Spring 2021

CDFI Loan Fund Capital Needs Survey Report

CNote

Executive Summary

This report presents the information gathered in a semi-annual survey of Community Development Financial Institution (CDFI) Loan Funds designed to understand CDFI capital needs. The findings included here are meant to serve as a bridge between CDFIs and investors, helping the latter understand the capital needs and areas for CDFI investment that most address community needs.

The vast majority of CDFIs included in this study reported an increased need for debt capital and the capacity to deploy significantly more loans if provided on favorable terms. Outside of debt funding, CDFIs expressed overwhelming interest in EQ2 and equity investments with 87% and 70% of CDFIs reflecting interest in those funding sources. CDFIs reported low stress on their lending portfolio despite the overall economic impact of the COVID-19 pandemic.

Regarding expectations around the cost of debt capital, CDFIs reported an average cost of capital of 2.61% with expectations for a similar cost of capital for the next 12 months. They expressed a strong desire for long-duration loans of five to ten years.

CDFIs reported that low-to-moderate income (LMI) communities were the most underfunded demographic they serve and that small business lending was the most underfunded segment of lending activity they provide. Around 80% of CDFIs surveyed expressed an urgent (0-6 months) or somewhat urgent (6-12 months) need for additional capital. 65% of CDFIs surveyed said their capital needs had increased over the last twelve months.

Overall, CDFIs remain in good financial condition but have several areas of underfunding that could be addressed by new debt capital if it was provided on attractive terms. We provide more details about expectations around cost of capital and other survey findings below.

Introduction and Methodology

The CDFI Loan Fund Capital Needs Survey was funded and conducted by CNote, a community investment platform working to drive investor capital from new and diverse sources into CDFIs across America. As a capital intermediary, CNote aims to support the CDFI industry and educate investors. We plan to conduct this survey on a bi-annual basis and will share longitudinal along with discrete findings going forward.

The data shared in this report was collected between December 5, 2020 and January 19, 2021. There were a total of 52 respondents, which made up roughly 10% of the 554 certified CDFI loan funds nationally at the time. Participants were sourced from CNote’s existing partner network, referrals from the same, and online CDFI forums and direct outreach. A handful of CDFIs that were not loan funds were surveyed, but because there was not a significant number of non-loan fund responses, only loan fund submissions were analyzed for the findings of this report.

We hope to share data on non-loan-fund partners in the future as we grow our sample size. For those interested in responding to the survey visit our Capital Needs Survey page to submit responses when the survey is active and to review past findings.

