CDFI Industry Analysis: *Summary Report*

By Michael Swack,University of New Hampshire, Jack Northrup, New England Market Research, and Eric Hangen, I² Community Development Consulting, Inc.

Introduction

Community development financial institutions (CDFIs) fill a market gap by supplying financial products and services tailored to the needs of underserved communities and are targeted to promote community development. The economic challenges stemming from the recent recession have significantly impacted the CDFI industry and have required organizations to adjust their practices and rethink their strategies going forward.

In order to understand the changing landscape of the CDFI industry, the Carsey Institute, under contract to NeighborWorks® America and the U.S. Department of Treasury's Community Development Financial Institutions (CDFI) Fund, conducted a detailed analysis of a large sample of CDFIs on issues of capitalization, liquidity and portfolio, and risk management by CDFIs from 2005 to 2010. This study involved a large sample of CDFIs of all types, including loan funds, credit unions, banks, holding companies, and venture funds within the finance/insurance/real estate industry sector. It is important to note that the analysis is not necessarily representative of all CDFI loan funds;but it is representative of CDFI banks, CDFI credit unions and CDFI bank holding companies, as information obtained is from all institutions with CDFI certification. This article is an excerpt from the full report, which is available from the CDFI Fund and the Carsey Institute.[1]

Primary Findings

Finding 1: CDFIs have been "stepping into the breach" to address lending-related needs during the recession—and have paid a financial price for doing so.

CDFIs are willing to take risks and serve customers with financial products that traditional capital markets are unlikely to provide. CDFIs have expanded their assets and their loan portfolios since the market peak in 2005, as the economic crisis has made it harder to access traditional credit markets.

- Among loan funds in this sample, median assets doubled and loan portfolios increased 76 percent. The median CDFI loan fund deployment ratio grew 3.1 percent annually from 2006 to 2009.
- The median CDFI credit union portfolio grew 47 percent from 2005 to 2010, compared with 29 percent growth for non-CDFI credit unions. Assets grew by 38 percent, compared with 47 percent for non-CDFI credit unions.
- CDFI banks saw median assets grow at an annualized rate of 7.9 percent from 2006 to 2010, while the assets of corresponding traditional banks grew at an annualized rate of 0.63 percent. CDFI banks saw their median loan portfolios grow 33 percent over the same period, versus 27 percent for the comparison group.[3]

At the same time, CDFIs appear to have paid a financial price for their actions during the recession.

- CDFI credit unions experienced declining earnings and rising delinquency rates from 2005 through 2010, and they had higher delinquency rates than the credit union industry as a whole.
- Median net income for CDFI banks, which equaled median net income for corresponding traditional banks in 2006, dropped sharply in the recession. As of 2010, median net income for CDFI banks was 63 percent of that of traditional banks. Net loss to average total loans and leases grew from 0.13 percent in 2005 to 0.88 percent in 2009 before falling back to 0.82 percent in 2010.

Finding 2: CDFI portfolio performance has been mixed, but only for a minority of organizations is it an issue that significantly affects overall financial performance.

The very limited data available on delinquencies and charge-offs for CDFI loan funds are mostly positive. In 2009, CDFI loan funds that were dedicated exclusively to home financing reported a median portfolio at risk (i.e., 90+ day delinquency) of two percent, up from 0.9 percent in 2008. Similarly, CDFI loan funds engaged solely in business lending had a median charge-off rate in 2009 of 1.3 percent. Loan funds engaged solely in real estate development lending had a median portfolio at risk of 1.6 percent in 2009, up from 1.4 percent in 2008. Charge-offs were two percent in 2009, up from 0.6 percent in 2008.

For a minority of CDFI loan funds, however, loan losses have affected financial sustainability. Among real estate and home financing loan funds in this study, 27 percent of portfolios showed risk greater than seven percent, which is the CDFI Fund's Minimum Prudent Standard (MPS). Among business loan funds, 26 percent of their portfolios exceeded the MPS of 10 percent at risk. Among all the loan funds in this study, 11 percent reported portfolios at risk greater than the CDFI Fund's "overall" MPS of 15 percent.

