2013

INSIDE COMMUNITY FINANCE

THE CDFI INDUSTRY IN THE UK

cdfa

Supported by unitytrust bank

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 disadvantaged and underserved communities, bringing wealth, well-being 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 Unity Trust bank

Unity Trust Bank is a specialist bank for organisations in the social economy providing day-to-day banking and much needed affordable finance to civil society organisations including CDFIs across the UK. We were founded thirty years ago on strong principles of social responsibility and with a commitment to developing a fairer society. We promote a socially responsible and sustainable approach to banking and lending, and aim to create positive social change through our business activity. Because of this, we take a 'double bottom line' approach to business, which sees socially focussed values and social impact form a key part of our offering alongside financial returns. We achieve this social return by investing in organisations that in turn help their communities prosper and grow through creating jobs, services and living spaces. As well as this, we operate our business in a socially responsible way. We are a Living Wage accredited employer, ensuring we pay all of our staff a fair wage for their work – the first British bank to achieve that recognition.

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About this publication

Inside Community Finance is based on a survey conducted by the CDFA, which was completed by 52 CDFIs. The reporting period was 1st April 2012 – 31st March 2013. The survey has been conducted annually since 2003, and was previously known as *Inside Out*.

This report was written by Sam Collin with contributions from Theodora Hadjimichael, Ben Hughes and Sean Dennis.

Acknowledgements

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This publication is available for download from www.cdfa.org.uk
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Contents

Forewords

Financial Secretary to the Treasury

2013 has seen welcome signs that the economy is growing, the deficit is falling and jobs are being created. Initiatives like the Funding for Lending scheme have helped to ease credit conditions.

However, there is still work to be done. For many ambitious businesses access to credit can still be hard to come by and I am determined to see this barrier to growth removed. That is why I am pleased that community finance initiatives are playing an increasingly important role in the UK's economic recovery, particularly in areas less well served by mainstream providers.

It is clear that CDFI services are being used as never before – business lending to SMEs was up almost 75% in 2013. Crucially, more and more businesses are now aware of these providers, who are ready and willing to invest in local enterprises. All of this is testament to the Community Finance industry's development and the increasing quality and breadth of services offered by the sector.

Last year, CDFIs funded 9,300 businesses, 8,400 of which were new businesses. This funding created over 11,700 jobs, many in areas with slower performing economies. This is an impressive achievement that will have real impact within those communities for years to come.

The CDFA's blended funding, which combines Regional Growth Fund, Start Up Loan and New Enterprise Allowance funding, is a real strength. It provides CDFIs with the flexibility to meet the varying needs of local businesses. I welcome the industry's efforts to bring about closer cooperation with the banking sector. In particular, I am pleased to see the progress of the bank to CDFI referral scheme (on which the CDFA works together with the British Bankers' Association) as well as innovative co-financing arrangements that enable banks to align their services with the CDFI sector to maximise the contribution of local enterprise to growing the nation's economy.

As you can see the CDFA has had another strong year, and I hope it will use 2013 as a platform for further growth and continue to make a valuable contribution to the UK economy.

Sajid Javid MP

Unity Trust Bank

Unity Trust Bank is a unique social bank, providing specialist banking services to civil society and not for profit organisations. Now in our third year of sponsorship of *Inside Community Finance*, we are pleased to champion the work of CDFIs, which make a substantial impact on communities nationwide.

The impact of CDFIs is growing and reaching more lives across our communities. CDFIs are making more loans than ever, and the number of loans to businesses has soared in 2013. The expertise and ability of CDFIs in reaching the most financially deprived areas and individuals in the UK is unmatched, and they are truly playing their part in boosting the UK economy and along with it the job market and the prospects for our communities. We proudly remain the largest provider of wholesale loan finance to CDFIs, having lent almost £15m to CDFIs since 2002, with a further £7m committed, both as part of the Regional Growth Fund programme and outside of this. We have established close working relationships with CDFIs across the country and lend to them in order to support the delivery of vital finance to businesses, civil society organisations and households across the UK thereby creating and maintaining employment and stimulating local economies.

Peter Kelly
Business Development and Marketing Director

Introduction: From sector to industry

Ben Hughes

2013 saw finance – and banking in particular – shift from holding the dubious accolade of no.1 broadsheet hate topic, to being a, if not the, headline theme for policy makers and general public alike. Lack of credit, mis-selling of finance products, spiralling interest rates, inappropriate regulation, lack of competition, the role of the state in banking, payday lending: we had them all.

Why? Because it's the foundation on which lives are built; Finance, and the flow of funds this should create, is the lifeblood of any nation's economy, shaping the way society runs itself. Hence it can be viewed as a litmus test for the nation's well-being.

So given this, we didn't do too well in 2013. We saw the rapid growth of payday lending, growing variance in the nation's economic performance (virtual stagnation in the North West and East vs. the housing fuelled boom of the South East) and the depressingly familiar lack of access to even basic finance, evidenced by the two million adults that remain unbanked.

Compounding what is an industry wide failure to meet the needs of underserved communities, a recent Nottingham University study revealed that underserved communities have also been hardest hit by bank branch closures. Access is about both the funds (and consequent lack of opportunity and growth), and the means by which to access them – a toxic combination that's blighting communities and the enterprises so key to their functionality.

Yet the extremes of this *have* mobilised the seeds of change. As highlighted in this publication, a 257% annual increase in CDFI lending to small business is evidence of a rapidly growing market, helped by governments introduction of Start Up Loans and expansion of RGF and NEA; the FCA's recent proposals to limit the high cost credit industry; public disclosure of mainstream bank lending data and of course the emergence of challenger banks – all are positive developments.

Welcome, yes. But not quite enough.

We need a viable, nationwide network of outlets able to meet the finance needs of these underserved markets. In short, a community-style banking model, built on principles of serving people rather than to make profit, but equally that are viable, professional and sustainable businesses.

CDFIs are the corner stone to this new financial services model. With flexibility to raise capital from a broad range of investors, they have great potential to scale and be part of the ethical, 'high street' finance outlet society wants. In short, to move from being a sector to an industry.

Ben Hughes
Chief Executive, CDFA

KEY FINDINGS
CDFI lending activity and outcomes

IN 2013*…

CDFIs LENDING TO **BUSINESSES** …

LENT £**52**m
TO **9,300**
BUSINESSES

CREATING **8,400**
NEW BUSINESSES

CREATING AND
PROTECTING
15,000 JOBS

REACHING
257% MORE
CUSTOMERS

CDFIs LENDING TO **INDIVIDUALS** …

LENT £**19**m
TO **40,600**
INDIVIDUALS

SAVING **29,000**
PEOPLE FROM HIGH-
COST LENDERS

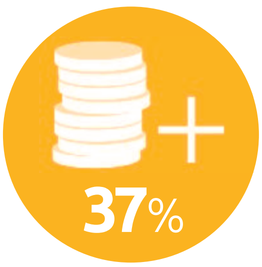
SAVING £**7.8**m
IN INTEREST
REPAYMENTS

REACHING
40% MORE
CUSTOMERS

CDFIs LENDING TO **SOCIAL VENTURES** …

LENT £**13**m
TO **204** SOCIAL
VENTURES

CREATING AND
PROTECTING
1,900 JOBS



INCREASING
LENDING
BY **37**%

*For the period 1 April 2012 – 31 March 2013

SOCIAL BANKS LENDING TO **SOCIAL VENTURES** ...

LENT £**35**m
TO **102** SOCIAL
VENTURES

CDFIs LENDING TO **HOMEOWNERS** ...

LENT £**4**m
TO **540**
HOMEOWNERS

ENABLING **531**
PEOPLE TO STAY
IN THEIR OWN
HOMES

ALL CDFIs...

LENT £**123**m

TO **50,700**
CUSTOMERS

CREATING AND
PROTECTING
17,000 JOBS

REACHING
52% MORE
CUSTOMERS

CHAPTER 1 CDFIs IN THE UK

What are CDFIs?

Community Development Finance Institutions (CDFIs) lend money to businesses and people who struggle to get finance from high street banks. They are social enterprises that invest in customers and communities, providing fair and affordable finance.

CDFIs create jobs and help businesses to start and grow. They help people to pay bills, meet unexpected expenses or improve their home. They help people who may otherwise use high cost credit, such as payday lenders. They often provide support as well as finance, giving extra help and advice where it's needed. They are about people. They get to know their customers; they help viable enterprises and people who can afford to repay.

CDFIs support customers in all regions of the UK. Each CDFI is unique, serving local needs. The fair and affordable finance provided by CDFIs is also known as community finance.

Why are CDFIs needed?

Everyone – every family, every small business, every social enterprise – in every community across the entire UK deserves access to affordable credit.

Without access to fair credit, many businesses would not be able to start, survive or grow, jobs would not be created or saved, social enterprises would not be able to deliver services to their local communities, families would turn to high-cost credit companies or go without basics, and cash-poor homeowners would be living in substandard conditions.

Mainstream banks have reduced their presence on the high street. They have become more risk averse, focused on consolidating balance sheets to comply with new regulations, and this has created gaps in the financial services market.

New players such as crowdfunders and challenger banks have emerged to fill some of the gaps, and work in underserved markets. The most notable growth has happened in the payday lending industry, providing high-cost, short-term consumer loans. Their services are in demand, but the consequences of irresponsible lending practices have prompted widespread concern.

There remains a big gap in the market for affordable, fair credit. Research conducted by GHK estimated that current potential annual demand for community finance is up to £6.75 billion[1].

All CDFIs provide loans as a core service. Many have also diversified into other forms of finance; it is common for CDFIs to provide mentoring, advice and training in addition to finance to give that extra support when it is needed. As a result of these services, thousands of jobs are being created, thousands of businesses are supported and tens of thousands of families are helped with affordable credit, but the CDFI model can do far more. Potential economic and social benefits are being lost to the UK economy and society.

[1]ICF GHK (2013) Mind the Finance Gap: Evidencing demand for community finance

CDFIs in the UK

In 2013:

- CDFIs served 52% more customers than in 2012, disbursing 50,700 loans totalling £123 million
- Business lending grew by record amounts – lending increased by 72% and 257% more business customers were supported
- Personal lending grew by 70% and over 40,000 people were helped
- CDFIs delivered outcomes for government entrepreneurship and growth programmes, creating and safeguarding 17,000 jobs
- CDFIs earned more income from lending activities than ever before

CDFI customer markets

CDFIs provide finance to customers underserved by mainstream institutions in the following four markets, each of which are addressed in subsequent chapters of this report:

Businesses
Almost three-quarters of CDFIs (37) served businesses *(sole traders, microenterprises and SMEs)*

Social ventures
Almost one-third of CDFIs (16) served social ventures *(social enterprises, charities and voluntary sector organisations)*

Individuals
Almost one-fifth of CDFIs (10) served financially excluded individuals

Homeowners
Fifteen per cent of CDFIs (8) provided home improvement finance to *cash-poor* homeowners

The majority of CDFIs specialise in lending to one market, however it has become increasingly common for personal lenders to also serve the business market. This shift is partly explained by the personal lenders who are helping individuals set up in business – particularly through the Start Up Loans (SUL) programme and New Enterprise Allowance (NEA).

Inside Community Finance

In 2013 there were 53 CDFIs operating in the UK, as measured by the CDFA's membership. They operated from 125 branches and employed more than 670 staff.

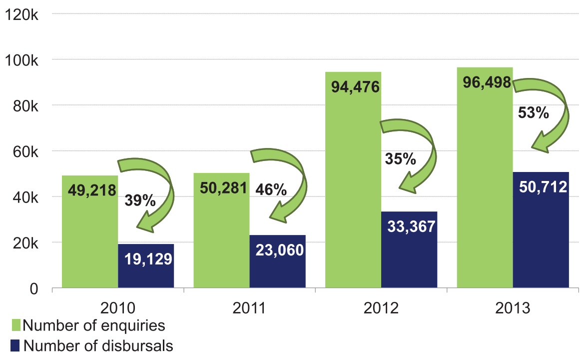
This report is based on the findings of the CDFA's annual survey of members. We have traditionally included social banks in the survey as they, along with other CDFIs, provide finance to the social venture sector. However, as evidenced by continuous growth, CDFIs are establishing a distinct sector within 'alternative finance'. Therefore, we have decided to distinguish between CDFI and social bank lending, as they operate differently, with distinct structures, regulation, models and target markets.