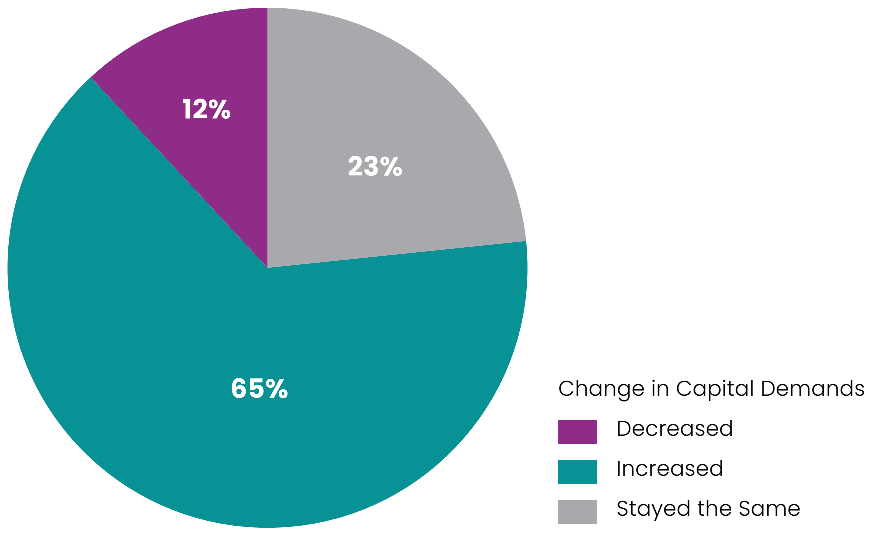
Purpose and CDFI Industry Background

This report catalogs for potential investors the capital needs of Community Development Financial Institution (CDFI) Loan Funds. For those unfamiliar, CDFIs are mission-driven financial institutions that operate with a primary mission of serving low-income communities. CDFIs are certified by the CDFI Fund, an agency within the U.S. Department of Treasury. Their focus on community and their commitment to keep capital flowing to small businesses and the low income, even when mainstream finance pulls back, has led to them being called "economic shock absorbers" by the Federal Reserve Bank of San Francisco. The Brookings Institute's retrospective on 25-years of CDFI anti-poverty and community lending activities stated that "CDFIs have succeeded by all obvious measures." Our hope is that this report bridges the gap between investors and CDFIs, increasing the flow of capital into underserved communities.

Findings
CDFI-Level Capital Needs

Turning to the survey results, when asked, 65% of CDFIs noted an increase in capital demands while only 12% of CDFIs noted a decrease. Additionally, **over 75% of survey Loan Funds expressed an "urgent" or "somewhat urgent" need for capital over the next 6 - 12 months**. Around 50% of CDFIs reported that they had the potential to deploy $1 million or more (28% reporting they could deploy $7 million or more) within the next 12 months if they could secure loan capital.

% of CDFIs Experiencing a Change in Capital Demands
Most are Experiencing an Increase in Capital Demands



One of the more compelling findings for additional investment in this survey was the amount of capital surveyed CDFIs said they could deploy in the next 12 months if they were provided attractive debt financing terms. In aggregate, **the 52 CDFIs surveyed said they alone could deploy $182,000,000 over the next twelve months**. It's worth noting that this is likely an underestimation as we assumed the low value of $7M when CDFIs selected the total of $7M - $10M range which fails to capture responses that far exceed that $10M cap. CDFIs have a strong appetite for additional debt capital on attractive terms.

% of CDFIs Experiencing a Change in Capital Demands

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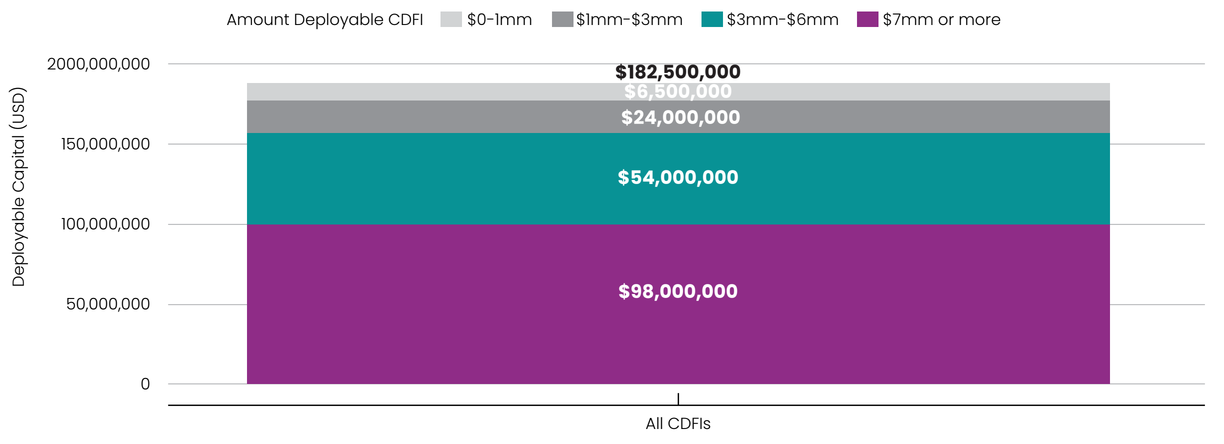
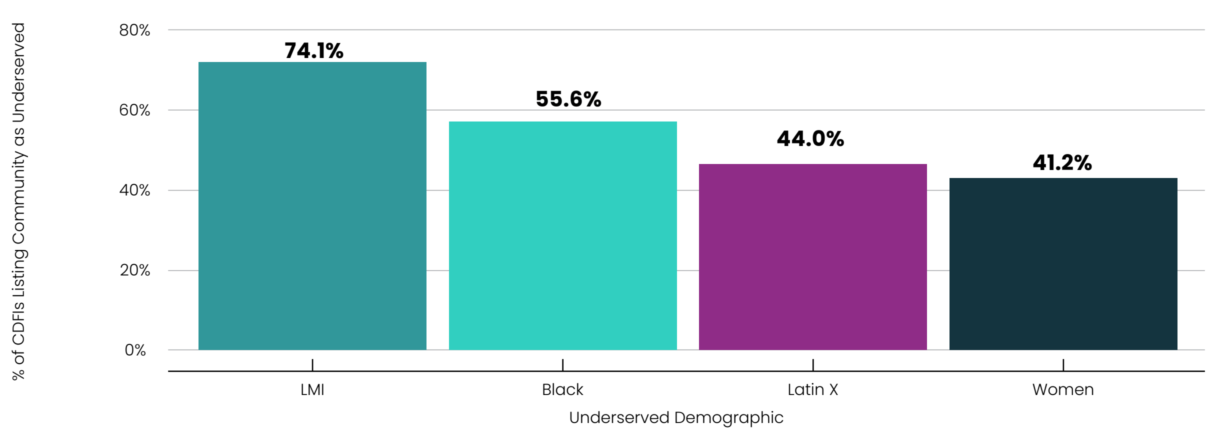


