CDFI Growth and Capitalization

J. Nowak Associates, LLC

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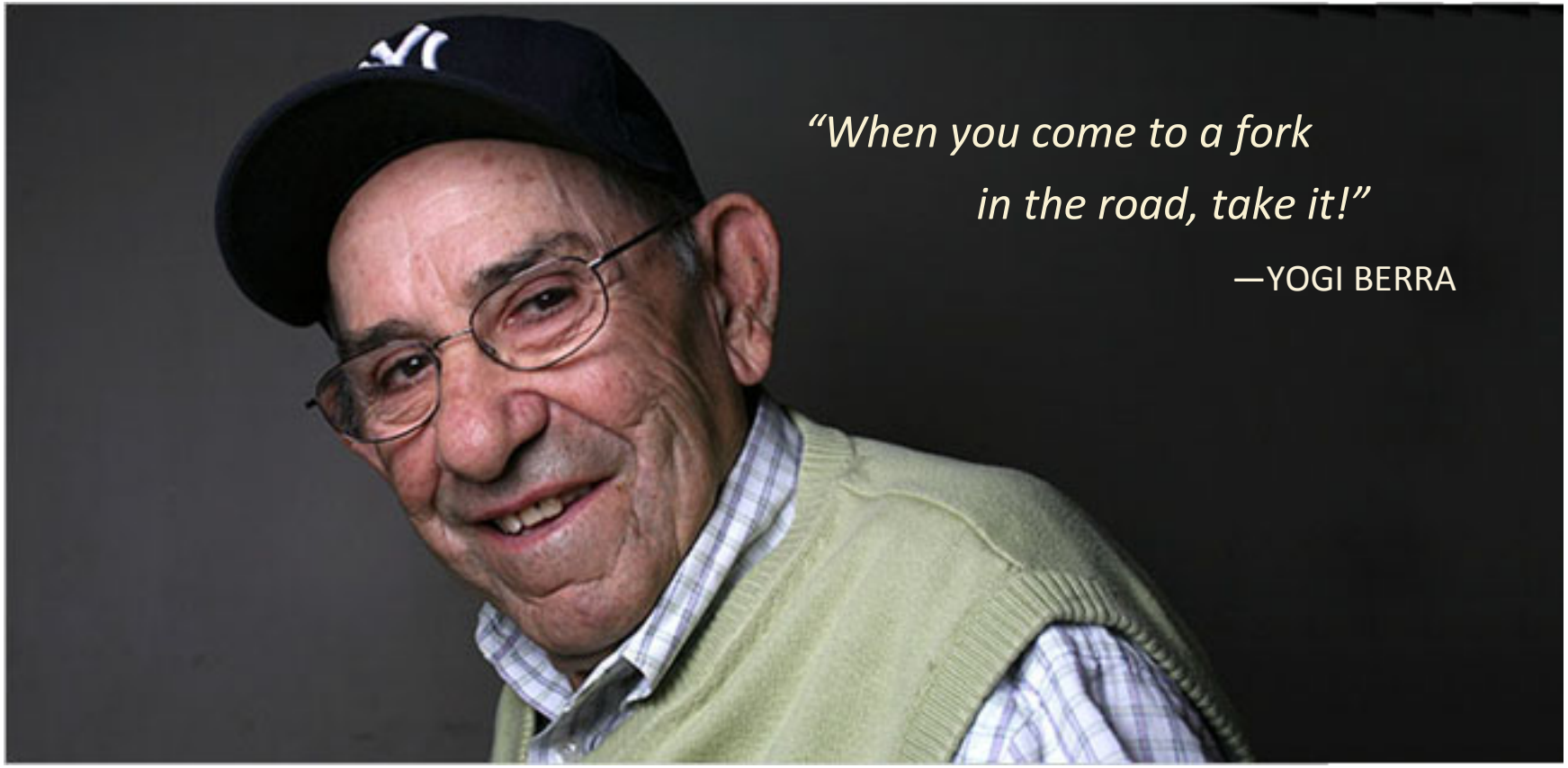
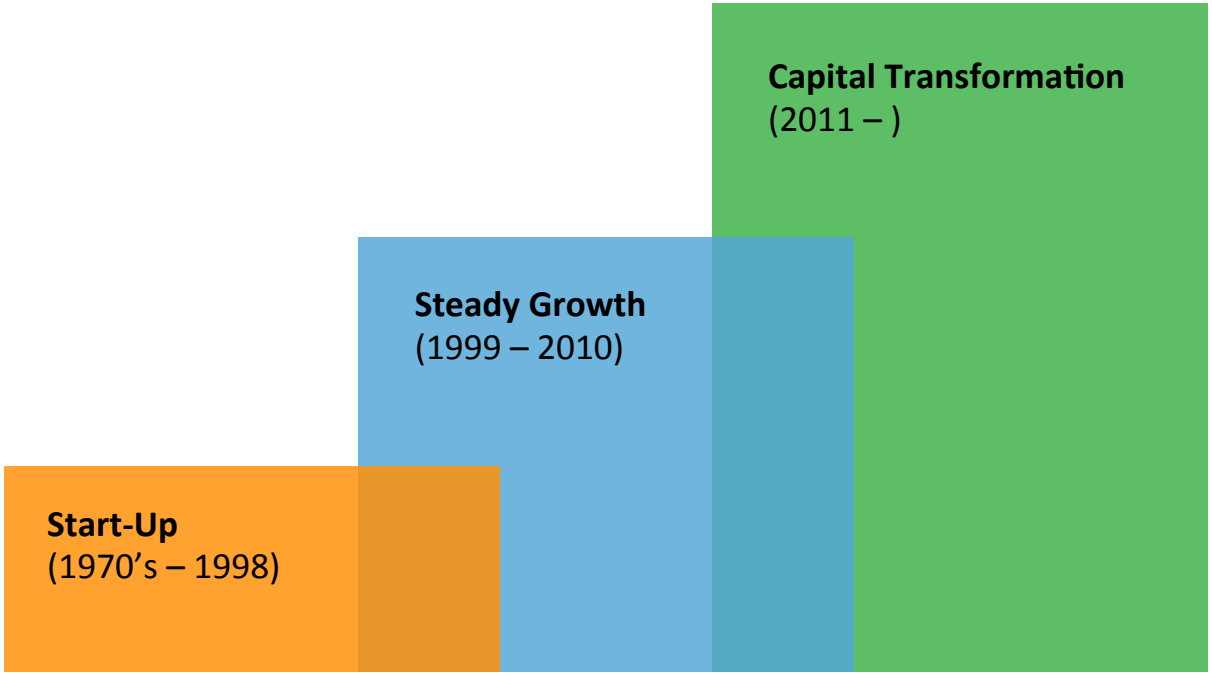

