m
Total number of loans disbursed to social enterprises	**512**	**392**	**347**	**306**	**470**
Total value of loans disbursed to social enterprises	**£153m**	**£146m**	**£145m**	**£48m**	**£78m**

Loans to **individuals**, 2010-2014

	2010	2011	2012	2013	2014
Total number of loans disbursed	15,288	20,652	28,992	40,562	41,938
Total value of loans disbursed	£6.7m	£8.3m	£11.4m	£19.4m	£18.9m

Loans to **homeowners**, 2010-2014

	2010	2011	2012	2013	2014
Total number of loans disbursed	66	516	1,420	541	584
Total value of loans disbursed	£475k	£5m	£13m	£4m	£4.3m

CDFI lending pipeline and conversion rates

Enterprise loan pipeline and conversion rates

	#	Conversion rate	£	Conversion rate
Enquiries for finance	28,350	–	£248m	–
Formal applications	15,896	56%	£135m	54%
Total loans approved	13,230	83%	£72m	53%
Total loans disbursed	13,230	100%	£72m	100%

Social Enterprise loan pipeline and conversion rates

	#	Conversion rate	£	Conversion rate
Enquiries for finance	2,022	-	£465.2m	-
Formal applications	649	32%	£121.8m	26%
Total loans approved	432	67%	£82.3m	68%
Total loans disbursed	370	86%	£78.4	95%

Personal loan pipeline and conversion rates

	#	Conversion rate	£	Conversion rate
Enquiries for finance	86,913	-	£43.8m	-
Formal applications	63,206	73%	£34.1m	78%
Total loans approved	41,938	66%	£18.9m	55%
Total loans disbursed	41,938	100%	£18.9m	100%

Home improvement loan pipeline and conversion rates

	#	Conversion rate	£	Conversion rate
Enquiries for finance	1,128	-	£6.4m	-
Formal applications	677	60%	£4.7m	74%
Total loans approved	625	92%	£4.5m	93%
Total loans disbursed	584	93%	£4.3m	95%

CDFI loan characteristics

Loan size, interest rate and term

	Average loan size	Average term	Interest rate (APR)
Enterprise	£5,400	3.5 years	13%
Existing Micro	£21,600	3.5 years	14%
Existing SME	£46,900	3.5 years	14%
Start Up Loans (SUL)	£5,700	3.5 years	6%
New Enterprise Allowance (NEA)	£1,200	3 years	12%
Social Enterprise	£211,800	5.5 years	8%
CDFI loan	£46,000	5.5 years	8%
Social Bank loan	£609,000	N/A	N/A
Personal	£450	11 months	67%
Home Improvement	£7,300	6 years	8%

CDFI Security (secured against property or assets, or using a loan guarantee scheme such as Enterprise Finance Guarantee or European Investment Fund guarantee)

	Loans secured by number	Loans secured by value
Enterprise		
Existing Micro/SME	25%	34%
SUL/NEA	0%	0%
Social Enterprise		
CDFI loan	25%	61%
Social Bank loan	94%	99%
Personal	0%	0%
Home Improvement	68%	77%

CDFI referrals

Source of referrals for **enterprise** lending CDFIs

Job Centre Plus	55%
Own marketing activities	20%
Start Up Loans Company	13%
Other	3%
Banks	3%
Enterprise Agencies	2%
Accountants	1%
Brokers	1%
Informal referrals (family/friends etc)	1%
Chambers of Commerce	1%

Source of referrals for **social enterprise** lending CDFIs

Own marketing activities	55%
Other (including accountants)	29%
Social enterprise support organisations	9%
Informal referrals (family/friends etc)	7%
Banks	2%

Source of referrals for **personal enterprise** lending CDFIs

Own marketing activities	71%
Informal referrals (family/friends)	16%
Housing Associations	7%
Local Authorities	6%

Source of referrals for **home improvement** lending CDFIs

Local Authorities	72%
Own marketing activities	28%

CDFI funding

Sources of CDFI funding, 2010-2014

Source	2010	2011	2012	2013	2014
Central Government	56%	18%	7%	26%	44%
Banks	13%	22%	10%	10%	20%
Other (including individual investors)	2%	10%	16%	20%	14%
European Union	24%	8%	38%	11%	13%
Local Government	4%	33%	24%	14%	7%
Trusts/Foundations	1%	10%	6%	1%	1%
Social Investors	0%	0%	0%	11%	1%
Housing Associations	0%	0%	0%	7%	0%
Total received in the year	£32.6m	£28.3m	£15.8m	£42.3m	£59.4m

Earned and other income, 2010-2014

	Earned income – interest and fees from lending	Earned income – income and fees from managing funds	Earned income – other	Other income (revenue and capital grants, donations)
2010	£9m	£6m	£6m	£9m
2011	£14m	£2m	£8m	£7m
2012	£13m	£2m	£17m	£8m
2013	£15m	£5m	£7m	£7m
2014	£17m	£7m	£8m	£7m

Portfolio performance by market, 2012-2014

	2012	2013	2014
Micro & SME			
PAR	19.2%	20.4%	7.7%
Write-offs	14.3%	7.6%	4.7%
Social Enterprise			
PAR	5.5%	1.4%	2.8%
Write-offs	0.9%	0.6%	2.6%
Personal			
PAR	18.4%	12.0%	17.8%
Write-offs	6.0%	7.7%	11.2%
Home Improvement			
PAR	0.1%	0.2%	0.6%
Write-offs	<0.1%	<0.1%	0.1%

CDFI lending outcomes

Enterprise lending outcomes

Number of businesses created	11,482
Number of businesses safeguarded	641
Jobs created (FTE)	15,146
Jobs safeguarded (FTE)	3,701
Business clients mentored	8,759
Business clients trained	6,812
Increase in clients' turnover	£66m
Funds leveraged from other providers	£40m

Social enterprise lending outcomes

Number of social enterprises created	38
Number of social enterprises safeguarded	339
Jobs created (FTE)	346
Jobs safeguarded (FTE)	1,794

Personal lending outcomes

Number of clients helped to open a bank account	4,186
Number of clients given financial capability support/advice	8,096

Home improvement lending outcomes

Number of homes brought up to a decent standard	304
Number of clients able to stay in their homes	432

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