Lending activity

Lending demand

Demand for community finance continued to rise in 2013. CDFIs received more than 96,000 enquiries from potential customers seeking £811m of finance. CDFIs went on to receive 64,000 applications, and 50,700 (87%) of these resulted in a loan being made.

1.1 Enquiries and disbursals, **by number,** 2010-13



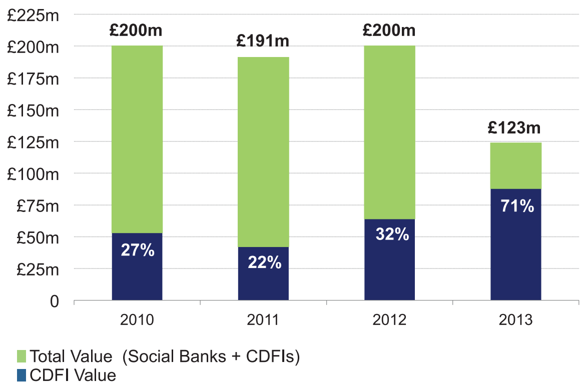
Loans disbursed

In 2013, CDFIs made over 50,700 loans, more than ever before. There has been huge growth in personal and business lending, which resulted in a 52% increase in the number of customers served compared with 2012.

The launch of the Regional Growth Fund (RGF) and SUL programmes in 2013 helped to boost CDFI lending to record levels. As these programmes expand in 2014, CDFIs are anticipated to continue this strong performance.

The overall value of loans made fell in 2013 – to £123m. This drop can be attributed to a decrease in social bank lending, due to restructuring in the sector. Social banks have traditionally made a small number of high value loans. When social bank lending and other time-limited investments are excluded from lending figures, it reveals a very different picture of CDFI activity, targeted at local communities and disadvantaged markets. CDFIs (excluding social banks) made 50,600 loans (99.8% of the total) valued at £88m (71% of the total). The value of loans made by this group of CDFIs increased by 37% from 2012.

1.2 Annual lending **by value,** 2010 – 2013



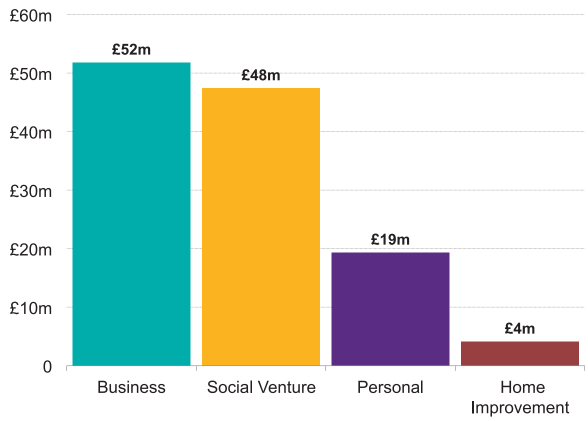
Loans disbursed by market

Of the 50,700 loans disbursed in 2013, the vast majority (80%) went to individuals in the form of personal loans, 18% went to businesses (up from 8% in 2012), 1% went to homeowners, and 1% went to social ventures.

But in terms of loan value, the picture is quite different. The biggest share in terms of value is now for business lending, which accounted for 42% of lending (up from 15% in 2012); 39% went to social ventures (down from 73% in 2012).

The average loan sizes reveal the very distinctive nature of each of the markets that CDFIs serve. For business lending, the average loan size is about £5,500, as many of the SUL and NEA loans are made to start ups, for which the loan size tends to be smaller. Social Venture lending is typically done in larger amounts (the average is £157,000). The personal loans tend to be high volume, low value loans, averaging £478. The average home improvement loan was £7,700.

1.3 Loans disbursed by market, **by value,** 2013



Capital for on-lending

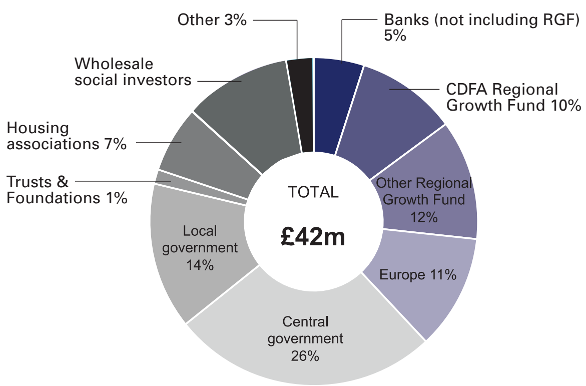
Capital received to on-lend

CDFIs secured £42.3m in capital for on-lending in 2013, a huge increase from the 2012 figure of £16m. Capital is received in the form of loans, investment and in some cases grants, and CDFIs also manage capital on behalf of third parties. It is needed to replenish and build capital funds, to expand services and enable CDFIs to move towards complete self-sufficiency.

Greater diversification of income streams was a key driver in this increase. Business lenders received three-quarters of this capital; these lenders have been able to take advantage of government funding programmes.

Government funds account for half of capital received. The CDFA's RGF programme also accounts for some of the growth in new capital. The programme disbursed funding throughout 2013 and is expected to continue to be a big contributor to CDFIs' capital to on-lend next year and beyond.

1.4 Capital received to on-lend, 2013



CITR investment

Community Investment Tax Relief (CITR) provides a tax incentive to those who invest in accredited CDFIs. Investments may be in the form of loans, equity investment (either shares or securities) or deposits (for those few CDFIs that are banks). Investment raised is then on-lent by the CDFIs to qualifying enterprises in designated deprived communities.

CITR is available to any individual or company with a UK tax liability investing in an accredited CDFI, where the investment is held for at least five years. The taxpayer receives a relief to offset against their tax liability of 5% of the amount invested per annum, in addition to any interest or dividend paid by the CDFI.

In 2013, 21 CDFIs were accredited to use CITR, up from 15 in 2012. However, of these only six reported that they had raised capital using CITR in the year. They raised a total of £2.3m which represents a large drop from the £15.5m of 2007. However, CITR continues to be an important tool in raising capital, and this trend is expected to be reversed in future years due to the CDFA's RGF programme which will enable more CDFIs to take advantage of Unity Trust Bank's CITR scheme.

In 2014, the government will launch the Social Investment Tax Relief (SITR). This tax relief scheme is more flexible than CITR, both debt and equity investments in organisations with socially-focused missions will qualify for the relief. While SITR will certainly benefit CDFIs, reform of CITR is still necessary to incentivise greater private investment in communities.

Capital funds available

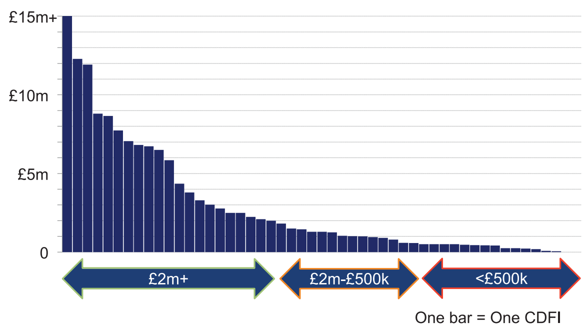
As of 31st March 2013, CDFIs had £181m available for on-lending. Thirty-six per cent of this (£65m) was managed funds, such as the SUL and NEA programmes, and the remainder was CDFIs' own funds. The amount of capital available to each CDFI varies; if one atypical CDFI is removed, the average capital available to on-lend is £2.7m.

The total capital funds held by CDFIs has almost doubled since 2012, when £96.5m was held. Even though there was previously a similarly large variation in capital fund size, there has been a shift this year and the average loan fund size has increased by £0.8m. A major reason for this, again, is CDFIs' successful delivery of programmes such as NEA and SUL funds which came on stream during the year.

Almost half of the capital was held by social venture lenders, and a further 40% was held by business lenders. The picture is therefore not quite so healthy for personal and home improvement lenders, which are in need of more capital.

The ten largest CDFIs account for 70% of the available capital, whilst the ten smallest account for just 2%. This indicates there is a sub-set of CDFIs able to operate at large scale, in contrast to small CDFIs operating at the local level, providing community-based services. Both models are important to meet the finance gap.

1.5 Capital available to on-lend
(own and managed funds), as at 31st March 2013



CDFI income

Not only do CDFIs require capital to lend to underserved markets, like any business, they also require revenue to cover operational costs. This comprises both earned income and grant and investment income received from third parties.

The CDFI model does not lend itself to profiteering, and many CDFIs, driven by their social mission to serve those who cannot access fair finance elsewhere and who may need additional support or advice as well as finance, cannot always cover all their costs through earned income.

CDFIs' missions, and the considerable social impacts that they achieve through their lending and enterprise support are aligned with the objectives of many public and charitable agencies. Many CDFIs are successful at securing funding from external sources in the form of grants, donations and investments.

Grant and investment income is crucial for the operation of CDFIs, as well as providing the capacity for CDFI Research & Development, organisational development, and innovations in CDFI infrastructure. Increased grant and investment income will enable the sector to build the infrastructure, models and capacity needed to scale, extend reach and achieve profitability more rapidly.

Grant and investment income

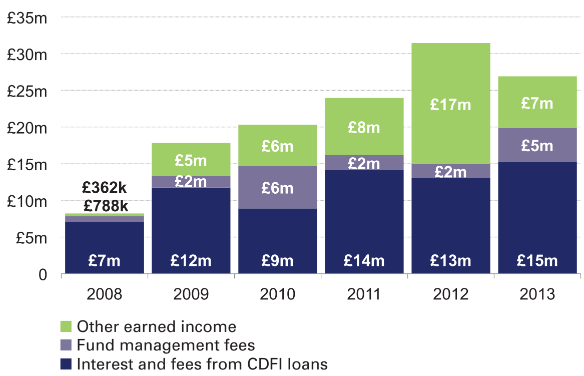
In 2013, CDFIs received £6.9m to cover operational costs – less than the £7.5m received in 2012. Public sources accounted for 81% of this – a similar level to the previous year – although central government provided more than previously at £2.9m, and the EU provided less than in 2012. Trusts and foundations provided £316,000 and banks provided £180,000.

Earned income

In 2013, CDFIs generated earned income of £27m. This represents 80% of total income and demonstrates CDFIs' increasing reliance on generating their own funds. Seventy-four per cent of earned income was generated through lending activities. £15m came from interest and fees charged on CDFI loans and £5m came from managed loan services (such as NEA and SUL). Although the total earned income is down slightly from the £31m of 2012, the amount received for core lending activities was the highest ever. The increase in income from core lending activities indicates that the CDFI sector is becoming more operationally sustainable, and is better placed to attract future commercial investment.

Other income in 2013 came from services such as training, mentoring and money management as well as interest earned on invested capital.

1.6 Annual earned income 2008-13



CDFI self-sufficiency

Comparing CDFI costs with earned income provides insight into commercial self-sufficiency. Operational self-sufficiency takes account of the entire organisation's activities in addition to the loan fund function. Thirty-one per cent of CDFIs were self-sufficient, and a further 21% covered 90% of costs. Those unable to cover costs completely through earned income use grants, reserves and other investments to cover the difference.

These figures are consistent with trends within the sector towards scale and sustainability, but also illustrate the continued need for additional income sources to cover operating costs.

Emerging developments in community finance

While the community finance sector saw some volatility in 2013, overall the trends indicate that demand is continuing to increase. CDFIs in some markets have more capacity to lend than others and there have been major areas of growth. Large managed loan funds contributed to the increase in business lending. These funds are set to grow, and if funding is also made available for other lenders (particularly personal lenders) increased delivery to underserved markets will continue in the future.

Additional developments in the CDFI sector will also provide increased capacity, potentially impacting loan delivery as well as organisational sustainability.

- CDFA and British Bankers' Association Loan Referral Scheme
- On-going development of a CDFI accreditation system
- Introduction of common CDFI Impact metrics and an economic modelling tool

CASE STUDY

The value of investment

Unity Trust Bank provides loan funding to organisations across the social economy including CDFIs, and remains the largest provider of wholesale loan finance to CDFIs.

Unity has recently increased its lending across the social economy with a lending commitment of £100m over three years. In 2013, Unity made loan commitments of nearly £7.8m to 16 different CDFIs, leveraging £10.9m additional funding as part of the CDFA RGF match-funding programme.

One of the CDFIs supported by Unity is BCRS Business Loans.