Areas in Need of Additional Capital

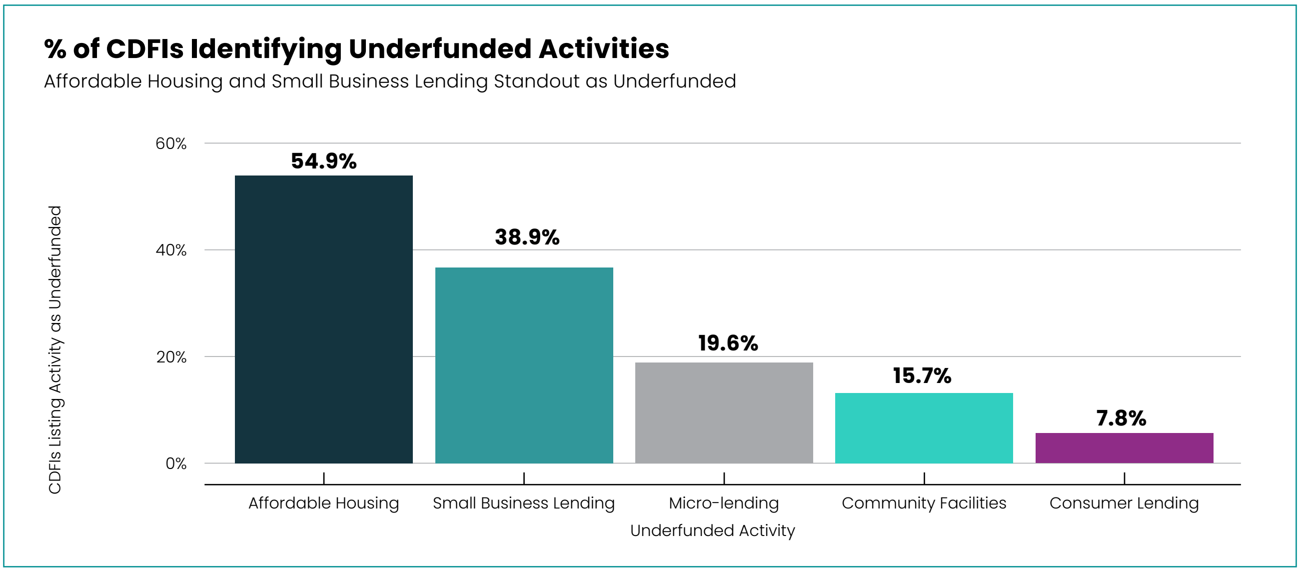
When asked what demographics were underserved due to a lack of capital, **74% of CDFIs reported Low-to-Moderate Income (LMI) borrowers were most underfunded, followed by 55% of CDFIs reporting Black borrowers and 44% of CDFIs reporting Latinx and women borrowers as underfunded groups**.