Data on credit unions indicate that CDFI credit unions have been experiencing greater risk in their loan portfolios than traditional credit unions. As of 2010, CDFI credit unions had more than double the rate of delinquent loans as a percentage of total assets relaive to the overall credit union industry: 2.9 percent compared with 1.0 percent. Charge-offs to average loans were only slightly higher, at 0.93 percent for CDFIs versus 0.89 percent for non-CDFIs.

Finding 3: Significant scale effects exist in all sectors of the CDFI industry.

The analyses strongly support a finding that CDFIs with larger assets are much more likely to achieve high self-sufficiency ratios than institutions with smaller assets. Among CDFI Loan Funds, larger funds outperform smaller ones along a range of factors that may result in greater self-sufficiency. At the same time, larger loan funds are able to achieve greater self-sufficiency despite operating at lower margins (smaller pricing mark-ups) than smaller funds, as can be seen in Table 1, showing three-year averages.

Table 1. *Financial Metrics by CDFI Loan Fund Asset Size*

Asset size[4]	% of applicants	Self-sufficiency ratio	Leverage ratio[5]	Combined interest / operating expense ratio	Margin[6]	Mean deployment ratio[7]	Mean charge-off ratio[8]
<$500k	10.3	0.107	-0.574	8.16	-1.640	0.23	0.00%
$500k-$1M	8.2	0.232	2.522	14.19	-0.651	0.54	0.00%
$1M-$5M	23.1	0.385	1.599	1.24	-0.348	0.68	0.52%
$5M-$10M	13.1	0.540	2.258	0.382	-0.210	0.71	0.40%
$10M-$50M	25.2	0.623	2.538	0.421	-0.137	0.82	0.38%
$50M-$100M	6.8	0.903	3.304	0.264	-0.094	0.92	0.18%
>$100M	13.5	0.848	8.138	0.079	-0.033	0.86	0.06%

Table 2. *Financial metrics by CDFI Credit Union asset size*

2010 numbers	<$10 M	$10M-$25M	$10M-$25M	$50M-$75M	$75M-$100M	$100M-$200M	$200M-$400M	>$400M
Loan interest	8.46%	7.50%	7.70%	6.73%	7.02%	7.14%	6.16%	5.77%
Gross yield	9.05%	8.21%	8.28%	7.30%	7.64%	7.82%	6.81%	6.31%
Cost of funds	1.55%	1.64%	1.67%	1.74%	1.48%	1.91%	1.76%	2.36%
Net yield with provision	5.12%	5.12%	5.07%	4.33%	5.25%	4.84%	3.72%	2.82%
Non-interest income	3.84%	3.11%	3.12%	3.08%	2.82%	3.46%	2.25%	1.63%
Non-interest expense	10.21%	8.59%	7.70%	7.17%	7.22%	7.42%	5.84%	3.38%
Net income	-1.25%	-0.37%	0.49%	0.23%	0.85%	0.87%	0.14%	1.07%

Similarly, among CDFI credit unions, larger credit unions have stronger net income performance while charging lower interest rates and fees on their loans, in large part by keeping non-interest expenses low (see Table 2). Economies of scale are also found in the CDFI banking sector, although these scale effects are more pronounced in traditional banks.

Finding 4: Operating expenses play the driving role in determining whether CDFIs achieve self-sufficiency.

As a cost driver for CDFI loan funds, operating expense is by far the largest component of an organization's expenses, dwarfing both cost of capital and loan loss expense, thus representing a key determinant of organizational sustainability. For 21 of the 34 loan funds studied, operating expenses make up more than 70 percent of total expenses. For only three of the loan funds studied do operating expenses make up less than 50 percent of total expenses, and two of these three funds report that an affiliate performs some operating functions for them at no charge.