BCRS supports local SMEs that struggle to obtain finance from mainstream sources, but which make a real contribution to the economy of the West Midlands. Walsall Community Transport is one of those organisations. The community enterprise received a loan of £40,000 from BCRS to help with cash flow to secure contracts for the future, thereby sustaining jobs and achieving stability to enable the organisation to continue to offer a sustainable local service. Unity has supported BCRS for over five years, and in 2013 lent BCRS £836,000 with a further £909,000 committed.

Walsall Community Transport provides minibuses for voluntary and community groups throughout the Walsall area, and has been supported by BCRS

Another CDFI supported by Unity is Key Fund – also a social enterprise – specialising in investment in social enterprises that help boost the social and economic wellbeing of communities across the North of England. Unity committed £1.25m to lend to Key Fund in 2013, both as part of the RGF programme and to meet funding gaps between European Regional Development Fund contracts.

Ability Tec is one of the many social enterprises that has benefitted from the financial support of Key Fund. Once a Remploy site in Bolton, Ability Tec was closed down in August 2012 as a result of government cuts. As part of a rescue plan to save the circuit board factory which focuses on employing disabled people, Key Fund invested £50,000 into the venture which will sustain 30 jobs over the next three years.

Unity's continued support for the sector will help more CDFIs to enable social change in communities in the years ahead.

CHAPTER 2

COMMUNITY FINANCE FOR BUSINESSES

CDFIs fill a market gap by providing finance tailored to the needs of businesses unable to access mainstream finance, often in deprived areas or owned by entrepreneurs from disadvantaged communities

"A lack of access to finance is still choking off too many small businesses, preventing them from growing, taking on new staff or investing in new equipment."
Business Secretary Vince Cable, March 2013

Why do businesses need community finance?

Small businesses are major drivers of economic growth through the creation of jobs, wealth, and private investment. SMEs in the UK account for 99% of the private sector, 60% of private sector employment and nearly 50% of its turnover[2].

Access to finance for business start up, investment and expansion is essential for sustainable economic growth. Many micro, small and medium sized enterprises access finance from banks and other commercial investors, but there is still a significant funding gap in the business lending market. Recent results from the Federation of Small Businesses' (FSB) quarterly survey indicate that half of the firms that apply for finance are declined[3]. The British Chambers of Commerce reports that SME confidence in their ability to secure finance dropped between 2012 and 2013, and nearly one third of SMEs cited access to finance as a major barrier to their continued operation[4]. This issue affects both viable businesses unable to access the finance they require as well as entrepreneurs who are unable to raise finance for their start up plans.

Since the financial crisis, banks have been more risk averse and are now subject to new financial regulations requiring that they hold more capital liquidity and reserves. As a result, banks are not able to offer services to many microenterprises and sole traders, which often seek small scale loans and may not have a track record or credit history. CDFIs exist to fill this gap and help small, viable businesses to start and grow. Whilst possibly not as profitable as the larger, more secure SME market, lending to this market is still a viable investment proposition and crucially provides important economic, social and community benefits.

Many CDFIs were initially established to lend to deprived communities and businesses owned by entrepreneurs from disadvantaged groups. As the sector has evolved, it is now common for CDFIs to serve all communities that are unable to access mainstream finance. This includes start ups, social ventures, sole traders, informal and unincorporated ventures, microenterprises (employing fewer than ten staff) and, more recently, SMEs.

By extending access to finance to these hard to reach or underserved businesses, CDFIs are supporting local economic growth. Many of the businesses to which CDFIs lend provide important goods and services to the local market, filling a need that would otherwise go unmet. New and growing businesses not only create jobs and occupy property, but also reinvest in the community and boost the local supply chain.

In 2013, 39 CDFIs provided finance to businesses. This chapter focuses on the 35 CDFIs that specialise in business lending as their primary market.

[2] FSB Small Business Statistics 2013
[3] FSB Voice of Small Business Index Q3 2013
[4] British Chambers of Commerce SME Finance Monitor for Q1 2013

Impacts of CDFI business lending

IN 2013* CDFIs...

LENT £**52**m

TO **9,303** BUSINESS CUSTOMERS

THEREBY HELPING TO...

CREATE **8,357** NEW BUSINESSES

SAFEGUARD **480** BUSINESSES FROM DECLINE OR FAILURE

CREATE **11,700** NEW JOBS

SAFEGUARD **3,420** JOBS

ENABLE BUSINESSES TO LEVERAGE AN ADDITIONAL £**33**m OF FINANCE FROM BANKS

*For the period 1 April 2012 – 31 March 2013

CDFIs serving businesses

In 2013:

- CDFIs lent a record amount of money to a record number of businesses
- CDFIs served three and a half times more customers than in 2012 – helping 9,303 businesses
- The value of loans made jumped 72% from 2012, to £52m
- The number of businesses seeking finance more than doubled in the space of a year
- CDFIs helped to create over 8,300 new businesses – demonstrating their value as a major delivery system for government entrepreneurship schemes, such as start Up Loans and New Enterprise Allowance

Lending activity

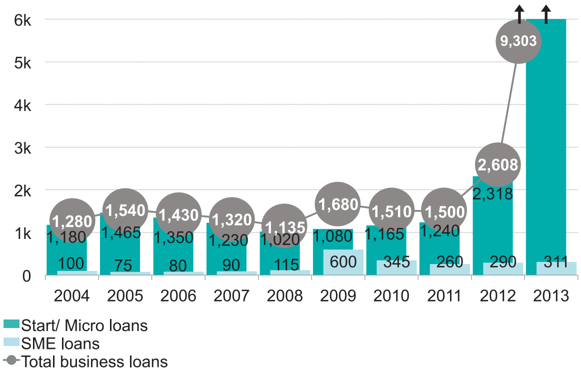
Loans disbursed

There has been huge growth in business lending in 2013. The year saw the highest level of lending since reporting began in 2004.

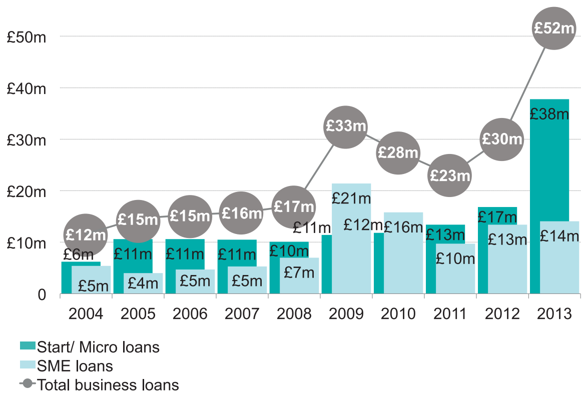
9,303 business loans were made by CDFIs – over 3.5 times as many as the 2,608 made in 2012. The value of loans made increased from £30.2m in 2012 to £51.8m in 2013.

The value of business loans made by individual CDFIs varied from £55,000 to £8.7m. Seventeen CDFIs made business loans totalling more than £1m in 2013, compared to just seven CDFIs doing so in the previous year. In 2012 the largest business lender made 543 loans, whilst in 2013 four CDFIs made more than 1,000 business loans, which indicates that some CDFIs are beginning to operate at a much larger scale.

2.1 Business loans disbursed, 2004-13, **by number**



2.2 Business loans disbursed, 2004-13, **by value**



Business size

Eighty-two per cent of business loans (7,584 loans) were made through the New Enterprise Allowance (NEA) and Start Up Loans (SUL) programmes to sole traders (one employee) and microenterprises (up to nine employees). These government programmes account for the notable growth in CDFI lending in 2013. This demonstrates the value of CDFIs as delivery agents for entrepreneurship programmes; they already have the skills, infrastructure and reach to deliver these schemes and can act as the drivers for economic growth that the government is looking for. This works only if the right mix of government-backed capital is made available, which offers flexibility, first loss cover and recognition of the higher risks associated with this market.

Lending demand

Business lending CDFIs received over 28,200 enquiries for loans worth £256.5m in 2013. The number of enquiries has more than doubled since 2012, when 12,900 enquiries were received. This surge in enquiries suggests that awareness of CDFIs is growing, and that there remains thousands of entrepreneurs and business owners unable to secure finance elsewhere.

New Enterprise Allowance

The NEA programme provides support for those out of work for six months or more who want to start their own business. As part of this programme, participants meet regularly with a volunteer business mentor to develop their business idea and create a business plan, and are given a weekly allowance and a loan to help with start up costs. The loan was initially capped at £1,000 but was recently increased to £2,500. Ten CDFIs act as loan providers for the scheme. Between them they helped 5,844 people into self-employment, with loans totalling £5.8m.

Start Up Loans

The SUL programme is a government-backed initiative to help people into business through the provision of a loan and business mentoring. Twenty-one CDFIs act as delivery partners for the scheme – either contracting directly with the Start Up Loans Company or as part of the CDFA's consortium. These CDFIs received 7,218 enquiries for £14m of SUL finance. Between them, they made 1,740 loans, with a total value of £10.5m.

Loans disbursed by region

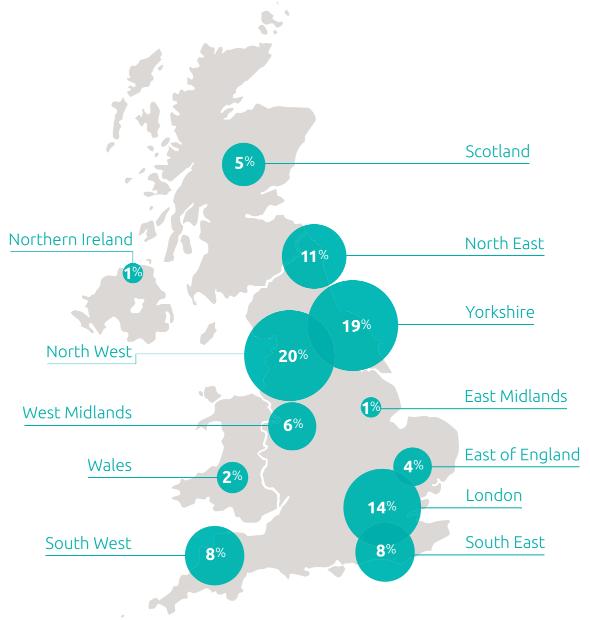
The maps show the proportion of number and value of loans disbursed in 2013 to businesses, by region. As is typical, the spread of coverage of CDFI services is highly variable. The North West and Yorkshire regions were the best served by CDFIs. Both regions have strong CDFIs and between them accounted for almost half of the value of business loans made. Some regions are underserved by CDFIs, with businesses in the East Midlands, Northern Ireland and Wales having weakest provision of CDFI loans.

Business Enterprise Fund

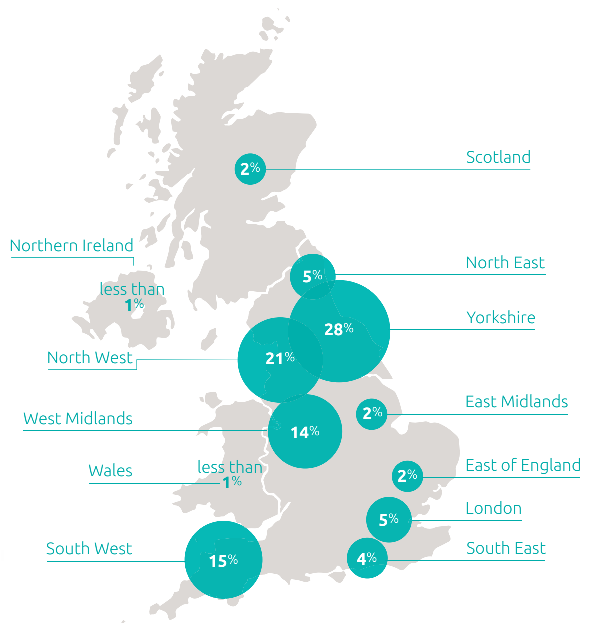
Established in 2004, the Business Enterprise Fund (BEF) supports new and young businesses in West and North Yorkshire with finance when they most need it. It works in some of the most deprived communities in the country. As well as lending money, BEF helps new entrepreneurs by vetting the viability of proposals and refining their business plans, as well as providing continued support throughout the term of the loan.

BEF has made a significant contribution to the increased impact and reach of CDFIs in the Yorkshire and Humber region, as well as helping to grow the community finance sector nationally. It has promoted, supported and attracted funding for other CDFIs in the region, which has led to Yorkshire and Humber being one of the most active CDFI areas in the country. The number of businesses supported in the region grew from 435 in 2011 to 1,374 in 2013. BEF has succeeded in doubling lending year on year for the last 3 years, and was shortlisted for the Citi Microentrepreneurship Awards in 2013 for its impact.