Number of CDFIs Identifying Underserved Demographic

LMI and Black Borrowers Were Identifed as the Most Underserved

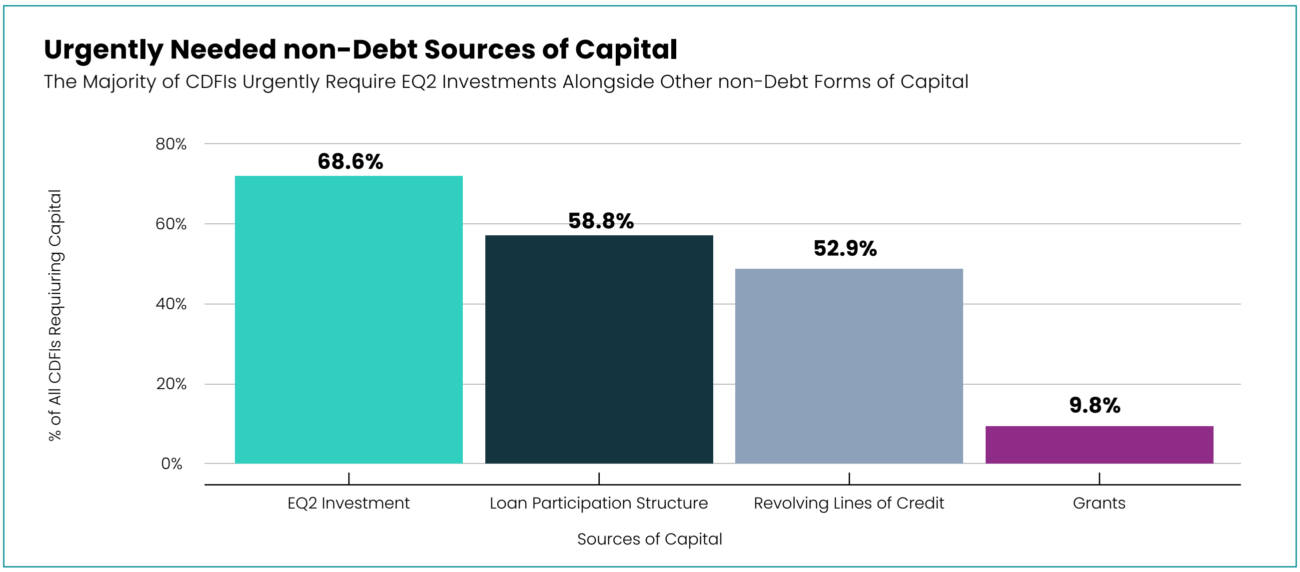


When asked "Are there segments of your lending activities that are underfunded?" CDFIs shared that affordable housing lending (55%) and small business lending (39%) were most underfunded.



Non-Debt Capital Needs

Not all CDFI investment and support come through attractive debt financing. Indeed, **CDFIs surveyed shared that equity-like EQ2 investments (68%), loan participation structures (58%) and revolving lines of credit (52%) were all urgently needed by the majority of those surveyed**. These capital structures provide CDFIs flexibility and can be leveraged to increase lending activity or support operational expansion. Any investor considering investing in the CDFI ecosystem should be aware of these alternative capital structures and be open to exploring new capital models for CDFI investment for CDFI investment.