"When you come to a fork
in the road, take it!"
—YOGI BERRA

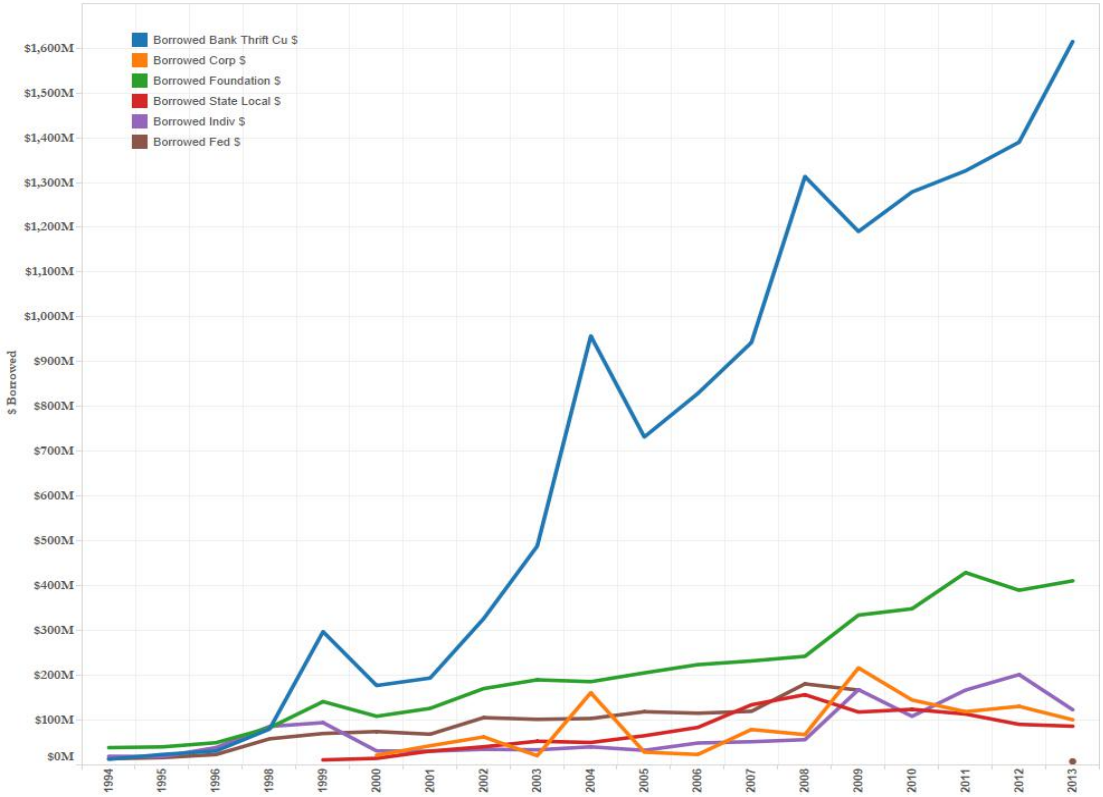
Seven Topics

1. Three Stages of CDFI Field Growth
2. CDFI Strength Model
3. Product and Place
4. Chasing the Impact Investment Brand
5. FinTech and CDFI Technology Capacity
6. Accelerating CDFI Innovation
7. Finance and Social Reform

Three Stages of CDFI Field Growth



By the end of the 1990's banks are the private sector growth driver for CDFIs



Attributes of Each Stage

Start-up

- Diversity of mission investors: individuals, religious, foundations, civic
- Limited balance sheet leverage
- Market and product exploration

Crisis: Legitimacy

Challenge: Basic lending systems

Steady Growth

- Public capital through CDFI Fund/NMTC
- Banks become dominant source of leverage
- Stronger product and process standardization
- Prototyping of boutique liquidity strategies and structured finance pools

Crisis: Diversification

Challenge: New investor structures

Capital Transformation

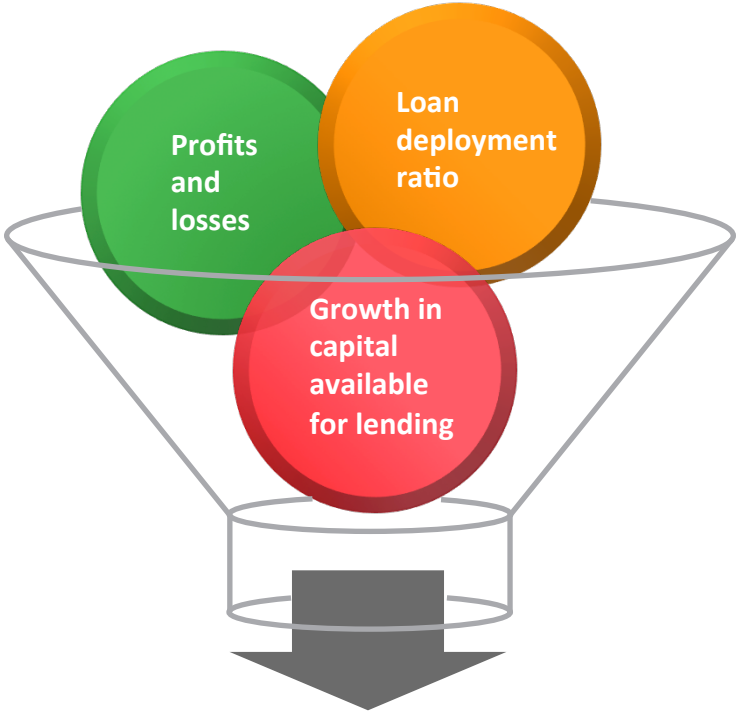
- Capital market recognition (e.g. S&P rated CDFIs)
- Balance sheet security to investors in exchange for long term capital
- Convergence with social impact investors
- Emergence of Tech CDFIs
- Growth of CDFI depository sector