2.3 **Number** of business loans disbursed, by region, **by %,** 2013



2.4 **Value** of business loans disbursed, by region, **by %,** 2013



Business sectors

CDFIs supported a wide variety of business sectors over the year. Twenty-four per cent of business loans supported retail and wholesale businesses, 11% went to creative industries, 11% to construction, 10% to financial and business services and 6% to manufacturing.

Customer referrals

The Jobcentre remained the largest source of client referrals in 2013, accounting for 36% of customers (due to NEA) followed by the Start Up Loans programme which referred 12% of clients. The remainder of customers served were referred from a variety of sources, such as CDFIs' own marketing activity (11%), banks (8%), and accountants (4%).

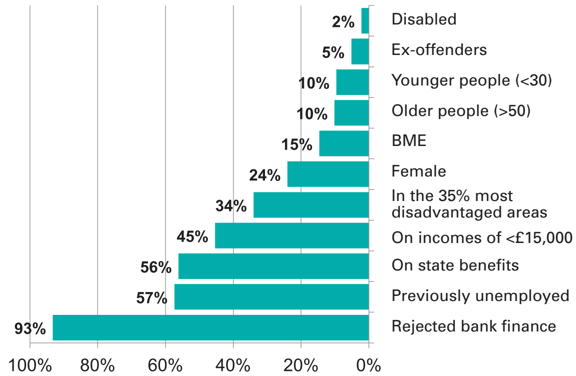
In 2013, the British Bankers' Association and the CDFA launched the CDFA/BBA Referral Scheme, which connects customers who have been declined bank financing with CDFIs. In 2013 there were 120 referrals made from banks to CDFIs. Although still in its infancy, referral schemes such as this are a promising new pathway to providing underserved markets with finance, as well as increasing the awareness of the CDFI sector as a viable source of finance.

Customer attributes

In 2013, 93% of CDFI business loan recipients had been turned down for finance by a bank. Fifty-seven per cent of loan recipients had previously been unemployed. This high proportion is largely explained by the participation of CDFIs in the NEA scheme.

Figure 2.5 shows the wide range of entrepreneurs that CDFIs reach.

2.5 Business customer socio-demographics 2013



Five Lamps

Five Lamps delivers an integrated range of social, economic and financial inclusion services, and is one of the growing number of CDFIs that serves several markets. Five Lamps reaches over 25,000 people each year, the majority of whom live in the most disadvantaged communities in the North East of England and North Yorkshire. The market served by Five Lamps spans financially excluded individuals, families and businesses.

In the coming year, Five Lamps plans to deliver around 15,000 personal loans, 2,000 loans to help unemployed people into self-employment, 250 business loans and 150 home repair loans. In addition, over 1,200 young people will be receiving financial education; over 100 long-term unemployed people will progress into employment; the team will work with 200 families, handle over 3,000 applications, and make 2,000 loans to individuals in crisis, fleeing domestic violence etc. Twenty families will be prevented from repossession of their home; c35 long-term empty properties will be refurbished and brought back into productive use and over 2000 aspiring entrepreneurs will be supported via mentoring and workshop activity. Five Lamps was shortlisted for the Citi Microentrepreneurship Awards in 2013 for its impact.

Loan characteristics

All CDFIs, by definition, provide access to finance as their essential core product, and all provide debt finance in the form of loans. Thirty-five CDFIs offered unsecured loans, 23 also offered secured loans while three offered equity/quasi equity finance and three offered Sharia-compliant products. As CDFIs serve the more risky end of the business market, many also offer additional support, particularly for start up businesses – twenty-three offer business mentoring, and 11 offer training.

Typical CDFI loans

Just as there is no typical small business, there is no 'typical' CDFI. There is much variation depending upon individual CDFIs and their target markets. Overall, the average loan sizes were:

- **Existing microenterprises:** £21,000
- **Start up microenterprises:** £10,500
- **SMEs:** £45,300
- **NEA:** £988
- **SUL:** £6,058

The interest rates charged by business lending CDFIs (excluding managed funds) ranged from 0 to 20%, and the average was 12%. This is consistent with 2012 rates. The interest rates charged on SUL and NEA loans were 6% and 10% respectively. CDFIs' interest rates reflect the cost of assessing and disbursing the loan, including establishing a relationship with the customer.

Many businesses, especially start ups and sole traders, but even established microenterprises, have little or no collateral to secure a loan, decreasing their chances of accessing credit from banks. CDFIs, and the government programmes they participate in, recognise this and many make unsecured loans. In 2013, 93% of business loans were unsecured. Of the remainder, 5% were secured with property and assets and three per cent were secured through the government-backed Enterprise Finance Guarantee scheme. Larger loans to larger businesses are more likely to be secured – in terms of value, 31% of loans were secured with property or assets.

Portfolio quality

CDFIs employ rigorous due diligence processes and will only lend to those deemed capable of repaying the debt. Their target market, however, still carries some risk.

The Portfolio at Risk (PAR) indicator shows the proportion of value of outstanding loans in arrears as at 31 March 2013. For CDFIs' own funds, 18% of total loans outstanding were over 90 days in arrears. Write-offs show the proportion of bad debt declared uncollectable during the period April 2012 to March 2013. Eight per cent of CDFIs' own funds were written off during the year.

Capital for on-lending

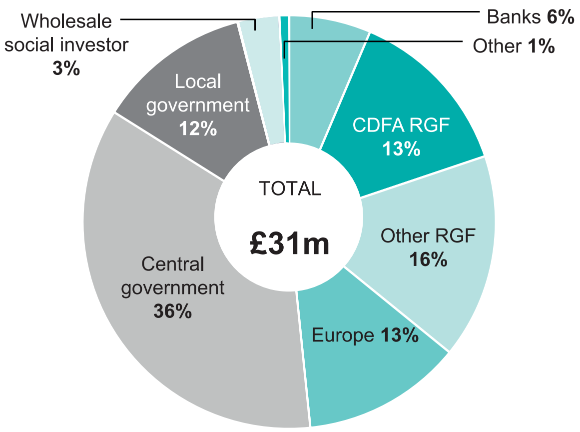
Capital received to on-lend

CDFIs receive capital in the form of loans, investment and in some cases grants. In 2013, business lenders received £31.2m in capital, a much-needed boost from the £9.2m received in 2012, and funding which enabled several CDFIs to recapitalise dwindling funds.

The public sector has always been an important source of funding for CDFIs. The establishment and expansion of government schemes to boost enterprise and economic growth have increased the availability of capital. European, central and local government sources account for 60% of capital received in 2013.

The CDFA's RGF programme – which provides grant funding from the Department for Business, Innovation and Skills (BIS), matched with loans from Unity Trust Bank and Co-operative Bank – was launched in the latter part of the year and contributed 13% of new capital to business lenders. CDFIs also raised 6% of new capital through bank loans outside of the RGF programme. Commercial investors are a growing source of capital for CDFIs. However, as the sector scales up, there is an increasing need for a designated CDFI fund of unrestricted capital, which serves as seed funding, first loss cover, and that can lever significant private sector investment into CDFIs.

2.6 Capital received to on-lend 2013



Capital funds available

Between them, 35 business lending CDFIs had a total of £78m in capital available to on-lend as at 31st March 2013. This is a healthy increase on the £59m held at the same point the previous year. Twenty-three per cent of CDFIs held less than £500,000 – an improvement on the 44% of CDFIs in the same position in 2012 but still worrying for the future impact and viability of a handful of CDFIs.

CDFI income

In 2013, business lending CDFIs raised £22.3m in income to cover operating costs. This was made up of both earned and grant/investment income.

Grant and investment income

In 2013, CDFIs raised £6.3m from third party sources to cover operational costs – compared to £4.7m in 2012. Public sources continue to provide the vast majority of this funding, though this year European sources fell to 24% of the total, central government's contribution grew to 45% and local government contributed 15%. Trusts and foundations contributed 4%.

Local Enterprise Partnerships

After the dissolution of the Regional Development Agencies in 2011, Local Enterprise Partnerships (LEPs) were developed to drive local strategies for economic growth and development. LEPs' focus on enterprise and the local economy is in line with CDFIs' objectives, and therefore there is potential for delivery partnerships between CDFIs and their LEPs.

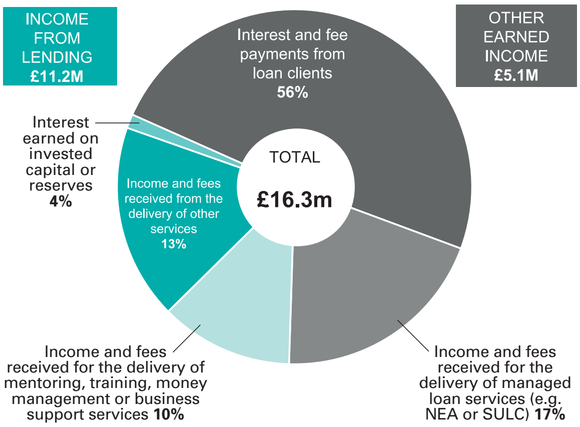
CDFIs' expertise and demonstrated success in investing in local markets can also be leveraged when deploying the 2014-2020 European Structural and Investment Funds (ESIF). CDFIs are uniquely positioned to play a key role in deploying this funding strategically, to stimulate enterprise development in underserved markets, generating local wealth and economic prosperity.

Earned income

CDFIs reported earned income of £16.3m in 2013, which represents 72% of income. This is consistent with 2012 levels of £16.6m, up from £8.6m in 2011.

Income earned from lending activity (charges on customer loans and income from the delivery of managed loan services) accounted for 56% of the total raised – double the 28% of income received from lending in 2012, indicating a re-focusing on the core business of lending and greater sustainability.

2.7 Earned income 2013



CDFI self-sufficiency

In 2013, 12 CDFIs (48% of those who provided data) were able to cover the costs of providing customer loans through income received specifically from their lending activity; a further five CDFIs covered at least 80% of lending costs through income for lending activities.

Many CDFIs also provide other services that earn income which contribute to the overall self-sufficiency of the organisation. If all earned income is compared to total organisational expenditure, 11 CDFIs (39% of those who provided data) were sustainable. The average organisational self-sufficiency ratio was 90%.

These strong levels of self-sufficiency demonstrate the recent shift amongst CDFIs to diversify income streams, making them more robust organisations.

CHAPTER 3

COMMUNITY FINANCE FOR SOCIAL VENTURES

CDFIs fill a market gap by providing finance tailored to the needs of social ventures – charities, the community and voluntary sector and social enterprises – recognised as likely to confront financial exclusion

"Social enterprises, charities and voluntary organisations need access to sustainable finance to develop and flourish."
HM Government Cabinet Office, Building a Stronger Civil Society, October 2010

Why do social ventures need community finance?

The value of social ventures in tackling social issues is gaining greater recognition, and it is a sector that is increasing in numbers, strength and diversity. In the face of this growth, the social venture sector, which includes charities, community and voluntary organisations and social enterprises, needs accessible, appropriate and sustainable sources of finance – now more than ever.

Organisations with social missions have traditionally relied on grants and donations as their primary source of income. However, social ventures report that grant income from statutory sources has flat lined since 2008[5], largely due to public sector cutbacks. Social ventures are experiencing this constraint in funding first-hand, and it is having an impact on their ability to grow. Social enterprises report access to finance as the largest barrier in both starting up and in becoming operationally sustainable[6].

As social ventures become more reliant on contracted and other earned income, they are in a better position to use loans and investment to finance their start up, survival and growth. This transition has been supported by social investment funds, social banks and especially CDFIs.

CDFIs are themselves social ventures. They aim to tackle issues of social exclusion in their communities, and make investments that generate wealth and prosperity in local neighbourhoods. They are well placed to understand the needs of other social ventures and provide the credit, investment and support that are needed.

Recently, public funds such as the Investment and Contract Readiness Fund (ICRF) have focused on making social enterprises more competitive. Funding schemes such as these are a welcome mechanism for building the social venture market; CDFIs are well placed to assist with this development, and with increased capacity and infrastructure, can meet the growing demand for their services.

[5]NCVO (2013) UK Civil Society Almanac
[6]SEUK (2013) State of Social Enterprise Survey

Impacts of social venture lending

IN 2013* CDFIs...

