NCIF Social Performance Metrics:

Increasing the Flow of Investments in Distressed Neighborhoods through
Community Development Banking Institutions

Saurabh Narain and Joseph Schmidt

National Community Investment Fund

*Is it possible to develop a practical methodology that differentiates commu-
nity development banking institutions from all other banks and thrifts?*

*Can we create a direct correlation between a bank's community develop-
ment activities and the level of investor support that it receives, resulting in a
"reward" tied to the developmental impact of these institutions?*

*Can we actually measure this social return for investors and stakeholders and
combine social return with financial return to generate a total return that is
higher than the total return achieved from mainstream investments?*

With these questions, the National Community Investment Fund (NCIF)
began developing a methodology for identifying depository institutions
whose mission is to serve the financial needs of residents, entrepreneurs,
and businesses in low- to moderate-income communities. The NCIF Social
Performance Metrics[SM] methodology uses publicly available census data, branch location
data, and mortgage loan data to measure the social impact of banks and thrifts. After iden-
tifying banks that operate in and serve low-income communities, NCIF and other investors
are supporting these Community Development Banking Institutions (CDBIs)[1] with deposits
and other funding. (Disclosure: Both authors are representatives of NCIF.)

Community Development Banking Institutions serve the needs of low-income commu-
nities by providing access to much needed depository services and loan products, and
they serve an institutional role in improving the economic health and quality of life in
these economically vulnerable areas. Although most CDBIs refrained from the irresponsible
lending practices associated with the current recession, they are nevertheless hit hard as
their customer base is ravaged by rising unemployment and foreclosures, and as budget-
strapped governments cut back on social services. Now is the time to combat this decline
by acting quickly to stimulate the economy in distressed areas. To accomplish this, NCIF is
working with socially responsible investors to identify and support CDBIs as intermediaries

---

[1]   NCIF coined the label "Community Development Banking Institution" to denote banks, thrifts, and credit unions
that generate superior economic development effects and reasonable financial return. Although these CDBIs,
walk, talk, and look like certified Community Development Financial Institutions (CDFIs), they may or may
not be certified as such. NCIF hopes that eventually these institutions will become certified and expand the asset
class of CDFIs.

that can quickly and efficiently get investment dollars to where they are needed most: in the hands of the small businesses and entrepreneurs located throughout the nation.

Industry leaders have responded positively to this new methodology. Luther Ragin, Jr., vice president of investments at the F. B. Heron Foundation, said that "these metrics are an important step in the creation of consistent, verifiable, and cost-effective measures of social impact by commercial banks. They allow us to analyze social and financial return in a rigorous way."[2] NCIF looks forward to working alongside the investor community to move the needle of community investing and translate this support to the benefit of low-income communities.

The Growth of Socially Responsible Investing

According to the 2007 Report on Socially Responsible Investing Trends in the United States, investment in socially responsible organizations is growing at a rapid pace. Between 2005 and 2007, assets in the category of socially responsible management grew 18 percent to $2.7 trillion. These assets are divided into three broad categories of screening, shareholder advocacy, and community investing. However, among these three categories, only $25.8 billion (0.9 percent) is dedicated to community investing. This is unfortunate, as the current recession is severely affecting low-income individuals and low-income communities. A greater level of community investing can generate needed economic growth and job creation.

Why are the amounts flowing into direct community investing so small relative to the size of the industry? And why is the volume so small relative to the stated desire to spur economic development through investor dollars? Proposed reasons include a lack of an investment "product" that provides market returns and economic development impact; a lack of an investment "vehicle" that can facilitate investments; and a lack of a "metric" to measure and communicate the economic development impact of the investment.