Crisis: Identity

Challenge: Risk management & technology

CDFI Strength Model

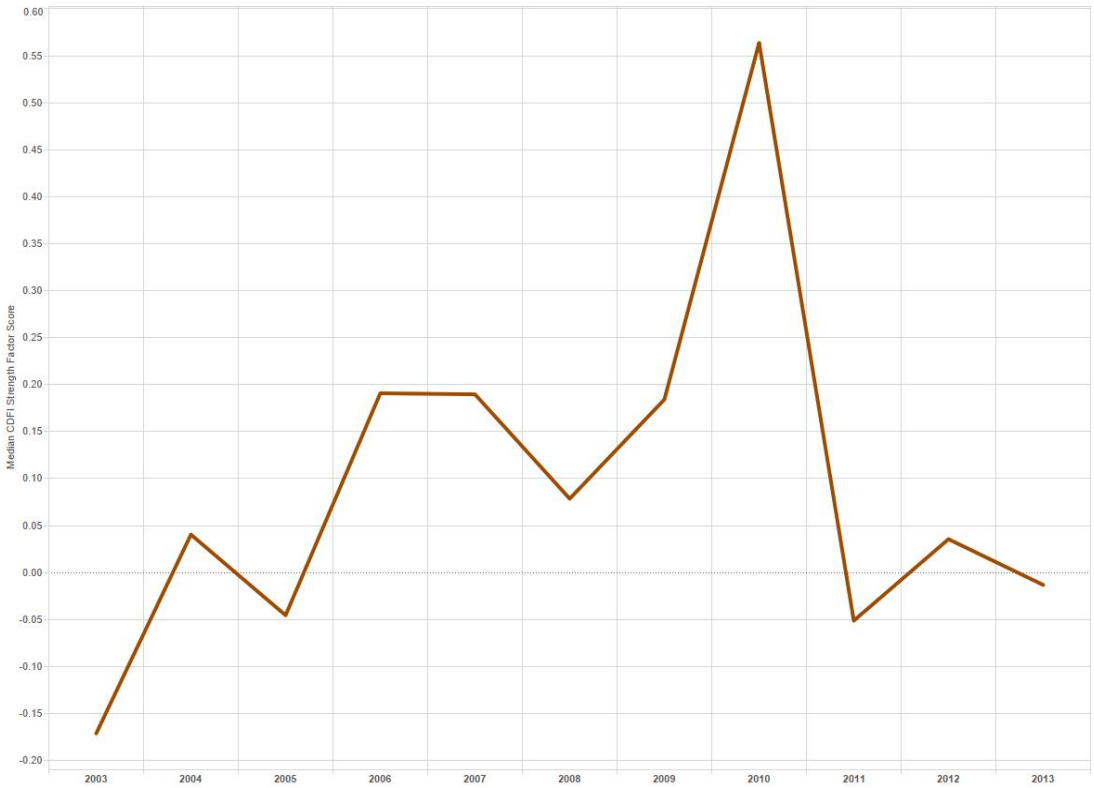
Factor Analysis Based on Co-Relationship of Three Variables