Indeed, as alluded to in Finding 3, a major reason why larger CDFI loan funds may be more likely to have high self-sufficiency ratios is that they have drastically lower levels of operating expense per dollar of assets managed. Given the results obtained from the "deep dive" analysis, it is safe to assume that operating expense is the main component of the combined interest and operating expense ratio that was calculated for all loan funds. This ratio is significantly lower for large loan funds. There is some evidence that organizations with smaller operating expense ratios may have less intensive development services or may receive development services or other services from an affiliated organization, thus reducing their expenses.

Even among CDFI credit unions and banks, there is a similar dynamic, in which operating expense is consistently a much more powerful driver of profitability than loan performance or cost of capital. For example, among the largest CDFI banks ($1 billion to $3 billion in assets), non-interest expense runs at 3.14 percent of assets. This compares with interest expense at 2.12 percent and loan and lease losses at 0.98 percent. This dynamic is as strong or stronger among the smallest CDFI banks (under $100 million in assets), where non-interest expense is on average 3.65 percent of assets and interest expense is only 2.2 percent, and loan and lease loss provisions count for 1.12 percent of assets.

The factors driving CDFI operating expenses are clearly complex, but the bottom line is that more efficient delivery mechanisms may be critical for CDFIs' survival. These mechanisms could include greater use of technology, more collaboration between organizations, and expanding overall assets so that fixed expenses are spread over a much larger asset base. Perhaps a larger challenge for the field is that portfolio performance is directly tied to providing the very same services that are driving up the operating costs. The challenge therefore resides not simply in improving efficiency, but may be a core component of the basic business model.

Finding 5: CDFIs, particularly CDFI loan funds, face numerous barriers preventing them from using and leveraging capital more effectively.

CDFI loan funds are generally not well leveraged, possibly reflecting the cost of debt available to them.

Particularly among loan funds, a large number of CDFIs have very little leverage (i.e., they fund themselves mainly through net assets, not debt). The median CDFI loan fund in 2009 was leveraged at just $1.10 in liabilities for every $1 in net assets. About eight percent of loan funds had no liabilities whatsoever. Banks and credit unions are typically leveraged at a rate of 10:1 or more.

One reason why CDFI loan funds use little leverage may be that their "equity" (net assets) is free, whereas their cost of debt can be surprisingly high. The 31 loan funds selected for deeper analysis that reported having debt (notes payable and lines of credit) on their audited balance sheets, had a median cost of debt (interest expense/debt) of 2.7 percent. This compares to banks, which may have an overall cost of funds of less than one percent.

CDFI loan funds struggle to perform the asset transformation function and thus may need more help to meet market needs for longer-term financing.

Another issue affecting loan fund leverage levels is that generally, loan funds do not appear to have access to long-term debt. Of the 34 loan funds studied in the deep dive, only four had a term of 10 or more years remaining on most of their debt. By comparison, 17 loan funds had less than five percent of their debt with 10 years or more remaining on it, and three loan funds had no debt at all.

On-balance-sheet CDFI loan products appear largely oriented toward shorter-term products, particularly for business loan funds, real estate loan funds, and multi-line loan funds. Longer-term products appear largely to be either sold to secondary market players or are funded by net assets. For home financing CDFIs in particular, the collapse of Neighborhood Housing Services of America has made the secondary market route more difficult.

What appear to be absent from the CDFI loan fund business model are strategies by which the organization funds longer-term assets using shorter-term debt. Unlike banks and credit unions, many CDFIs have no role in asset transformation. Only 17 percent of CDFI loan fund survey respondents said they borrow short and lend long. The study results suggest, albeit not conclusively, that some mechanisms may be needed to help CDFI loan funds originate longer-term loan products, whether by enabling these CDFIs to borrow long-term debt, or by helping them hedge the asset-liability management risk stemming from borrowing short and lending long.