However, contrary to assumptions, a readily available investment product exists in the form of deposits in community development institutions that provide a safe, market rate return with an acceptable level of risk yet with significant positive impact in distressed communities. Investors can deposit funds in FDIC-insured, domestic, CDBIs (the vehicle), which in turn invest in low- to moderate-income communities. Once the investors become comfortable with the CDBIs, other forms of higher impact funding (such as debt and equity) can also be provided. These mission-oriented banks and thrifts (referred to as banks in this article) spur growth in local economies by increasing access to responsible financial services in underserved communities and by establishing partnerships that result in sustainable economic development.

---

2   See Saurabh Narain and Joseph Schmidt, "NCIF Social Performance Metrics: A Quantitative Approach to Measuring the Social Impact of Banks and Thrifts, and to Investing Capital in the Community Development Banking Sector," White paper (Chicago: NCIF, 2008), available at www.ncif.org/images/uploads/NCIF_SPM.pdf.

As Federal Reserve Board Chairman Ben Bernanke stated in a recent speech, "The current crisis points to the importance of a strong network of healthy community-based organizations and lenders. As many communities struggle with rising unemployment, high rates of foreclosures, and vacant homes and stores, these organizations lead efforts to stabilize their neighborhoods. Rather than pulling back, CDFIs are introducing new products and programs to help communities respond to the crisis."[3] In contrast to large banks that are scaling back their lending, many CDBIs continue to offer innovative products and services tailored to the specific needs of their customer base.

By identifying, supporting, and communicating the significant impact of CDBIs throughout the country, NCIF is working to highlight these attractive targets for socially responsible and mainstream investment. NCIF hopes to create a virtuous cycle of high impact community investing (See Figure 3), leading to increased financial support of an often overlooked investment class that is deeply involved in the economic development of disadvantaged communities. NCIF's Social Performance Metrics and the model CDBI framework provide a formal methodology and proxy for evaluating the social performance of CDBIs; investors can overlay their own metrics and preferences on top of this. The "investment allocation methodology" then provides a mechanism to allocate assets into CDBIs that meet the programmatic and geographic objectives of the investors.

While measurement of social performance using credible metrics is important for socially responsible investors, it is as critical for the investors to demonstrate that they will reward the CDBIs as they generate more impact. As impact increases from "x" to "2 times x" the CDBIs should expect to get more funding from the investors.

Identifying CDBIs as an Asset Class

Community Development Banking Institutions are "double bottom-line" institutions with proven track records of directing their products and services to the most economically vulnerable communities. By doing so, they serve as a necessary alternative for consumers who are forced to rely on predatory lenders, check cashers, and pawn shops. An investor in CDBIs is providing critical capital that will be immediately put onto the street. Whether it is providing a local entrepreneur with a small business loan or stabilizing disadvantaged neighborhoods by lending to mom and pop real estate developers, these banks are doing more than completing one-off transactions; they are serving an institutional role in the ongoing development of their communities.

The most recognizable CDBIs are certified as Community Development Financial Institutions (CDFIs) by the CDFI Fund. The CDFI Fund is a division within the U.S. Department of the Treasury that promotes economic revitalization and community

---

3   Federal Reserve Board Chairman Ben S. Bernanke, "Community Development Financial Institutions: Challenges and Opportunities," at the Global Financial Literacy Summit, Washington, D.C., June 17, 2009. Available at: http://www.federalreserve.gov/newsevents/speech/bernanke20090617a.htm.

development by investing in and assisting financial institutions that display a proven mission of community development. However, as of July 1, 2009, only 63 of the 8,255 banks active in the United States were certified as CDFIs.

As not all CDBIs are certified by the CDFI Fund, it is necessary to identify them using other means, both quantitative and qualitative. To quantify community development, NCIF created the social performance metrics methodology. As noted above, the metrics use publicly available data to identify institutions that locate a high percentage of their activity in low-income areas. In addition, NCIF created the model CDBI framework to qualitatively assess a bank's impact on community development. The framework provides potential investors with information on an institution's operation to help ascertain whether an institution has a community development orientation.