LENT £**48**m

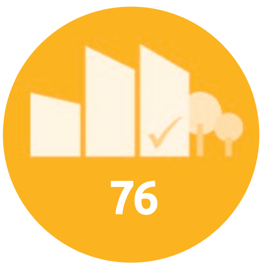
TO **306**
SOCIAL VENTURES

CDFIS (EXCLUDING SOCIAL BANKS) LENT £**13**m TO **204** SOCIAL VENTURES
SOCIAL BANKS LENT £**35**m TO **102** SOCIAL VENTURES

SUPPORTING VENTURES WORKING ON A RANGE OF SOCIAL ISSUES:

- **15%** OF INVESTMENTS IN **ARTS, CULTURE AND HERITAGE**
- **12%** OF INVESTMENTS IN **COMMUNITY DEVELOPMENT**
- **12%** OF INVESTMENTS IN **HOUSING**
- **11%** OF INVESTMENTS IN **EMPLOYMENT SUPPORT AND TRAINING**
- **10%** OF INVESTMENTS IN **SOCIAL CARE**

ENABLING...



76 SOCIAL
VENTURES
TO START

230 SOCIAL
VENTURES TO
SURVIVE AND GROW

CREATING AND
SAFEGUARDING
OVER **1,900** JOBS

*For the period 1 April 2012 – 31 March 2013

CDFIs serving social ventures

In 2013:

- CDFIs (excluding social banks) lent £13m to social ventures, a 37% increase from 2012
- **Banking regulation and developments in the social investment market resulted in social banks undergoing a period of strategic re-positioning. As a result, there was a 74% drop in social bank lending**
- **Ninety-four per cent of the income received by CDFIs to cover operational costs was from their own earned income**

Sixteen CDFIs provided finance to social ventures in 2013. This chapter focuses on the nine CDFIs that specialise in lending to social ventures. Their lending accounted for 96% of the 306 social venture loans made in 2013. Seven business lenders made a very small number of loans to social ventures over the year; their activities are captured in chapter 2.

All social venture lending CDFIs offer loans. Three offer wholesale lending and two offer equity/quasi-equity finance. CDFIs serve the full range of the diverse social venture sector, from small community groups to large capital and asset-based projects.

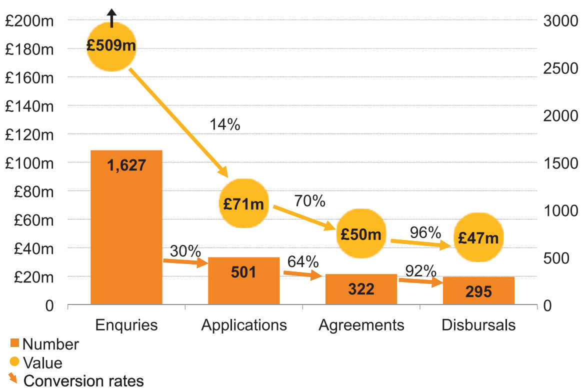
All lenders included in this chapter lend to social ventures and have a social mission. To maintain consistency with previous Inside Community Finance reports, two deposit-taking social banks are included in this chapter. Where possible, we have distinguished between CDFI and Social Bank lending, as they operate differently, with distinct structures, regulation, models and target markets. We have used the term CDFI to cover all social venture lenders, and specified those sections where social banks are excluded from analysis.

Lending activity

Lending demand

In 2013, social venture lending CDFIs received 1,627 enquiries for finance of £509m. Thirty-one per cent of enquiries were converted to applications; 501 applications were received, requesting finance of £71m. Sixty-four per cent of those applicants were successful – broadly equivalent to the 69% of successful applicants in 2012.

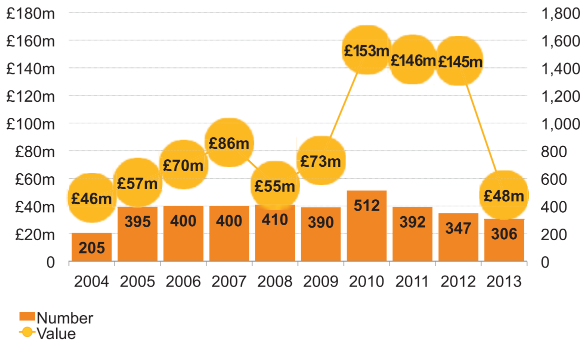
3.1 Social venture loan application pipeline 2013



Loans disbursed

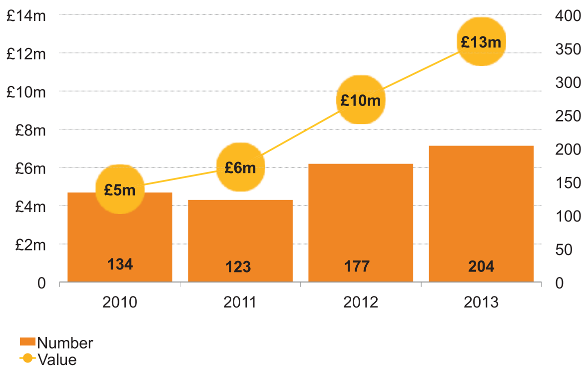
In 2013, CDFIs disbursed 306 loans worth £48m to social ventures. This represents a small decrease (12%) in the number of loans made and a more significant decrease (66%) in terms of value of loans compared to 2012. There has been a temporary decline in the number of very large loans made to social ventures, due to the restructuring within the social bank sector, and it is expected to return to industry averages in 2014.

3.2 Social venture loans disbursed 2004-13



If social banks are removed from the analysis, social venture lenders supported 204 ventures with £13m of loans – a 37% increase in terms of value compared to 2012.

3.3 CDFI social venture loans
(excluding social banks) disbursed 2010-13



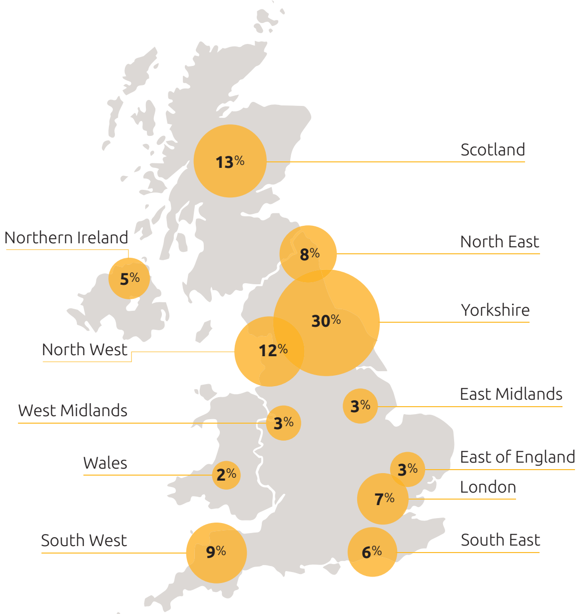
Loans disbursed by region

Serving a sector defined by social mission rather than by the needs of specific communities or localities, social venture lending CDFIs are less location oriented than other CDFIs. Many operate nationally, and others operate at least at a regional scale. The maps show the proportion of number and value of loans disbursed last year to social ventures by region.

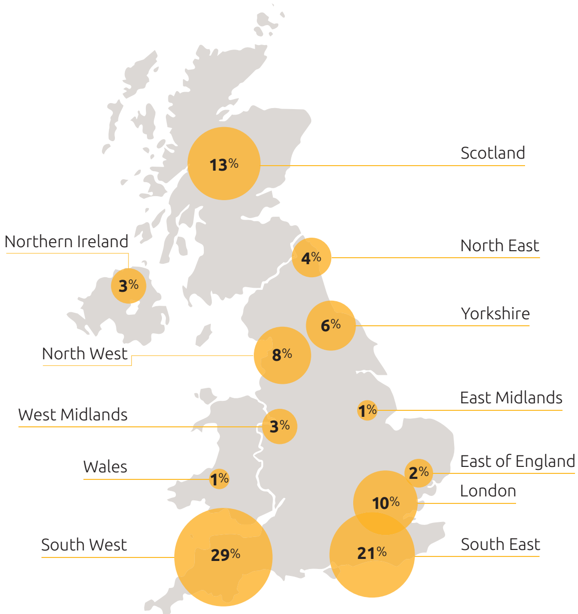
In terms of numbers of loans, the Yorkshire region received the most loans – as it has a CDFI dedicated to helping social ventures in the region, which is building a strong social enterprise sector. Scotland and the North West were also well-served, whilst social ventures in Wales, the East of England, East Midlands and West Midlands received fewer loans.

In terms of value, the South East and South West together accounted for almost half of all loans made, mainly due to the activities of social banks. Wales, the East of England and East Midlands again received a very small share of loans, attributable to there being fewer CDFIs in those regions.

3.4 **Number** of social venture loans disbursed, by region, **by %,** 2013



3.5 **Value** of social venture loans disbursed, by region, **by %,** 2013



Key Fund

At a time of declining industry and growing long-term unemployment, the Key Fund was established in 1999 by a group of entrepreneurs, keen to meet the needs of budding social enterprises and community organisations. The mission of Key Fund is to break down the barriers to accessing finance, enabling organisations to increase their community, economic and environmental impact. Disadvantaged communities from all walks of life across the North benefit from Key Fund activities, such as: supporting community hubs like post offices and swimming pools; reinvigorating rural economies with Green energy schemes, and helping charities develop trading arms.

Key Fund delivers its goals by making grants, loans and investments from European Funds, public sector monies, private sector stakeholders and from its own legacy fund. It offers support, expertise and flexibility. The model works because it takes a long-term sustainable approach to the economic longevity of its clients. Over 84% of funded enterprises continue in business after 18 months.

It has invested over £29m and supported over 2,000 organisations, creating and saving over 1,800 local jobs. Key Fund was shortlisted for the Citi Microentrepreneurship Awards in 2013 for its impact.

Customer attributes

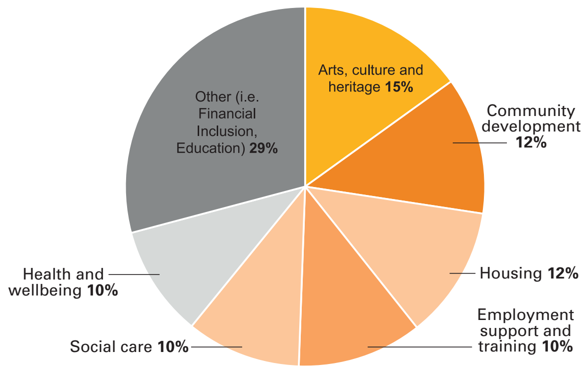
Financial exclusion

Ninety-one per cent of the social ventures served by CDFIs in 2013 had unsuccessfully applied for finance from a mainstream bank; a significant number of ventures would clearly not be able to achieve their goals without CDFI support. Three quarters of social ventures served by CDFIs are based in disadvantaged areas. This underscores just how vital the increasing presence of CDFIs in social venture financing is.

Social sectors

CDFIs provide finance to a broad cross-section of social ventures that are working on a range of social and environmental issues, as shown in figure 3.6. The largest proportion of loans were made to the arts, culture and heritage sector (15%), followed by community development (12%) and housing (12%).

3.6 Social venture sectors supported by CDFIs 2013



Customer referrals

CDFIs' own marketing activities are currently the strongest path for receiving referrals from social venture customers. CDFI's marketing accounted for 67% of social venture customers in 2013, and a further 8% came from informal sources. Almost a fifth (18%) of customers were referred from social enterprise organisations, and just 1% from banks.

Loan characteristics

There is great diversity in the social venture sector, and also in the CDFIs that serve them. Average loan sizes vary from £33,000 to £563,000.

If social banks are removed, the average loan made by CDFIs is £63,000. This is much higher than the average loans made to the business sector. Social venture loans tend to be made to existing enterprises, can often be used for the purchase of assets and are usually secured on property or assets.

In 2013, the interest rates charged by CDFIs varied from 4.5% to 8%, and the average was 6.4%. The interest rates charged by CDFIs are more consistent than in 2012, when there was much more variance and a much higher average of 12%.

Portfolio quality

Social venture lenders continue to report relatively low PAR (Portfolio at Risk) and write off rates – perhaps due to large average loan sizes and the security taken on these. For CDFIs' own funds, overall just one per cent of loans outstanding were over 90 days in arrears and less than 0.5% of the value of loans outstanding was written off during the year.