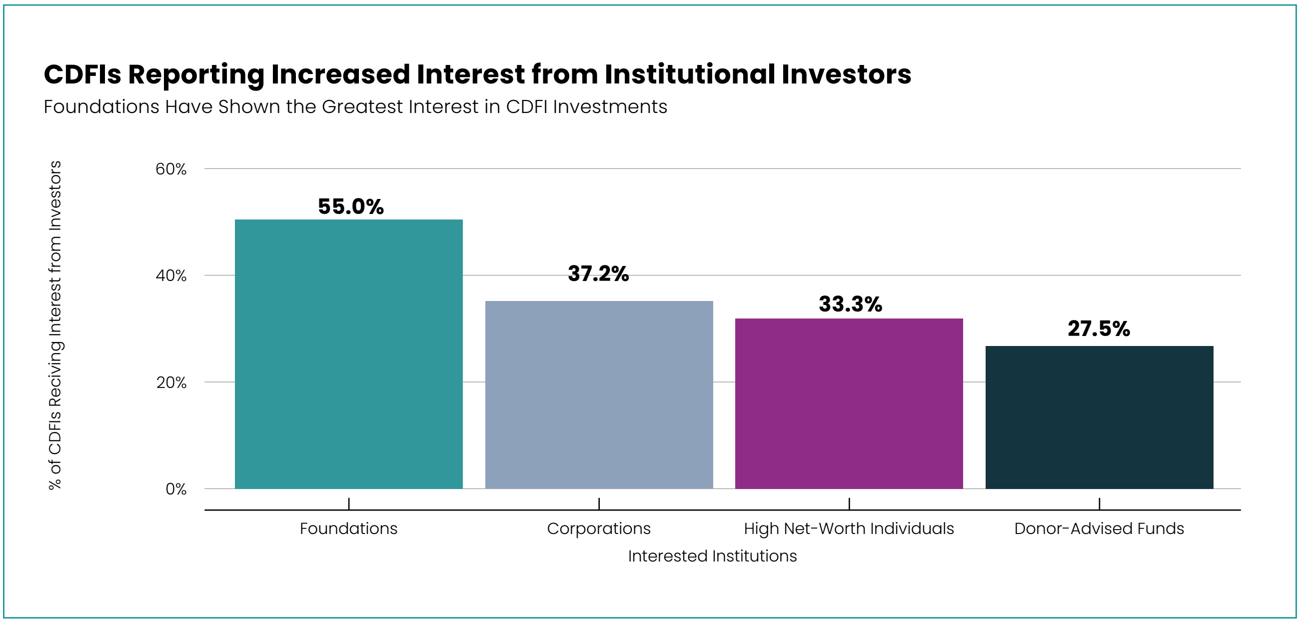


Covid Impact

While not the primary focus of the survey, participants were asked one question regarding the impact of the covid pandemic on lending activity, "What % of your current loan portfolio consists of stressed loans or bridge loans due to covid-related economic impact?" **The vast majority had minimal stressed or bridge loans: over 16% of respondents shared that 0% of their portfolio contained such loans and 66% of respondents shared that their portfolio contained 10% or less of such loans**. To note, "stressed loans" were not defined within the survey and CDFI participants determined for themselves the stress of their portfolio.