Quantitatively Identifying an Asset Class: The NCIF Social Performance Metrics

To measure the social impact of banks and thrifts, the social performance metrics analyze the share of an institution's home lending and branches located in low-income areas. [4] NCIF[SM] has created a full suite of social performance metrics that have proven valuable to investors. As an example, according to Scott Budde, Managing Director of Global, Social, and Community Investing at TIAA-CREF Asset Management, "the NCIF metrics are proving a helpful tool for understanding the relative strategies and outcomes of CDFIs. The addition of systematic, objective data to an otherwise relatively subjective process is a major advance both for TIAA-CREF and the SRI industry."[5]

The first core metric in the social performance metrics is Development Lending Intensity (DLI) and is calculated using an institution's Home Mortgage Disclosure Act data. This DLI-HMDA metric assesses the percentage of an institution's home loan originations and purchases, in dollars, that are located in low- to moderate-income (LMI) census tracts. This can be seen as one proxy for the CRA lending test. NCIF has proposed 40 percent for DLI–HMDA as an initial threshold for institutions to prequalify as CDBIs. The second core metric is Development Deposit Intensity (DDI), which is the percentage of physical branch locations that are located in LMI census tracts. Given that the presence of branches in these census tracts is likely to increase the availability of financial services; this can be one proxy for the CRA service test. NCIF has proposed 50 percent as the threshold for DDI.[6]

Using the scores on these two metrics, it is possible to map each domestic bank into a two-by-two matrix, as detailed in Figure 1. Although banks located in Quadrant 1 meet both

---

4   See David Porteous and Saurabh Narain, "Social Performance Measurement for CDFI Banks." In Reengineering Community Development for the 21st Century, ed. Donna Fabiani and Terry F. Buss (New York: M.E. Sharpe, 2008). The metrics are available at www.ncif.org (see "database tool" tab).

5   See Saurabh Narain and Joseph Schmidt "NCIF Social Performance Metrics: A Quantitative Approach to Measuring the Social Impact of Banks and Thrifts, and to Investing Capital in the Community Development Banking Sector" White paper (Chicago: NCIF, 2008), available at www.ncif.org/images/uploads/NCIF_SPM.pdf.

6   Ibid.

thresholds, banks within Quadrants 2 and 3 have different attributes and their community development orientation needs to be analyzed further.

Figure 1. Development Lending Intensity and
Development Deposit Intensity of HMDA Reporting Banks
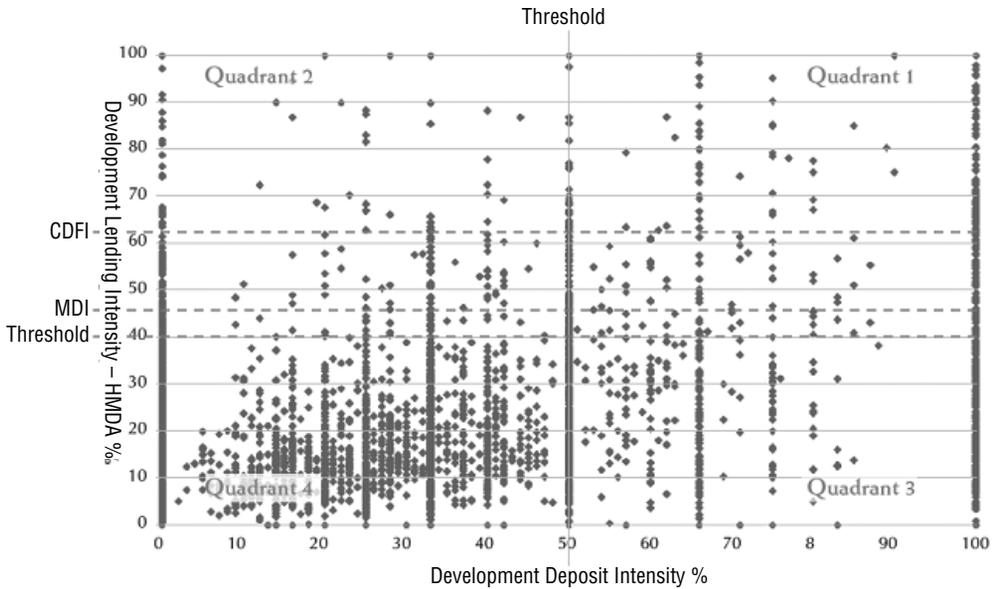
Quadrant 1 is composed of institutions that score above the threshold value for both DLI-HMDA and DDI. By virtue of their lending activity and branch location, these institutions display a high level of activity within low-income communities and that activity is likely a sign of a community development mission.