Potential exists to more effectively use large amounts of undeployed capital in the industry.

Of the 282 CDFI loan funds studied, the 112 organizations that were leveraged at less than $1 of debt per $1 of net assets had over $350 million in aggregate cash. About $53 million of this cash was held by loan funds with less than $10 million in assets, and $297 million held by loan funds with more than $10 million in assets. Given that there are about twice as many CDFI loan funds (572) than the 282 in this study, there might be over $700 million in cash at under-leveraged loan funds across the entire sector. The availability of this cash raises the question of whether inter-CDFI transactions could somehow be facilitated to improve liquidity for those CDFIs that need it, while providing a better return for the investing CDFIs than they receive at the bank.

Inadequate data and non-standardized auditing practices may present a barrier to CDFI capitalization.

In developing this report, the research team encountered significant data limitations at every turn. These limitations are substantial enough to be a significant barrier to CDFI capitalization, especially for CDFI loan funds, but also, to some degree, for other types of CDFIs. The limitations include:

1. Very little product-specific portfolio performance information is available for loan funds.
2. Loan level data are not available for the CDFI industry, short of compiling and harmonizing datasets from individual organizations.
3. Standards and formats for audited financials vary.
4. Uniformity in underlying business models is lacking, so a given financial ratio cannot be compared across organizations.

Policy Recommendations

Policy Recommendation 1: Create Networks, Build Infrastructure, Attract Resources and Build Scale

For community development, scale means: (1) Providing services to a large number of low-income people; (2) Providing services to a significant percentage of those in need; (3) Being able to leverage size to improve results; (4) Having enough capital to develop new products and services; (5) Getting beyond year-to-year funding concerns; (6) Capturing enough market share to influence for-profit providers; and (7) Being significant enough to have a voice with legislators and regulators.

Developing models for scale in the community finance sector can create an antidote to inefficiency, strengthen small organizations, and develop the blueprint that will promote thriving models of community development finance in urban and rural areas while maintaining the mission objectives of CDFIs.

Policy Recommendation 2: Promote the Availability of Longer Term Capital

The availability of long-term debt and equity capital for CDFIs, particularly loan funds, is one of the major structural issues facing the industry. The lack of long-term debt financing forces CDFIs to "hoard cash," pushing down leverage and giving the appearance that many underleveraged CDFIs are not lending as much as they could, thus neglecting demand among its targeted consumers. It is not a reluctance to borrow that pushes leverage down, it is the lack of long-term debt and equity or near-equity funding that is undermining the capital structure of many CDFIs.[9]

In addition, the lack of long-term capital distorts the CDFIs' product suite by default. Demand for longer-term consumer debt products is either not being met at all, or is being met by providing mismatches of assets and li-

abilities. Many CDFIs simply do not lend long, and the demand for long-term debt is either ignored or fit into the available product mix, which typically is a shorter-term debt product.

The CDFI Bond Guarantee Program, which will be able to offer long-term, fixed-rate debt financing, at terms just slightly above comparable Treasury securities may help address the issue of access to long-term, fixed-rate debt. Another possible source of this type of capital will be collaborations among CDFIs.

Policy Recommendation 3: Promote Streamlined Access to Industry Data

Consistent with policies that promote scale creation, is a policy that promotes the availability of transparent industry data from which managers can make informed decisions. Data are available for banks and credit unions, but not for loan funds or venture funds. Why not require applicants to the CDFI Fund or recipients of CDFI funding to provide uniform, consistent and accurate financial and performance data on their portfolio and operations? Bank and credit union quarterly reports can be provided using Financial Performance Reports (FPR) and Uniform Bank Performance Report (UBPR) data and call reports. Yet information for 60 percent of the industry (CDFI loan funds) is not available. Any understanding of the industry, and therefore any sensible planning, is severely handicapped by this lack of data.