Capital Partners

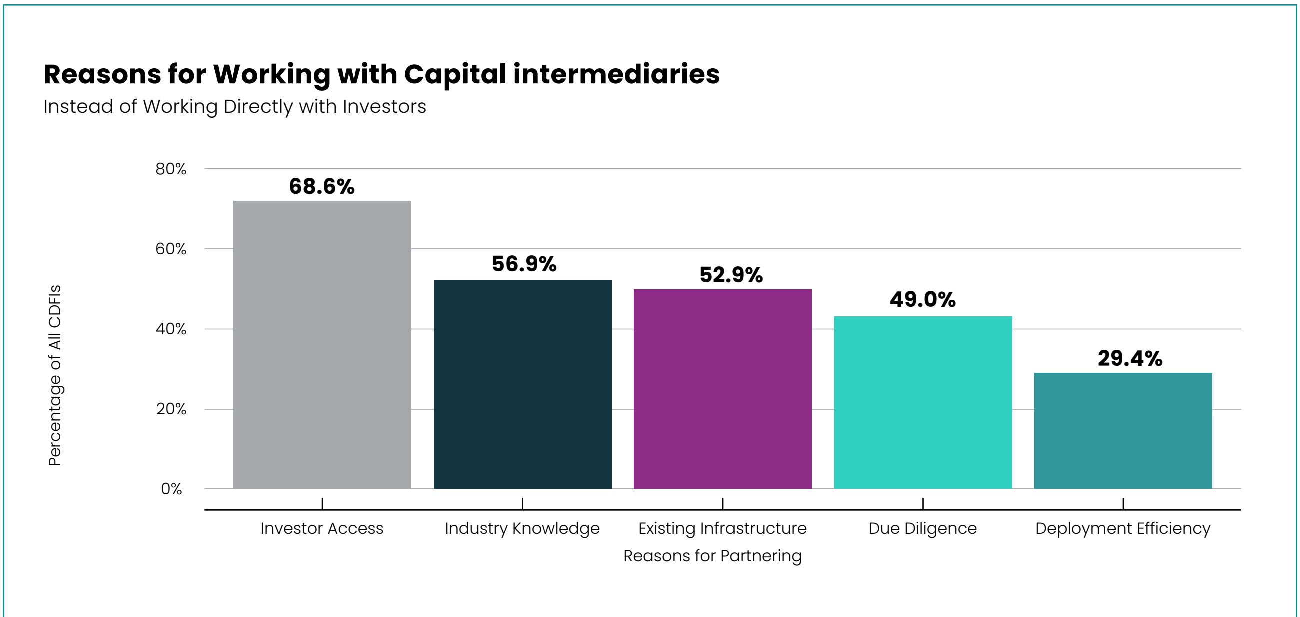
Recent media headlines reflect increased attention on the CDFI industry and their role in supporting underserved communities throughout the pandemic. This development is promising. Participating CDFIs were asked what organizations had shown an increased interest in investing in CDFIs, and **the majority, over 55% of Loan Fund respondents, said foundations had shown an increased interest, followed by 37% citing corporations and 33% citing high net-worth individuals**.



Participating CDFIs were asked whether they work with capital intermediaries and the benefits, if any, of doing so. **CDFIs reported that the primary benefit of working with a capital intermediary was access to new investor sources (68%)**. However, industry knowledge/familiarity (57%), infrastructure (53%), and due diligence simplicity (49%), were strong benefits of working with a capital intermediary.

The following free response answers to the capital intermediary question illustrate that context is an important factor in determining the value of working with an intermediary:

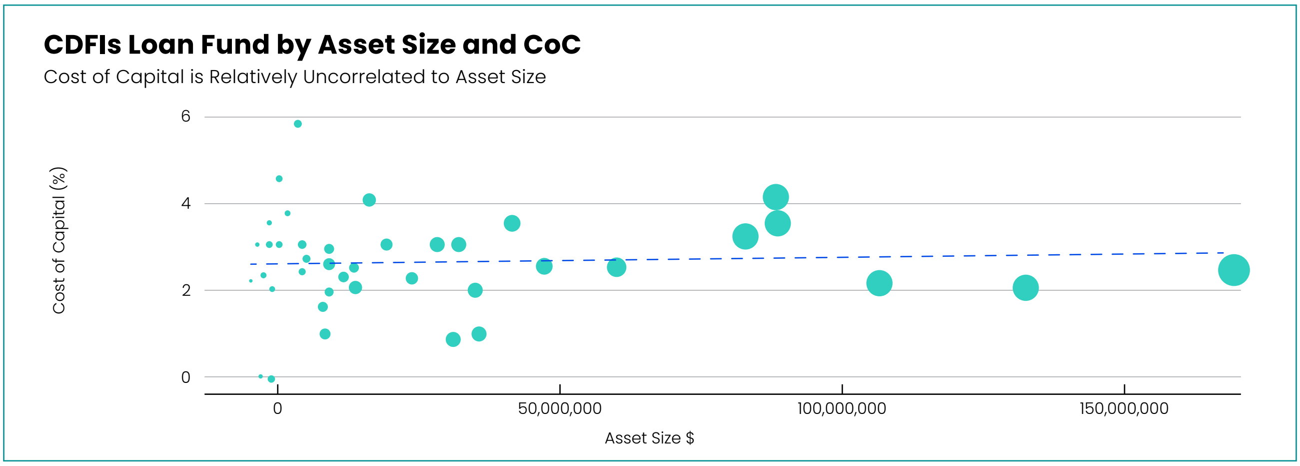
> The benefit of capital intermediaries is really as it relates to new investor classes, like high net worth individuals, DAFs, corporations, etc. The role is less beneficial when it comes to CRA motivated investors or investors that mimic this type of investing (insurance companies, foundations)