Capital for on-lending

Capital received to on-lend

Four CDFIs reported receiving capital in 2013 – totalling £5.9m, an increase on the equivalent figure of £2.5m in the previous year. Fifty-eight per cent came from Big Society Capital, 15% from ERDF funding, and 10% from trusts and foundations.

Capital funds available

The amount of capital held by CDFIs for on lending was £87m. If social banks are excluded, social venture lenders held a total of £25m, and the average was £3.6m. This is consistent with the average loan fund size of 2012.

Co-operative & Community Finance

Co-operative & Community Finance (C&CF) lends to employee or community owned social enterprises throughout the UK, including co-operatives, community businesses, development trusts and businesses developed from the charitable and voluntary sector.

It was set up 40 years ago, making it the oldest CDFI in the UK. It has over £4m of its own capital to lend and also manages funds on behalf of other like-minded organisations. C&CF takes pride in its ability to manage funds, assess risks and minimise losses whilst maximising social impact.

C&CF has worked closely with practitioners to design an innovative fund for communities carrying out a share offer. The Co-operative Community Shares Fund involves investment rather than loan finance, and welcomes applications from community-owned ventures of all kinds including renewable energy projects, community pubs and shops and supporter-owned sports clubs. As well as an offer of investment, C&CF can support marketing activities and help the investment to meet its target. The fund earns income by charging an arrangement fee.

Since its launch last year, the Community Shares Fund has worked with 19 communities that have gone on to carry out successful share offers, which has attracted national and local press coverage. C&CF was shortlisted for the Citi Microentrepreneurship Awards in 2013 for its innovation.

CDFI income

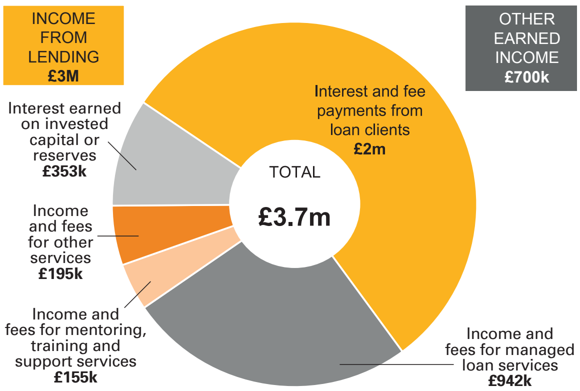
Social venture lending CDFIs require revenue to cover operational costs, provided in the form of earned income and grant/investment income secured from third parties.

In 2013, social venture lending CDFIs (excluding social banks) raised £4m of income, 94% of which was from their own earned income. This demonstrates a shift towards self-reliance, enabled by a strong growth in lending amongst this group of CDFIs.

Earned income

Social venture lenders (excluding social banks) generated earned income of £3.7m in 2013. Eighty-one per cent of this was earned through lending activities; £2m was generated through interest and fees from customers and £942,000 was generated from management fees for delivery of loan fund services.

3.7 Earned income, social venture lending CDFIs (excluding social banks) 2013

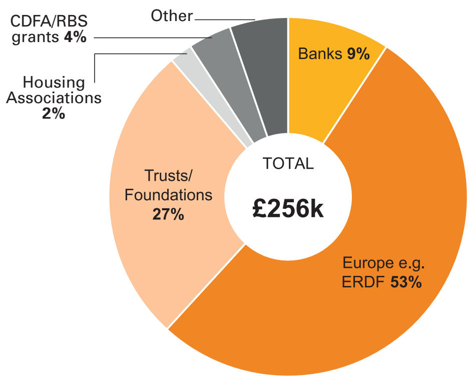


Grant and investment income

The mission of CDFIs aligns well with the objectives of public and charitable bodies, but in 2013 CDFIs (excluding social banks) only raised £256,000 from these sources to cover operational costs. This is a notable drop from the equivalent figure of £647,000 in 2012.

This decrease in public grant support for CDFIs mirrors the experiences of the social ventures they serve. It presents a challenge for CDFIs, which still need funding to build their capacity for research and development, organisational development and new infrastructure – developments that will build scale and sustainability.

3.8 Grant and investment income, social venture lending CDFIs (excluding social banks) 2013



CHAPTER 4 COMMUNITY FINANCE FOR INDIVIDUALS

CDFIs fill a market gap by providing affordable personal loans in a responsible manner to those unable to access mainstream finance

"For other forms of local finance to develop, we need a bottom-up movement of local organisations working to change the sources of supply."
Justin Welby, The Archbishop of Canterbury, House of Lords, 20 June 2013

Why do individuals need community finance?

People need access to finance in order to meet their personal and household finance needs and to respond to financial shocks. However, individuals, particularly those living in areas underserved by the mainstream, struggle to access this kind of finance as banks typically do not lend small sums. Many people turn to high cost short term lenders for their credit needs and as a result of the cost of these products, can become trapped in a cycle of indebtedness.

CDFIs offer a fair and responsible alternative to fill this gap.

Last year, 10 CDFIs provided credit to financially excluded individuals in the form of personal loans. They account for a fifth of the CDFI sector, but serve four-fifths of all CDFI customers – showing the significant reach and scale of personal lenders; it also highlights the distinctive nature of the different markets CDFIs serve.

Personal lending CDFIs tend to focus on a local area or county, in contrast to social venture lenders, and are more closely linked to the geographical community they serve. Many operate through several branches in order to reach particular communities – with an average of six branches each. In this market, the customer's relationship with their credit provider is an important factor for their ability to access finance. Not only is it their point of entry for their consumer finance needs, but also a source of financial education. As the personal lending market is more relationship-based, these CDFIs have more branches than CDFIs operating in other markets, in order to reach more customers in each community. Personal lenders manage economies of scale by centralising their back-office services, so that their branches specialise in client relationships and financial literacy training.

This chapter focuses on the nine CDFIs that provided full data about their lending in 2013.

Outcomes of personal lending

IN 2013* CDFIs...

LENT £**19**m

TO **40,600** INDIVIDUALS

SAVING CDFI CUSTOMERS...

£**7.8**m IN INTEREST REPAYMENTS

THANKS TO CDFIs...

29,000 PEOPLE AVOIDED USING HIGH-COST LENDERS

3,900 PEOPLE OPENED BANK ACCOUNTS

900 PEOPLE RECEIVED FINANCIAL LITERACY SUPPORT

5,800 MANAGED EXISTING DEBTS AND **10,500** PAID BILLS

*For the period 1 April 2012 – 31 March 2013

CDFIs serving individuals

In 2013:

- There was an unprecedented level of CDFI support for individuals. Personal lending increased by **over 70%** in value from 2012 and **by 40%** in number of loans disbursed
- CDFIs provided affordable loans for over 40,000 households, the majority of which were social housing tenants and were living in disadvantaged neighbourhoods
- Customers taking a typical loan of £500 over 12 months saved over £200 in interest repayments with a CDFI compared to a doorstep lender

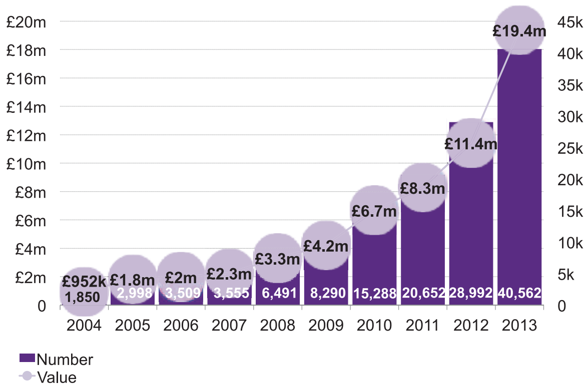
Lending activity

Loans disbursed

CDFIs reported lending £19.4m to 40,562 customers in 2013. This continues the significant growth in personal lending that has been seen over the last four years. CDFIs are now reaching many more people than in 2009, when CDFIs lent £4.2m to 8,290 customers.

It is clear that personal lending CDFIs have extended their reach in 2013 and provided finance and support services to substantially more people, who were previously considered ‘un-investible’. By doing so, personal lenders not only helped individuals avoid high-cost loans, but also created significant economic opportunity.

4.1 Personal loans disbursed 2004-13



Lending demand

In 2013, CDFIs received enquiries from more than 65,000 people seeking £35m of loans.

The proportion of enquiries that was converted to a loan was 62% – much higher than 2012, when it was around a third. The personal lending model, which requires more branches to maintain in-person relationships with customers, has been successful in boosting enquiries; through working closely with applicants CDFIs were able to support them with a record number and amount of loans.

Lancashire Community Finance

Lancashire Community Finance (LCF) has come a long way since it opened its first office in Preston in 2005. Its commitment to change the lives of financially excluded residents through affordable loans and free financial education has not changed, but the scale and impact of services has. In its first year the CDFI had four staff and made 118 loans totalling £316,539. Last year LCF made 1,850 loans with a value of £1,152,498.

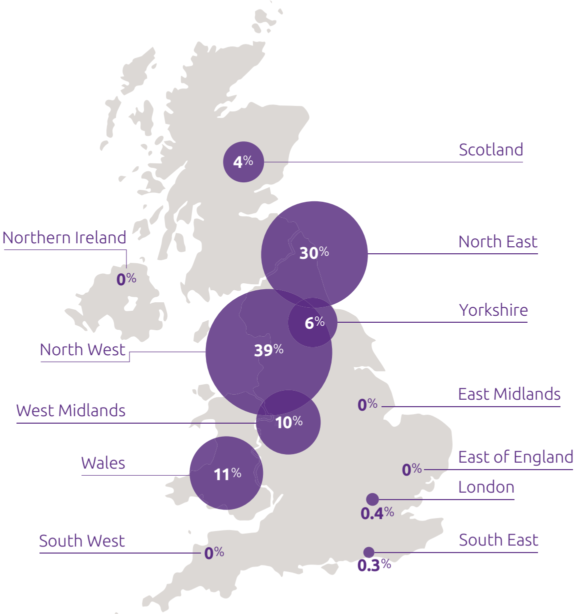
LCF now has eight outlets, most based in community premises which extends the reach of the CDFI into residential areas where poverty is high and the grip of payday and doorstep lenders is strong. A conservative estimate of the interest LCF has saved individuals from paying to high interest lenders since 2005 is over £3,400,000 – money that has, as a consequence, been available for use within the local economy. It has enhanced the services available by phone and online, and increased the range of products on offer, which now include personal, home improvement and business loans. In 2013 LCF was shortlisted for the Citi Microentrepreneurship Awards for its impact.

Loans disbursed by region

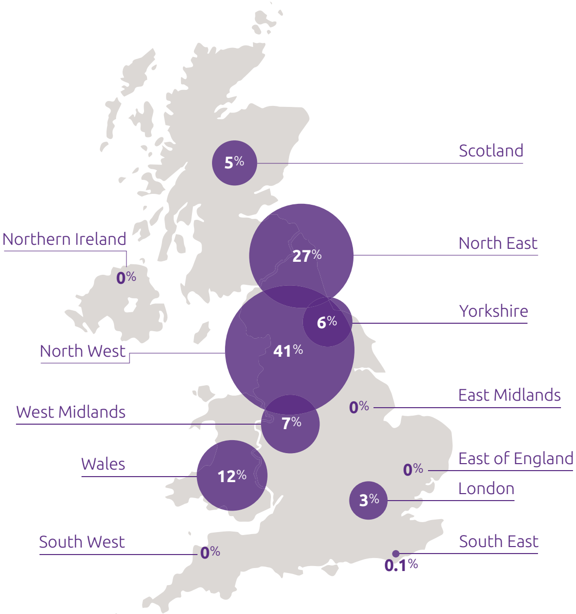
The maps reveal that the majority of personal loans were made in the North East and North West – together accounting for 69% of the number of loans made and 68% of the value. These regions are home to two large scale personal lending CDFIs.

No personal lending CDFIs were active in Northern Ireland, the East Midlands, the East of England and the South West, and there was very little lending in the South East. These areas would clearly benefit from the expansion of personal lending CDFI services to effectively meet the needs of those unable to access responsible and affordable credit.

4.2 **Number** of personal loans disbursed, by region, **by %,** 2013



4.3 **Value** of personal loans disbursed, by region, **by %,** 2013



Customer attributes

CDFIs have a mission to serve those experiencing financial exclusion, and chart 4.4 shows their effectiveness in reaching key target groups.

Almost three-quarters of loans went to customers who had used high-cost lenders in the previous year. A key aim of personal lending CDFIs is to help people move away from high-cost lenders, providing affordable alternatives and helping people make their money go further.