Quadrant 2 is composed of institutions that score above the DLI-HMDA threshold, but below the DDI threshold. These institutions are providing a high level of home mortgage lending within low-income communities, and that activity indicates a high degree of social performance. NCIF considers these institutions to be potential CDBIs and is interested in gathering more information about their operation.

Quadrant 3 is composed of institutions that score above the DDI threshold, but below the DLI-HMDA threshold. These institutions operate at least half of their branches within low- to moderate-income communities, and as a result are offering important financial and nonfinancial products and services within areas that are typically underserved by the mainstream banking community. Also, by being physically located in a community, the bank is providing a level of accountability to the community.

Quadrant 4 is composed of institutions that do not meet either threshold value. However, scoring below the threshold value does not necessarily indicate that these institutions are

not committed to community development. They may be active in other community development work that cannot be captured by these metrics. Investors should use other metrics for evaluating Quadrant 4 institutions, as appropriate.

By using the metrics, investors can readily identify institutions that are providing services to low-income and underserved communities. But do those service result in a positive outcome? Recent research would suggest so. Studies have demonstrated a link between the volume of financial intermediation and economic growth at a national level. Therefore, it is now generally accepted that increased levels of financial intermediation have a "first order positive causal impact on economic growth," according to Ross Levine.[7] Put another way, increasing the amount of loans and deposit accounts in a given area increases the area's overall economic growth.

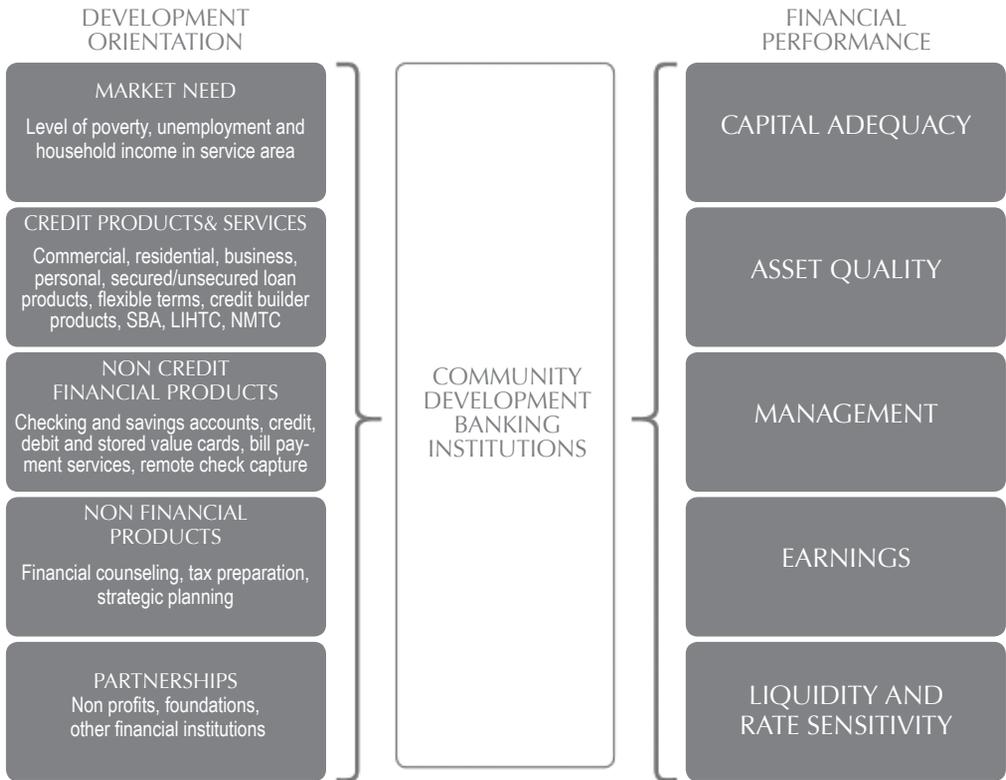### Qualitatively: The NCIF Model CDBI Framework