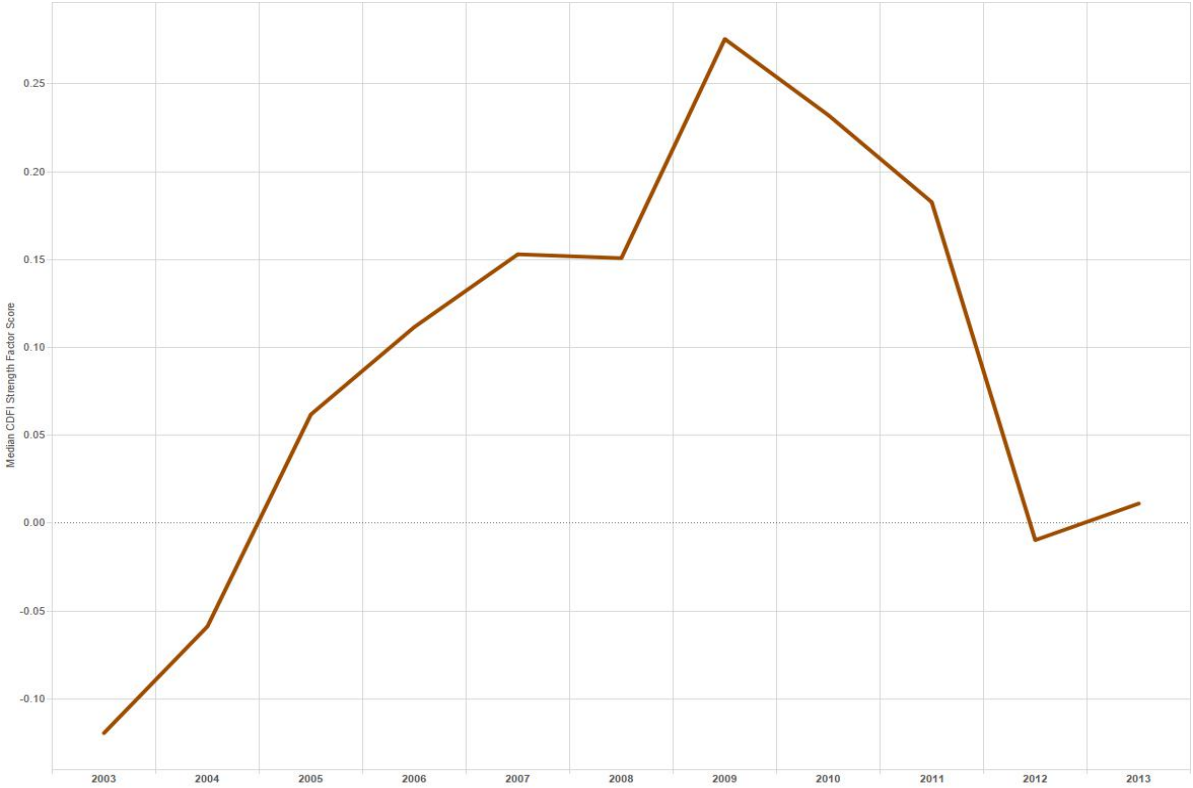
Factor score for every CDFI in OFN data base for each year

- ✓ Operating quality