In place of some of the current documentation required by the CDFI Fund, the Fund could consider creating a standardized quarterly report, similar to the call reports submitted by banks and credit unions, and require all CDFIs to submit them (or at least all CDFIs over a certain asset amount.) The Fund could make these reports public (like the Federal Deposit Insurance Corporation and the National Credit Union Administration do), which would be a great service to the industry. A quarterly call report that includes the impact data now required in the Fund's Institutional Level Report (ILR), would collect data more efficiently and would create standardized data from a universal data pool year after year. That report would accurately represent the industry and would provide meaningful data for research purposes. In addition, the CDFI Fund might consider assembling a group of CDFIs to meet with the Financial Accounting Standards Board (FASB) to establish a common set of industry reporting standards.

Policy Recommendation 4: Promote and Document Innovation

Every CDFI is slightly different, no matter what the institutional type. High performers have similar characteristics and operations. Many CDFIs are mission-bending, throwing out the capital net year after year, often linking programs and products to services. But it is often difficult to determine whether new programs are the result of innovation, or of copying other programs, or the result of "writing to the grant."

There are major, if unintended consequences for having no knowledge bank or other online resource for systematically cataloging or analyzing best practices. These information gaps stifle innovation and cause replication of ineffective approaches to capital deployment. Adequate data collection and performance metrics may diminish this consequence, but an institutional approach to promoting innovation, documenting the innovation and disseminating the results is critical in reducing overall inefficiencies within the field.

Policy Recommendation 5: Promote Education and Training

CDFIs need ongoing education and training on familiar issues: market definition, asset design, cash flow management, standardization of documentation, portfolio analysis, interest rate spreads, etc. Some need basic help with loan policies and procedures while many others need capitalization assistance and definition of that assistance.

Conclusion

The analysis suggests that the CDFI "story" is largely accurate. That story is that CDFIs are institutions that have learned to effectively manage the "risk" that discourages conventional financial institutions from serving low- and moderate-income individuals and communities. The data analysis suggests that CDFIs have succeeded in lending to and investing in individuals and communities not served by conventional financial institutions, while maintaining loan performance standards generally equivalent to those of the conventional financial sector. However, it is also true that the costs of serving these individuals and communities is somewhat higher because good performance is, in part, due to the additional technical and training services provided by most CDFIs. But some additional costs incurred by CDFIs could be mitigated if CDFIs, as a group, undertook certain changes in their operating procedures. Support for building CDFI "infrastructure," as described in this report could enhance the efficiency, productivity and impact of CDFIs. This report also suggests the need for additional research to address some of the ongoing issues faced by CDFIs including, but not limited to access to long-term capital, creating capacity for transformational activities, understanding of market failure/inefficiencies, and analysis of workforce development and retention issues for CDFIs.

Michael Swack is Faculty Director, Center on Social Innovation and Finance, the Carsey Institute, University of New Hampshire. Jack Northrup is President of New England Market Research, Inc. Eric Hangen, AICP, is President of I² Community Development Consulting. CI