The NCIF Social Performance Metrics are powerful quantitative tools for measuring the community development impact of a bank's lending. However, it is necessary to augment the metrics with a qualitative analysis that examines additional aspects of an institution's operations. To determine if a bank is truly mission focused, it is essential to use the model CDBI framework (see Figure 2).

This framework deepens the quantitative analysis and helps investors gain a comprehensive understanding of whether the institution truly has a "double bottom-line" mission.

It poses questions about the community the bank serves and how the bank serves that community. For example, the model gathers information on the market needs of the community. Is the bank located in a community with a high poverty or unemployment rate? Is the bank serving an area with a low median family income? What are the various products and services the bank offers? Does the bank provide innovative products that are tailored to the needs of their community? Are they providing financial literacy and counseling to their customer base? Is the bank active in creating partnerships that will enhance the bank's impact and improve the delivery of products and services? Is the bank working with local government, nonprofit organizations, and religious groups to maximize impact?

---

7   Levine, R (2005) "Finance & Growth: Theory and Evidence" in Handbook of Economic Growth, Elsevier.

Figure 2. Model CDBI Framework

DEVELOPMENT ORIENTATION		FINANCIAL PERFORMANCE
MARKET NEED — Level of poverty, unemployment and household income in service area	COMMUNITY DEVELOPMENT BANKING INSTITUTIONS	**CAPITAL ADEQUACY**
CREDIT PRODUCTS& SERVICES — Commercial, residential, business, personal, secured/unsecured loan products, flexible terms, credit builder products, SBA, LIHTC, NMTC		**ASSET QUALITY**
NON CREDIT FINANCIAL PRODUCTS — Checking and savings accounts, credit, debit and stored value cards, bill payment services, remote check capture		**MANAGEMENT**
NON FINANCIAL PRODUCTS — Financial counseling, tax preparation, strategic planning		**EARNINGS**
PARTNERSHIPS — Non profits, foundations, other financial institutions		**LIQUIDITY AND RATE SENSITIVITY**

Investing in Community Development Banking Institutions

Identifying and Allocating Investment in CDBIs

To help investors allocate assets on the basis of their programmatic and geographic objectives, NCIF developed an additional method and algorithm that can identify CDBIs serving as community development catalysts. The "investment allocation methodology" is a function of organizational information, financial performance criteria, and social performance criteria. By working with NCIF, investors receive assistance in creating a customized portfolio of investments in CDBIs that serves as a vehicle for investing into targeted communities. This portfolio can also be tailored to meet an investor's impact, risk and return criteria. For example:

Potential CDBIs = f {Organization Information, Geographic Location, Financial Risk and Performance, Social Performance Metrics, Model CDBI Framework}

- Organization Information includes data on whether the bank is a certified CDFI Bank, whether the bank is minority-owned, whether the bank is publicly or privately owned, etc.

- Geographic Location refers to the city and state of the bank's headquarters and branch operations.
- Financial screens are based on a traditional financial analysis of a bank.
- Social Performance Metrics are based on the methodology defined above.

The database tool, located on the NCIF website, allows investors to customize a methodology to identify high-impact CDBIs. NCIF has collected information on financial and social metrics since 1996, and it can create customized investment allocation algorithms that meet investors' criteria for a period in time or as a time series. Although there is much work to be done, NCIF's "investment allocation methodology" has had some initial success. In the prior 12 months, NCIF's work with interested investors has resulted in moving approximately $70 million of new deposit funding into the CDBI sector.