- ✓ Market knowledge
- ✓ Asset growth

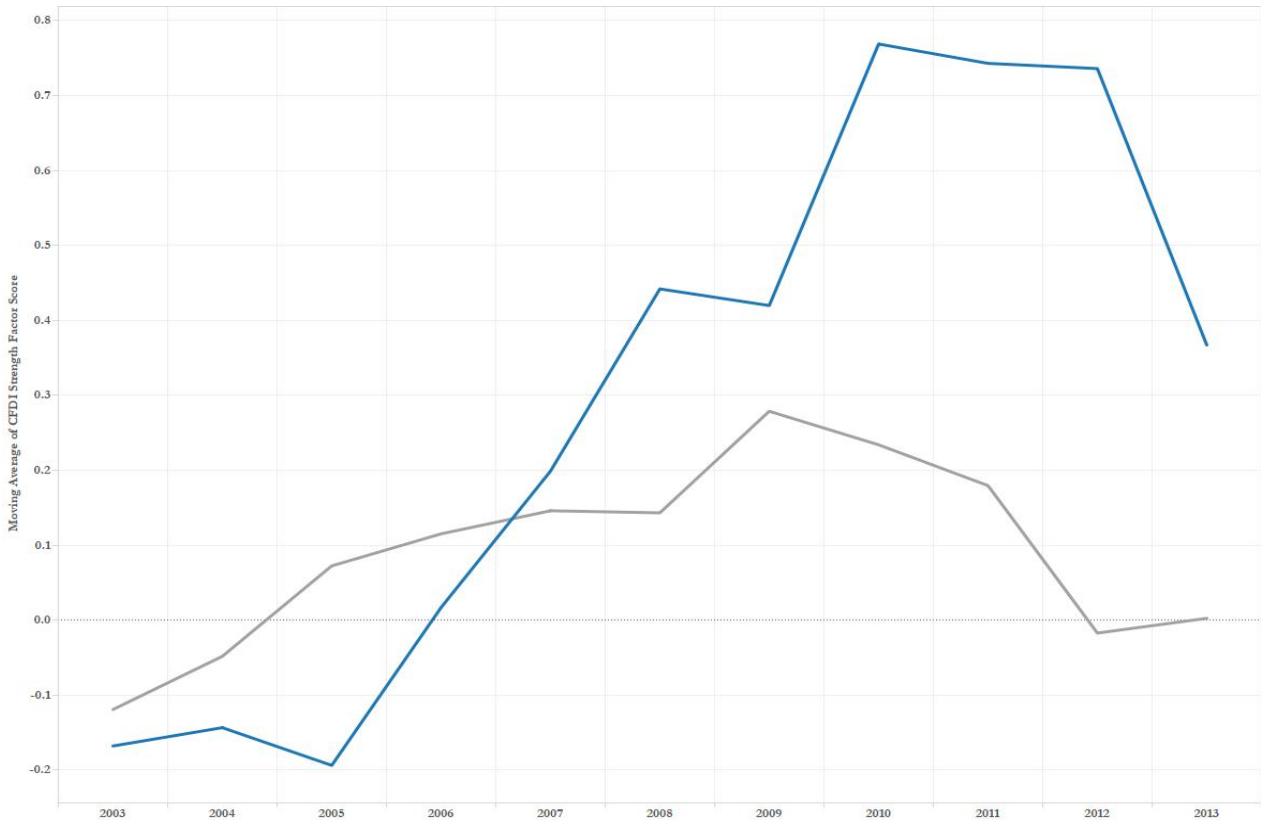
Industry-Wide Median CDFI Strength Factor Score (2003-2013)