Seventy per cent of customers were social housing tenants. Many CDFIs work closely with housing associations to reach this group – and some have loan officers based at the premises of housing associations. The majority of customers live in disadvantaged areas, are unemployed, are women and in households with annual income of less than £15,000.

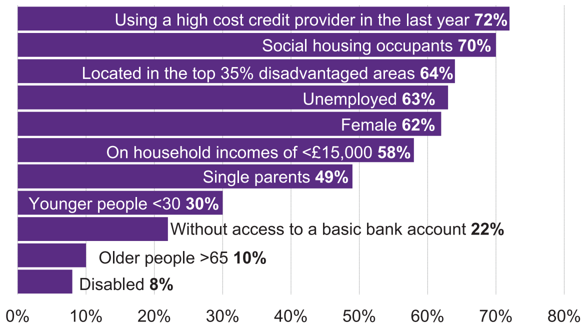
Products and services

As well as providing finance, four CDFIs also offer vital money management advice, two offer access to personal accounts and one provides financial literacy training – services that complement their core lending, their ability to maintain this is under increasing strain given rising costs and the withdrawal of public sector funding for this important service.

Loan purpose

In 2013, 29% of personal loans were made for one-off needs and 26% were for basic bill payments. This indicates that CDFIs helped support individuals with their daily cash flow needs. Fourteen per cent of personal loans were used to consolidate other, higher cost debts into affordable CDFI loans, and 11% were used for household goods and maintenance.

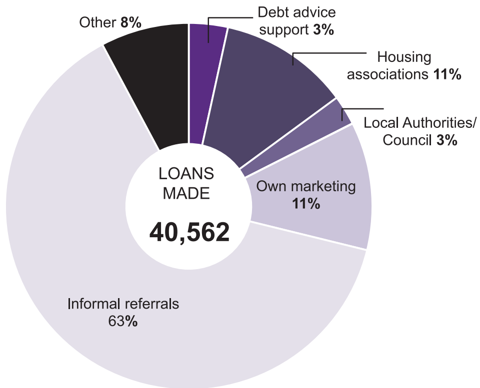
4.4 Personal customer attributes 2013



Customer referrals

CDFIs received 63% of referrals from informal sources, followed by their own marketing (11%), housing associations (11%), local authorities (3%) and debt advice providers (3%). The growth in informal referrals such as word-of-mouth is a good indication of the growing reputation of CDFIs and the loyalty built up as a result of the trust customers have in them.

4.5 Personal customer referrals by source 2013



Loan characteristics

The average size of CDFI loans ranged from £320 to £530, and the average for all personal loans was £478, which is slightly larger than 2012's average of £441.

The interest rates charged by personal lenders range from 16% to 60%, with an average charge of 38%. The rate charged in 2013 is very similar to the 2012 average of 39%. The typical fee charged per loan is £9. Compared with other CDFI markets, annual rates in the personal lending market are generally higher, reflecting the cost of providing a high volume of small loans. Recent work by the CDFA indicates that personal lending CDFIs have since increased their interest rates in order to move away from any grant dependency and achieve self-sufficiency; at the end of 2013 personal lenders charged an average interest rate of 69.9% APR.

Using current interest rates, for every £100 borrowed over 12 months, a CDFI customer is charged £42. As can be seen from the cost comparison table 4.6, this is half of the interest that would be repayable on an equivalent loan from a home credit provider. CDFIs are clearly providing an affordable alternative. CDFI customers saved a total of £7.8m in interest repayments – money that they could spend in the local economy.

4.6 Cost comparison of CDFI personal loan and high-cost loan

	Amount Lent (£)	Term (weeks)	APR (%)	Cost per £100 lent	Total repayable	Savings on Home Credit
Home Credit	£500	52	272%	£82	£910	
CDFI	£500	52	69.9%	£42	£709	£201

Portfolio quality

CDFI portfolio performance reflects the higher risks associated with unsecured lending.

Portfolio at risk (PAR) shows the proportion of the value of loans outstanding that is 90 days in arrears as of 31st March 2013. CDFIs that lent to over 1,000 customers in 2013 had PAR rates of 13% or less. This suggests CDFIs that operate at scale have the infrastructure in place for managing risk and collecting debts. Overall six per cent of loan portfolio was in arrears – down from 18% in 2012.

Eight per cent of loan portfolio was written off in 2013, and the average write-off rate was 11%.

Capital for on-lending

Capital received to on-lend

In 2013, personal lending CDFIs received £9m of capital to on-lend. Complementing this was the use of existing funds and recycled capital.

This is consistent with the £8.2m secured in 2011, and a much needed increase from the £545,000 received in 2012. But it remains low. Personal lenders do not have access to many of the sources of capital available to business lenders (such as RGF) but they have delivered some NEA and SUL funding to help individuals from unemployment into self-employment. Increased sources of long-term capital would enable personal lenders to meet more of the growing demand for their services; the CDFA is currently working with its members to develop a wholesale fund in response to this need.

Of the £9m secured in 2013, 31% came from housing associations, 24% came from local authorities, and 22% came from banks, 12% from central government and 11% from wholesale funds.

Capital funds available

Between them, nine personal lenders held a total of £17.2m in capital to on-lend as of 31 March 2013. Just over half of this (£9m) was held in managed funds. Two CDFIs held capital of less than £250,000 (compared to four CDFIs in 2012) and five held between £1m and £3.3m.

My Home Finance

My Home Finance (MHF) is a social enterprise, set up by the National Housing Federation in 2010 to provide financially excluded people with small sum credit and associated services at rates they can afford. Its mission is to become a national self-sustaining business, supported by Housing Associations (HAs) and operating in areas where residents are in greatest need.

After a successful pilot in the West Midlands, MHF is now rolling out services to HA residents across the country. Last year it made almost 3,000 loans.

MHF has taken a creative approach to raising capital, allowing it to expand and provide services for more people. In autumn 2012 MHF issued a loan note offer to the housing sector. The offer to housing associations was to invest in the business with a 6% annual return over 5 years in order to bring MHF products and services to their residents.

Housing associations have responded very positively, and in 2013 they invested circa £3.5 million, which has allowed MHF to expand its services into a number of new locations across the country. HAs have enabled MHF to market to residents and locate loan officers in their premises, and together they have explored new and innovative ways of reaching and serving those in need. MHF was shortlisted in 2013 for the Citi Microentrepreneurship Awards for its innovation.

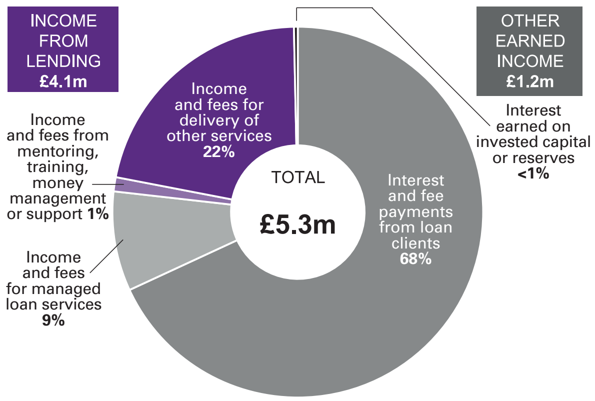
CDFI income

CDFIs cover their operating costs through both earned and grant/investment income secured from third parties.

In 2013, CDFIs reported raising £7m of income; 76% of this (£5.3m) was from their own earned income and the remainder (£1.7m) was raised from third parties.

Three-quarters of earned income was generated through lending activities – £3.6m from interest and fees charged to customers and £460,000 from fees for the management of loan service delivery. In 2012 only a quarter of earned income was generated through lending activities. This shift shows the increased resilience of personal lenders.

4.7 Earned income – personal lending CDFIs 2013



CHAPTER 5

COMMUNITY FINANCE FOR HOMEOWNERS

CDFIs provide home improvement loans for people who are unable to get conventional home finance and are living in sub-standard conditions, to upgrade, repair or maintain their homes

"Poor housing conditions have a detrimental impact on health, costing the NHS at least £600 million per year."
Briefing Note on Housing and Health, Parliamentary Office of Science & Technology, January 2011

Why do homeowners need community finance?

CDFIs provide finance and related support services to vulnerable households that need to carry out repairs, adaptations or energy efficiency improvements. Many of the people supported by CDFIs in this market are on fixed or low incomes and are unable to raise finance from mainstream providers; public sector cuts mean that in many places they are also unable to access grant support for work on their homes.

By providing affordable loans to those who cannot access them elsewhere, CDFIs are enabling people to live in decent conditions and stay in their homes.

Providing affordable home improvement finance in disadvantaged communities results in benefits beyond those intended for the homeowner. Improved housing conditions for poor, vulnerable and elderly households reduces demands on the NHS and other public services, saving public expenditure. Increasing the number of homeowners able to afford improvements helps to support the economy and jobs in the construction and other service industries. In addition to lower heating costs, energy efficient homes reduce carbon emissions, thereby improving environmental conditions. These add up to significant health and well being benefits and are evidence of the economic and social impacts achieved through community finance delivery.

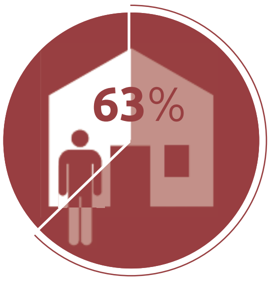
Home improvement lending outcomes

IN 2013* CDFIs...

LENT £**4**m

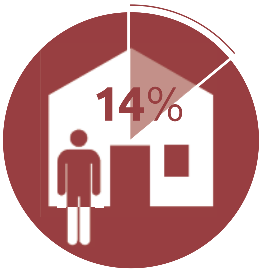
TO **540** HOMEOWNERS

IMPROVING THE HOMES OF HOMEOWNERS THAT WERE...



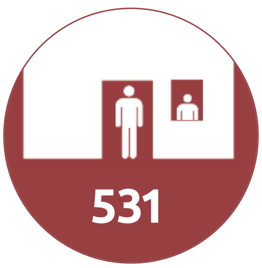
63% OLDER PEOPLE

58% LOW INCOME HOUSEHOLDS



14% DISABLED PEOPLE

THEREBY ENABLING...



531 PEOPLE TO STAY IN THEIR HOMES

420 HOMES TO BE BROUGHT UP TO A DECENT STANDARD

*For the period 1 April 2012 – 31 March 2013

CDFIs financing home improvements

In 2013:

- CDFIs targeted support to the elderly, income poor and people with disabilities, enabling them to continue to live independently and safely in their own homes
- 63% of customers were aged over 65, and 58% were in households with annual income of less than £15,000
- From 1,644 enquiries, 541 loans were made, a conversion rate of 33%

Eight CDFIs provide home improvement loans (16% of the sector). This chapter focuses on the three CDFIs that specialise in home improvement loans as their primary market.

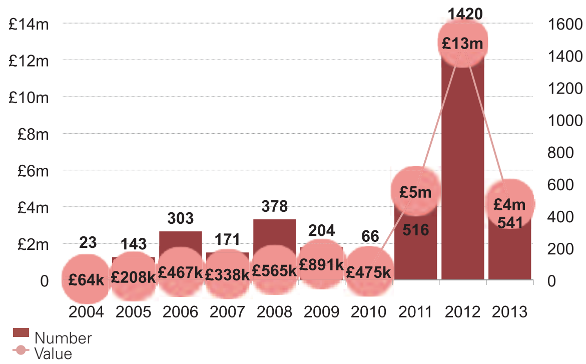
Lending activity

Loans disbursed

CDFIs provided £4.2m of home improvement finance to 541 households in 2013. Lending activity has scaled back since the peak of 2012 – falling by 62% in terms of number of loans made and 68% in terms of their value. CDFIs have been less active in this market, due in part to difficulties in raising appropriate capital from public sources.

In 2013, CDFIs received enquiries from 1,644 people seeking £12.3m of home improvement finance.