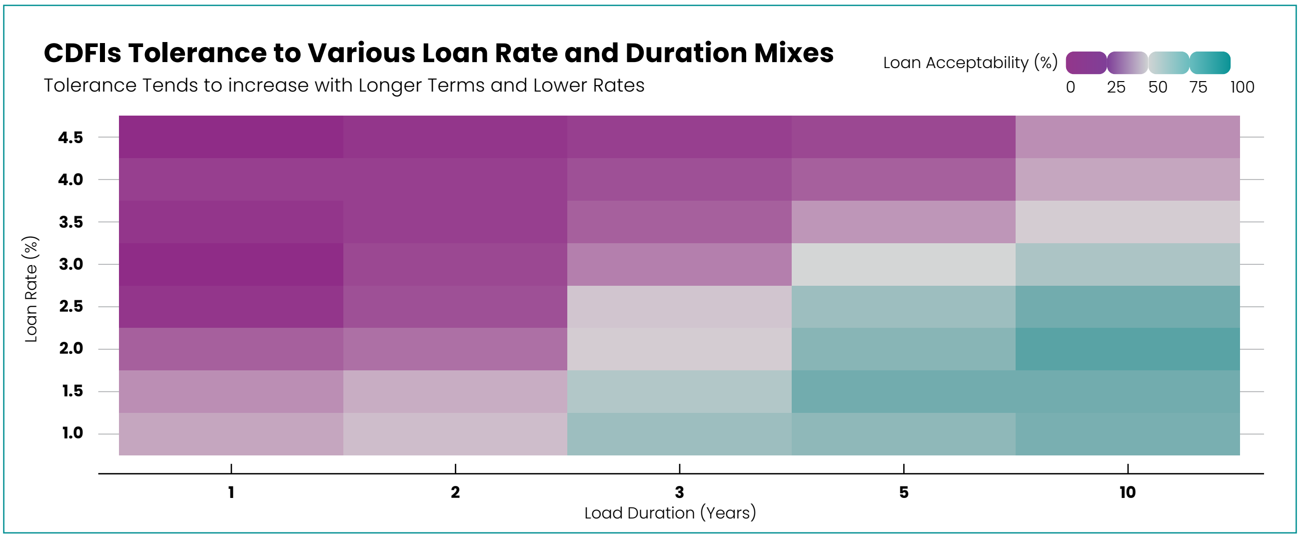
Cost of Capital Expectations for CDFIs

CDFI Loan Funds were asked detailed questions around capital pricing expectations. The average cost of capital across all CDFIs was 2.61% with expectations for a similar cost of capital for the next 12 months.