Smoothed Version: Each Year Is Average of Year Prior, Actual Year, and Year After



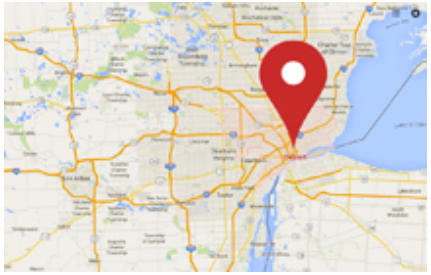
Random CDFI Versus Median Industry Pattern (2003-2013)



Product and Place

National

Local



Housing Finance

Small and medium enterprises

HEALTHY FOOD RETAIL

health care facilities

micro finance

Charter schools

Geographical Expansion

What are the incentives/tools that drive CDFIs to expand geographically?

- Public incentives
- Private investors/grantors
- Consolidation opportunities
- Following borrower expansion
- Strategy around product expertise
- Demand and social need
- Deals/Revenue
- Technology

Is the CDFI field dominated by national and multi-state funds?

- No

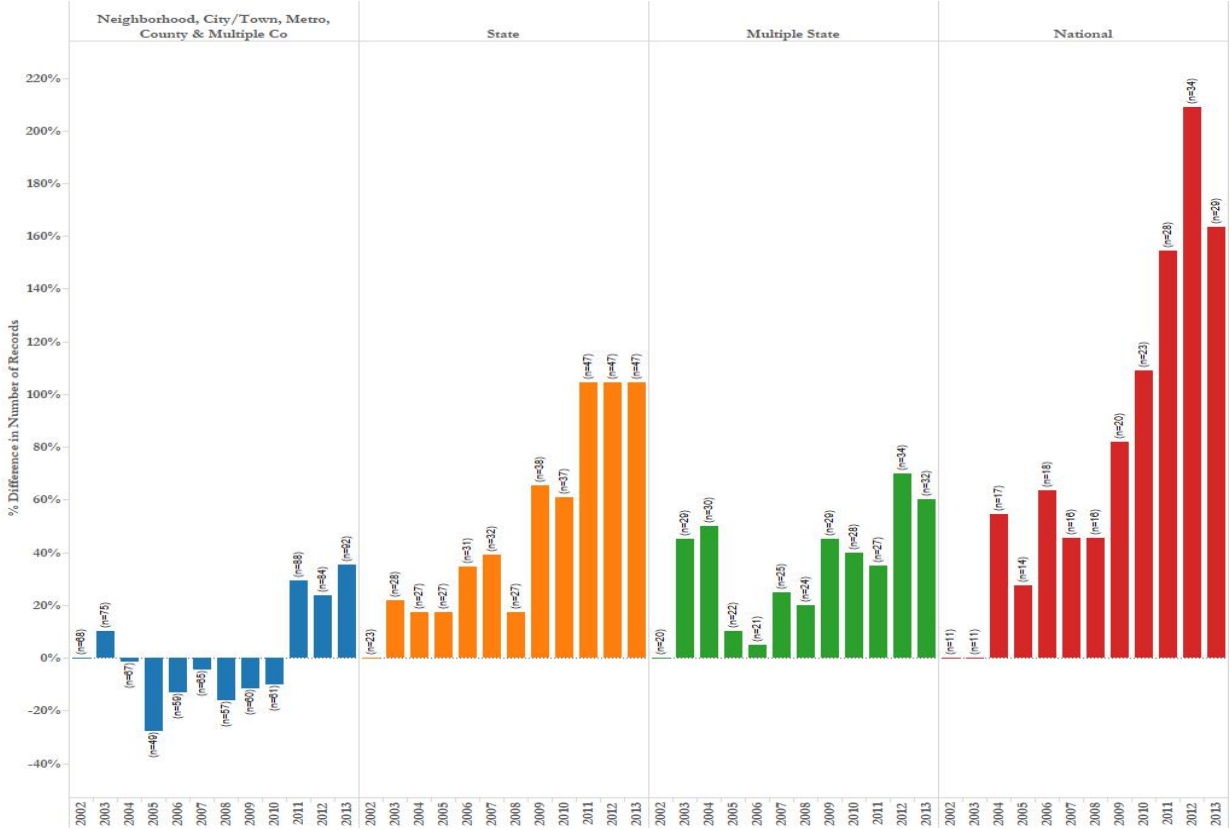
Is there evidence that geographical expansion by CDFIs results in a decline in organizational strength?