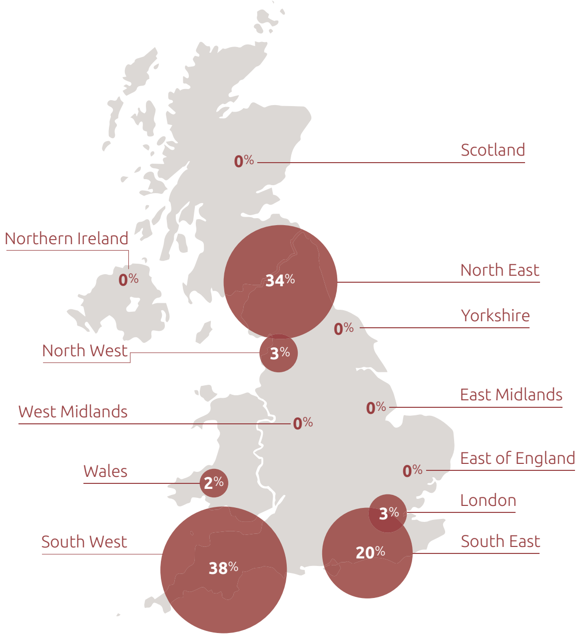
5.1 Home improvement loans disbursed 2004 -13



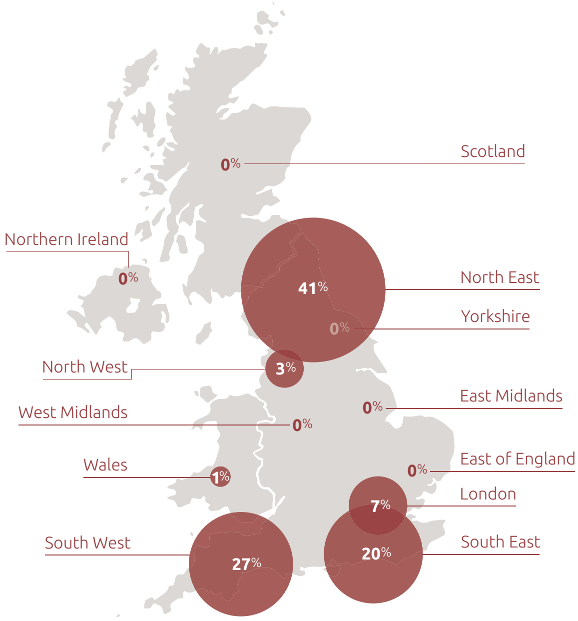
Loans disbursed by region

The South West and North East are well-served by home improvement lenders, and account for 38% and 34% of the number of loans made respectively. There is some lending in the South East but other regions are underserved by CDFI home improvement lenders – notably Yorkshire (which has a very strong business lending CDFI sector) as well as Scotland, Northern Ireland, the East of England and the East Midlands.

5.2 **Number** of home improvement loans disbursed, by region, **by %,** 2013



5.3 **Value** of home improvement loans disbursed, by region, **by %,** 2013



Parity Trust

Parity Trust improves quality of life for individuals and families by raising capital and investing in businesses and social enterprises, homes and community buildings through affordable finance. Based in Portsmouth, Parity Trust operates across the south east of England, focusing on Hampshire, Surrey and Sussex. It provides home improvement and equity HomeBuy loans, loans for charities and social enterprises and is also a delivery partner for the Start Up Loans scheme. It is one of only two CDFIs in the country regulated for mortgage lending by the Financial Conduct Authority.

Parity Trust went through a strategic review process, involving consultation with stakeholders, an assessment of changing local needs and a brand review which led to a new diverse product range for the whole community and a new business model. This approach has led to increased activities, with average lending of circa £700,000 for a lending team of three to four people, and more than £1m lent in the last financial year.

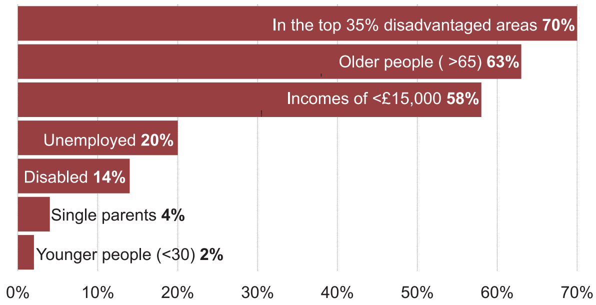
Parity Trust has also employed an innovative approach to capital raising, having launched a community share offer in September 2013. Parity Trust was shortlisted for the Citi Microentrepreneurship Awards in2013 for its innovation.

Customer attributes

CDFIs focus on serving homeowners who are unable to secure finance from mainstream lenders for essential repairs to their homes. They are effective in reaching key groups recognised as more likely to experience financial exclusion.

Sixty-three per cent of home improvement loans went to older people, and 58% went to households with annual incomes of less than £15,000. Twenty per cent of loan recipients were unemployed and 14% were disabled. These demographics indicate that home improvement lending CDFIs are making a significant impact by supporting underserved customers in need, despite this market being smaller than other CDFI sectors.

5.4 Home improvement lending customer attributes 2013



Loan characteristics

Products and services

All home improvement lending CDFIs offer loans, secured and unsecured, and some also offer mortgage products and money management support.

The average home improvement loan made in 2013 was £7,700. The average loan term is six years and CDFIs charged an average interest rate of 5%.

Portfolio quality

Home improvement lenders reported negligible risk to their portfolio (less than 0.2% of portfolio was in arrears), and wrote less than 0.1% of loans off. Much of this performance can be attributed to the nature of their products, which routinely use a charge over property as security.

Loan purpose

Eighty-five per cent of loans were used for general repair and thermal comfort. The remainder were used for energy efficiency, home adaptations for disabled people, and to bring empty homes back into use for those in need of housing.

CDFI loans have enabled at least 531 people to stay in their own homes, and brought 420 homes from sub-standard quality up to a decent standard. Aside from the clear social benefits this lending achieves, there is also a substantial economic benefit derived from reductions to health and social care budgets – through avoidance of residential and other costly health and support interventions that would otherwise need to occur. This is another example of how CDFIs make a significant – but often unrecognised – contribution to their local economies.

Wessex Resolutions

Wessex Resolutions CIC (WRCIC) believes in 'financial inclusion for all' and has a mission to improve the quality of people's lives by providing affordable home improvement loan finance and effective money management advice.

It works in partnership with 20 local authorities in South West England to provide a loan delivery and administration service to assist lower income homeowners who cannot afford to pay for essential repairs to their property. It offers a variety of discounted interest rate products, tailored to meet the needs of customers who qualify for assistance under local authority policy.

The scheme improves living conditions for low income homeowners and ensures that residents live in decent, safe, secure homes. The partners use limited public funding efficiently and effectively to assist as many vulnerable homeowners as possible.

The loan scheme has achieved a 100% client satisfaction rating, and a default rate of less than 2%. One client commented, "My loan was for central heating so without your help it would have been a long, cold winter."

To date, over £7.5million has been lent to nearly 1400 homeowners. The ultimate goal is to build a self-sustaining loan scheme in which the value of capital being repaid is sufficient to cover new demand. WRCIC was shortlisted in 2013 for the Citi Microentrepreneurship Awards for its partnership work.

Capital for on-lending

The amount of capital available for home improvement CDFIs to on-lend increased to £10m in 2013 from £7.2m held in 2012.

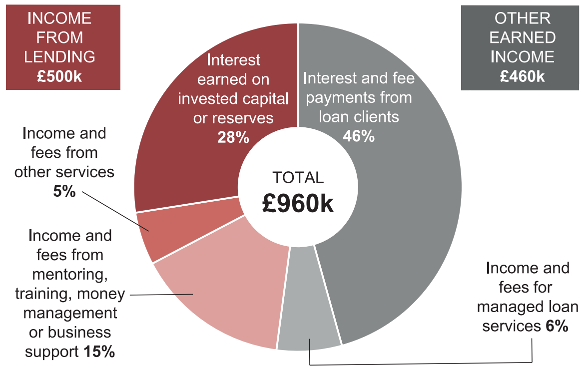
The amount of new capital received was very small. It is a market that has been limited by a lack of public sector investment, and the need to charge customers low interest rates. This also hampers the ability of CDFIs to borrow capital from the private sector. Given the high social impact of home improvement lenders, the CDFA will be working with its members to identify appropriate, viable capital streams for the future.

CDFI income

CDFIs cover their operating costs through both earned and grant and investment income secured from third parties. In 2013, home improvement CDFIs raised £1.1m income to cover operational costs, 86% of which was earned income.

Of the £960,000 earned in 2013, over half (£500,000) was generated through lending activities and over a quarter (£264,000) was generated from interest on invested capital and reserves – representing a larger proportion than for other markets and significant in terms of overall CDFI sustainability.

5.5 Earned income home improvement lending 2013



Policy conclusion

The year ahead

2014 looks set to be a year of change and new developments for the community finance sector. With LEPs moving into implementation stage, and the subsequent flow of European funds, new rounds of RGF confirmed and increasing pressure from social investors to reach the community level, CDFIs have a window of opportunity in being the only real delivery mechanism able to reach customers the mainstream cannot.

There are some key policy milestones in the year ahead that will be critical for CDFIs:

1 Budget '14

It is clear from the Autumn Statement that SITR will be featured as a new tax relief for individual social investors. This will complement the current CITR that, despite the £100m+ private sector investment it has generated for CDFIs, remains in need of revision; the CDFA will continue to lobby for these revisions to bring the relief into line with other, comparable schemes and generate the scale of investment needed.

2 British Business Bank

As the investment programme grows, the CDFA will continue to work on proposals with BBB to develop a substantial new CDFI facility that will support scaling of the sector. The aim is to create a facility that matches a consortium of private investors and draws on guarantee mechanisms from government and potentially European Investment Bank sources.

3 Fund management

Start Up Loans will continue through 2014, and offers an opportunity for CDFIs in the early stage enterprise market – significantly increased with the removal of age restrictions. The CDFA will continue to support members through its growing delivery consortium for CDFIs unable to gain a direct contract with the Start Up Loans Company. RGF round 5 will commence delivery, and round 6 will launch in late spring; the CDFA will be submitting a bid under this round. The CDFA will also continue to work with its personal lending members to create a dedicated wholesale fund that will deliver much needed capital to help meet some of the growing demand for this market.

4 Regulation

With the transition of the Consumer Credit Act from the Office of Fair Trading to the Financial Conduct Authority and phased introduction of changes to fees and definitions, CDFIs are presented with an opportunity and challenge: improving regulatory clarity and protection, without the potential increase in fees and bureaucracy. The CDFA will work closely with FCA to lobby for CDFI interests.

5 Infrastructure

Building on work already underway within the CDFA membership, ensuring strong and appropriate infrastructure is central to achieving the scale needed to meet the £6bn gap in finance. Launching in the summer, BIG's Power to Change programme offers £150m of grant support for community enterprise which, with other revenue based support is an opportunity to put in place local community finance partnerships, development of shared impact metrics, streamlined operating platforms and standardised best practice in governance and management.

Many other positive developments such as extending disclosure of bank lending data across all lending institutions, provide a full complement of opportunities for the CDFI industry to seize. With on-going political support and a more favourable fiscal environment, community finance could truly flourish.

CDFI participants

The following CDFIs provided information that was used for this report:

Aston Reinvestment Trust
Big Issue Invest
Black Country Reinvestment Society Ltd
Business Enterprise Fund
Business Finance North West
Business Finance Solutions
Capitalise Business Support Limited
Charity Bank Ltd
Coalfields Regeneration Trust
Community Land & Finance CIC
Co-operative and Community Finance
Coventry and Warwickshire Reinvestment Trust
Croydon Business Venture Limited
Donbac
DSL Business Finance Ltd
East Lancs Moneyline
East London Small Business Centre
Enterprise Answers
Enterprise Loans East Midlands
Enterprise Northern Ireland
Entrust
EV Business Loans Ltd
Five Lamps
Foundation East
Fredericks Foundation
GLE oneLondon
Goole Development Trust
HBV Enterprise
Hull Development Fund Ltd
Impetus
Innovative Finance
Lancashire Community Finance
London Rebuilding Society
Merseyside Special Investment Fund Ltd
Moneyline Yorkshire IPS Ltd
My Home Finance
North London Community Finance
Northern Pinetree Trust
Parity Trust
Robert Owen Community Banking Fund Ltd
Scotcash C.I.C.
Sirius
Social Investment Scotland
South West Investment Group
Street UK
The Isle Of Wight Lottery
The Key Fund
The Social Enterprise Loan Fund
Triodos Bank
Ulster Community Investment Trust
Wessex Resolutions C.I.C
West Yorkshire Enterprise Agency Limited

Community Development Finance Association (CDFA)
Telephone: +44 (0)20 7430 0222
Email: info@cdfa.org.uk
Website: www.cdfa.org.uk
Twitter: @thecdfa

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Company Number 04111603