Illustrations of the Investment Allocation at Work

Investors have a variety of needs and goals when seeking to invest in communities. They may hope to increase affordable housing or improve access to banks, or they may hope to spur retail development and jobs. The NCIF's quantitative and qualitative tools can help assess the viability of each of these goals. Investors have used the tools for a variety of goals. Below are three sample queries illustrating how investors are using the social performance metrics and website database tool to identify potential CDBIs .

Example 1. Investment Allocation Based on Current Institutional Performance

An SRI investor wants to make deposits in Illinois-based banks with $100 million or more in assets and a distinct housing focus. The banks should also be innovators in retail financial services, with 50 percent of their branches in LMI areas and more than 60 percent of their home lending in LMI areas.

Search Results: Illinois-Service Federal Savings & Loan, ShoreBank, Pacific Global Bank, Second Federal Savings & Loan

Example 2. Investment Allocation Based on Institutional Performance Over Time

A foundation wants to provide program-related investments to CDBIs with assets between $250 million and $1 billion that have at least 80 percent of their housing loans in low-income areas, and have tripled the percentage of their housing lending in low-income areas since 2003.

Search Results: First National Bank of South Miami, BNB Bank, OMNIBANK, Fullerton Community Bank FSB, Republic Bank of Chicago

Example 3. Investment Allocation Based on Performance Relative to a Peer Group

A CDFI bank in the Southeast wants to create a customized peer group of all southeastern CDFI banks and Minority Depository Institutions with assets between $150 million and $1 billion, Return on Average Assets greater than 25 basis points, more than 40 percent of branches in LMI areas, and a percentage of Home Mortgage Disclosure Act housing lending located in low-income communities. The goal is to then compare the social impact of the CDFI Bank relative to this peer group.

> **Search Results:** Elk Horn Bank and Trust Company, Southern Bancorp Bank of Arkansas, City First Bank of D.C., Premier American Bank, Citizens Trust Bank, Capitol City Bank and Trust, Liberty Bank and Trust Company, Guaranty Bank and Trust Company, M &F Bank, Lumbee Guaranty Bank

The Future of Impact Investing

As mentioned earlier, Socially Responsible Investing has historically focused largely on screening and shareholder advocacy with a relatively small proportion of investment going to community investing. As SRI investors increase the proportion of portfolio allocations to this sector, they are requesting detailed information on community impact. Unfortunately, while the CDBI sector has generated strong impact, the sector may not have succeeded in communicating this impact in a quantitative manner. With the Social Performance Metrics methodology, there is an opportunity for CDBIs to communicate this impact to investors and other stakeholders; in return the CDBIs hope to get tangible value out of the investors.

Currently, NCIF identifies high performing CDBIs through the publicly available data analyzed through the Social Performance Metrics methodology and through the Model CDBI Framework. However, as investors utilize these valuable tools to place deposits and other investment 'products,' the 'vehicles' delivering the impact will be required to provide additional data that both demonstrates impact and adds to the value of the Social Performance Metrics, thereby creating the virtuous cycle of high impact community investing (Figure 3). Several CDBIs are already demonstrating their willingness to report more impact information to investors since these institutions have received greater funding from the socially responsible investor community.