- No, at least not based on this data.

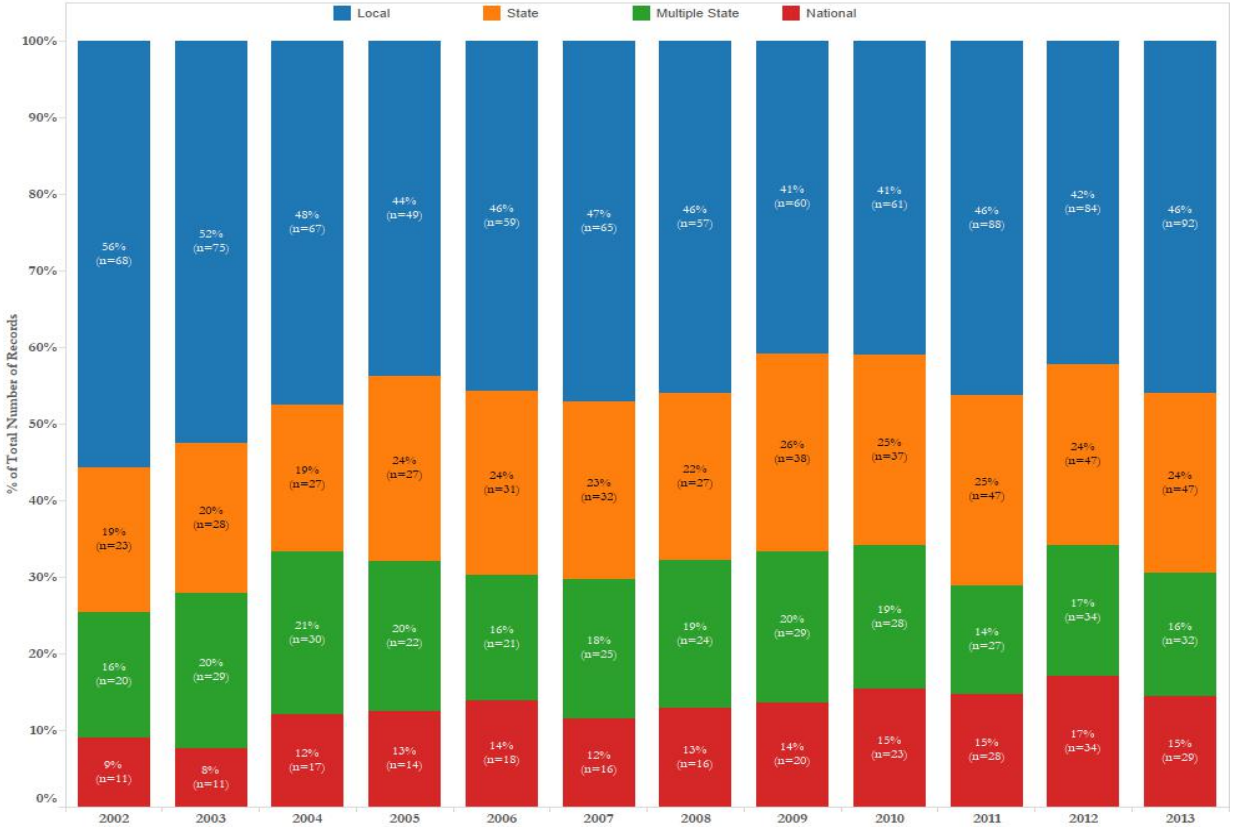
Do some leaders of local funds worry about a declining emphasis on local institution-building and feel disadvantaged regarding capital access?