4. My calculations, based on 2009 Current Population Survey data. See online appendix section 5.A3 (see Note 1).
5. Figures 1 and 2 display estimated 90/10 income achievement gaps from all available nationally representative studies that include reading- or math-achievement test scores for school-age children and family income. For most of the longitudinal studies (HS&B, NELS, Prospects, ELS, and ECLS-K), only estimates from the initial wave of the study are included. ECLS-B estimates come from wave 4, when children were five years old and tested on school readiness; SECCYD come from wave 5, when children were in third grade and were first administered a broad academic achievement test. The quartic fitted regression line is weighted by the inverse of the sampling variance of each estimate. Included studies are Project Talent, NLS, HS&B, NLSY79, NELS, Add Health (reading only), Prospects, NLSY97, ELS, SECCYD, ECLS-K, HLS, and ECLS-B. Family income is student-reported in Project Talent, NLS, and HS&B. See online appendix for details on computation of 90/10 gaps (see Note 1).
6. See online appendix 5.A4 (see Note 1).
7. My calculations, based on Main NAEP math and reading scores. See National Center for Education Statistics website, available at: http://nces.ed.gov/nationsreportcard/naepdata/dataset.aspx (accessed March 7, 2011).
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9. Figures 3 and 4 show estimated 90/10 income gaps (solid symbols) and estimated black-white gaps (hollow symbols) based on the thriteen studies with family income data. The estimated trends in the income and black-white gaps are fitted lines (quartic for income gaps, quadratic for black-white gaps), weighted by the inverse of the sampling variance of each estimate. The estimated black-white gap trend from NAEP is a fitted line (quartic for reading, cubic for math) through all available NAEP-LTT and Main NAEP black-white gap estimates. The NAEP trend is adjusted for the age of the NAEP samples and the difference between Main and LTT NAEP (the line is the predicted trend for thirteen-year-old students in NAEP-LTT). See appendix section 5.A5 for details (see Note 1).
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11. My calculations, based on Current Population Survey, 1968–2009. See appendix section 5.A3 (see Note 1).
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17. Because of the relatively small within-school samples in many of the studies that include measures of family income, it is difficult to assess the trends in school income segregation using the data available.

Looking Back and Moving Forward: Changes in the Affordable Multifamily Mortgage Industry

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2. Reznick Group. (2011). The Low-Income Housing Tax Credit Program at Year 25: A Current Look at Its Performance. Retrieved from http://www.reznickgroup.com/sites/reznickgroup.com/files/papers/reznickgroup_lihtc_survey_2011.pdf We hasten to add that both the Reznick and CCRC data may be favorably biased, in the case of the Reznick data because of survivorship bias as discussed in the article and in the case of CCRC because CCRC sold over $500 million of its mortgages and doesn't formally track its sold loans. We did check with CCRC's three major secondary market mortgage purchasers and they confirmed that they had not foreclosed on any CCRC-originated loans.
3. Ibid.
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6. According to the Marcus & Millichap Apartment Research Market Reports, 3rd quarter 2012.

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1. This article is an excerpt from the report "CDFI Industry Analysis: Summary Report," funded by the CDFI Fund, under Contract TPD-CDF-10-C-0003, Task Order 0002 and 0003. The curriculum and opinions expressed in these documents are those of the authors, who are solely responsible for the content, and do not reflect the opinions of the CDFI Fund or any other person, entity, or organization. The full report can be accessed at http://www.cdfifund.gov/docs/CBI/2012/Carsey%20Report%20PR%20042512.pdf or http://www.carseyinstitute.unh.edu/publications/Report-Swack-CDFI-Industry-Analysis.pdf
2. Although 282 CDFI Loan Funds were sampled, the outstanding question is: are the CDFI Loan Funds examined (as a result of their applying for 2010 funding to the CDFI Fund) different than those that did not apply? If one assumes that they are no different, then the results presented are representative of all CDFI Loan Funds, within the confidence levels and error margins discussed below. If, in fact, they are different, then the results may be representative of all CDFI Loan Funds. For CDFI Banks, CDFI Holding Companies and CDFI Credit Unions, a census was performed; in other words the data represents all of these CDFI institutions.
3. Median loans and lease value.
4. In this table, each year's number is averaged, so there is one number per organization.The median number is taken. The N Value for number is taken. The N Value for all CDFI loan funds is 282.
5. Leverage ratio= total notes payable/net assets.
6. Margin ratio = loan yield ratio minus charge-off ratio – combined interest and operating expense ratio.
7. This number is the average of each year's median deployment ratio.
8. This number is the average of each year's median charge-off ratio.
9. For a full discussion of this issue see: Tansey, C., Swack, M., Tansey, M., & Stein, V. (2010). Capital Markets, CDFIs and Organizational Credit Risk. The Carsey Institute. Available at http://www.carseyinstitute.unh.edu/docs/Swack_CapitalMarkets.pdf.