Figure 3. Virtuous Cycle of High-Impact Community Investing
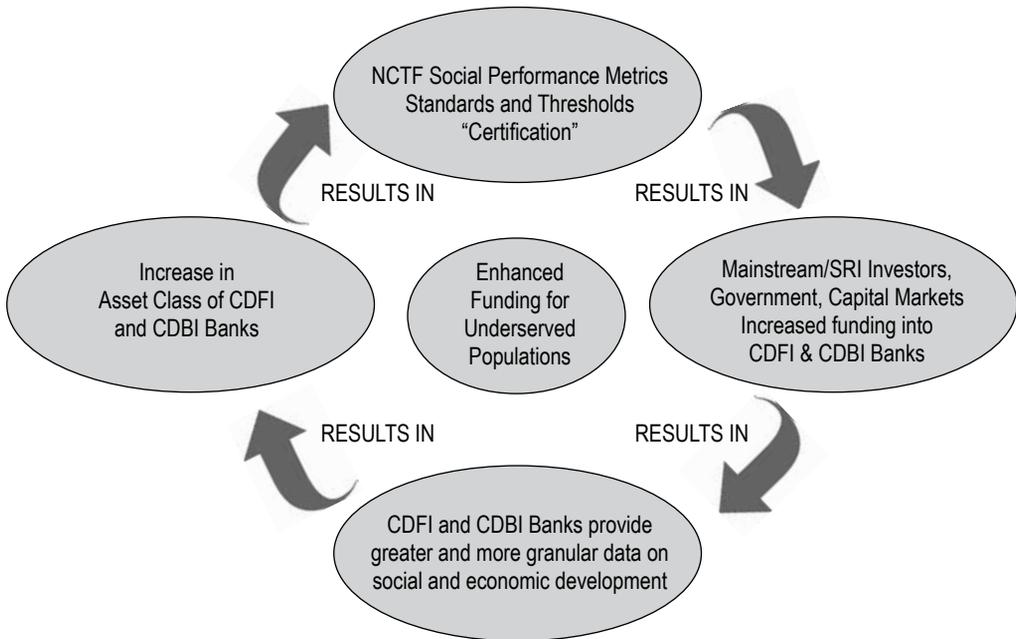
NCIF believes that, eventually, many CDBIs will recognize the value of communicating their community development impact, thereby increasing the asset class of mission oriented financial institutions in the country. As CDBIs meet the reporting requirements of the SRI community by becoming more sophisticated in the collection of impact data, they are also likely to expect an increase in funding support. In the final analysis, this virtuous cycle will result in a substantial increase in the flow of capital to the ultimate beneficiary – the underserved in this country.

NCIF encourages and fully expects that the Impact Investing industry will seek many more social metrics on positive outcomes and will then reward the sector with increased dollars. NCIF also expects that, over a period of time, measures of social return will emerge that will be additive to the financial return achieved from these investments.

Conclusion

Community Development Banking Institutions serve as a strong intermediary for socially responsible investing because they know their communities and can quickly and efficiently get investment dollars to where they are most needed. However, identifying CDBIs used to be difficult because there were no transparent measure to indicate a bank's level of activity in LMI areas. Also, many banks are not certified as CDFIs but yet have a mission of community development.

To fill this gap, NCIF developed a tool—the NCIF Social Performance Metrics—to identify banks with a community development mission. The tool helps to identify institutions whose activity is largely focused in low-income areas and whose positive effect on community development is notable. The Development Lending Intensity metric assesses the share of an institution's home loan originations and purchases that are located in lower-income areas, while the Development Deposit Intensity measures the share of a bank's branches that are located in these communities. Institutions performing highly on these metrics are identified with the dual objectives of recognizing the impact they have on their communities and increasing the level of funding that is available to them.

Currently, NCIF is working closely with the SRI community to direct new investment funding to the CDBI sector. During the past year, this work has resulted in moving approximately $70 million of new deposit funding into the CDBI sector. NCIF hopes to build on this initial success and to work with both the SRI and CDBI industries to develop a virtuous cycle of high-impact community investing that will result in a substantial increase in the amount of new community investing that is directed to CDBIs throughout the country.

Saurabh Narain is chief fund advisor (snarain@ncif.org) and Joseph Schmidt is fund advisor (jschmidt@ ncif.org) at National Community Investment Fund (www.ncif.org). NCIF is a nonprofit private equity trust set up to invest capital in Community Development Banking Institutions in the United States. NCIF created the social performance metrics.