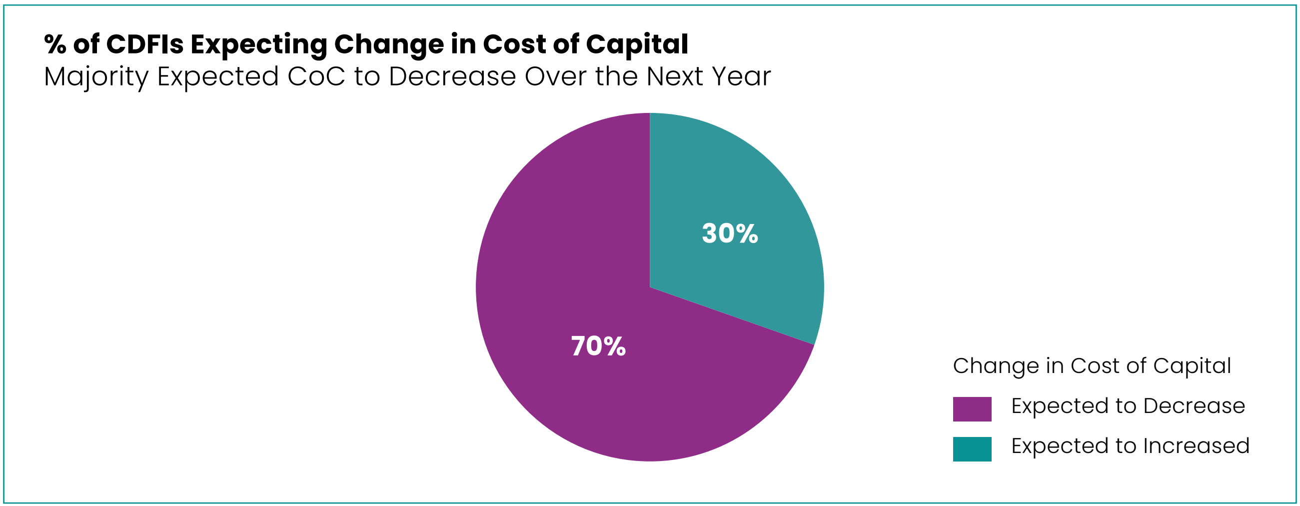
Interestingly, there was **not a strong negative correlation between cost of capital and CDFI size**, as some large CDFIs with assets around $100M reported borrowing costs well above that 2.61% rate.



CDFI partners were also asked a series of questions to map their rate-duration pricing sensitivity. The purple areas of the chart below reflect areas of low desirability while the green areas reflect rate-duration mixes that were most attractive. There was a strong preference for longer term 5 and 10 year debt financing.



Finally, respondents were asked how they expected their cost of capital to change over the next year, and **an overwhelming majority (70%) forecasted a decrease in cost of capital**. This likely is a function of the historically low-interest rate environment and prevailing monetary policy regime in place since the pandemic took hold.



Conclusion

CDFIs have a strong need for additional debt financing on attractive terms. It's clear that capital can be deployed into communities quickly and that there are significant areas of underfunding that likely align with the objectives of impact investors in the marketplace.

We hope this report was useful both to the CDFI community as a way to share institutional knowledge and perspectives but also to investors looking to gain a deeper understanding of the capital needs of CDFIs they may seek to partner with.

Please feel free to share this report with others. We hope to increase the awareness around CDFIs and education is a key component of that. We plan to make this longitudinal as well so we can track the change in capital needs and areas of underfunding over time to help inform how investors can best support the CDFI ecosystem overall.

Thank you for reading.

Investors looking to work with CDFIs can contact CNote's sales team at info@mycnote.com or by registering an inquiry here.	CDFIs looking to partner with CNote can contact our community development group at cdfis@mycnote.com or by registering an inquiry here.

About CNote
CNote is a women-led impact investment platform that uses technology to unlock diversified and proven community investments to generate economic mobility and financial inclusion. Every dollar invested on CNote's platform funds small businesses owned by women and people of color, affordable housing and economic development in financially underserved communities across America. With the mission of closing the wealth gap, CNote's customizable products allow anyone to generate social and economic returns by investing in the causes and communities they care about.

Learn more at mycnote.com