- Yes

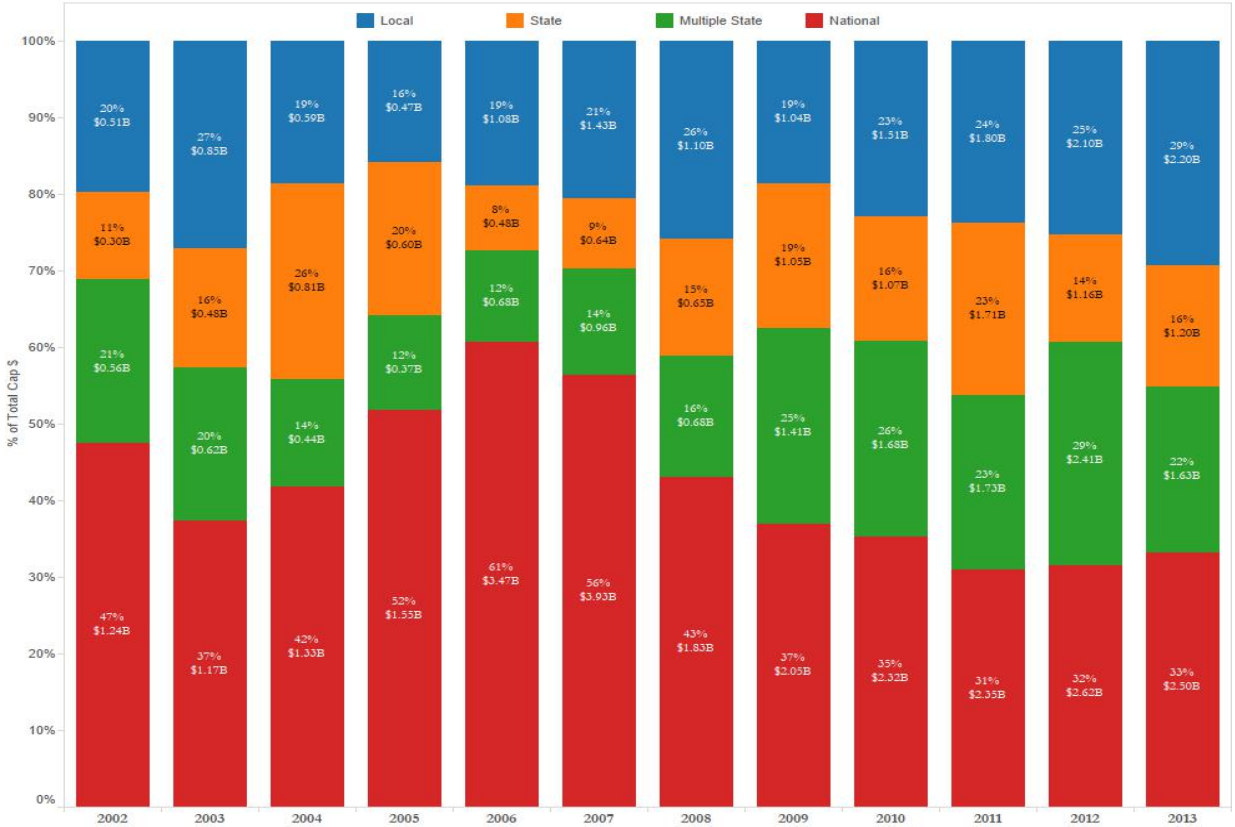
Growth of CDFIs Based on Geographical Coverage



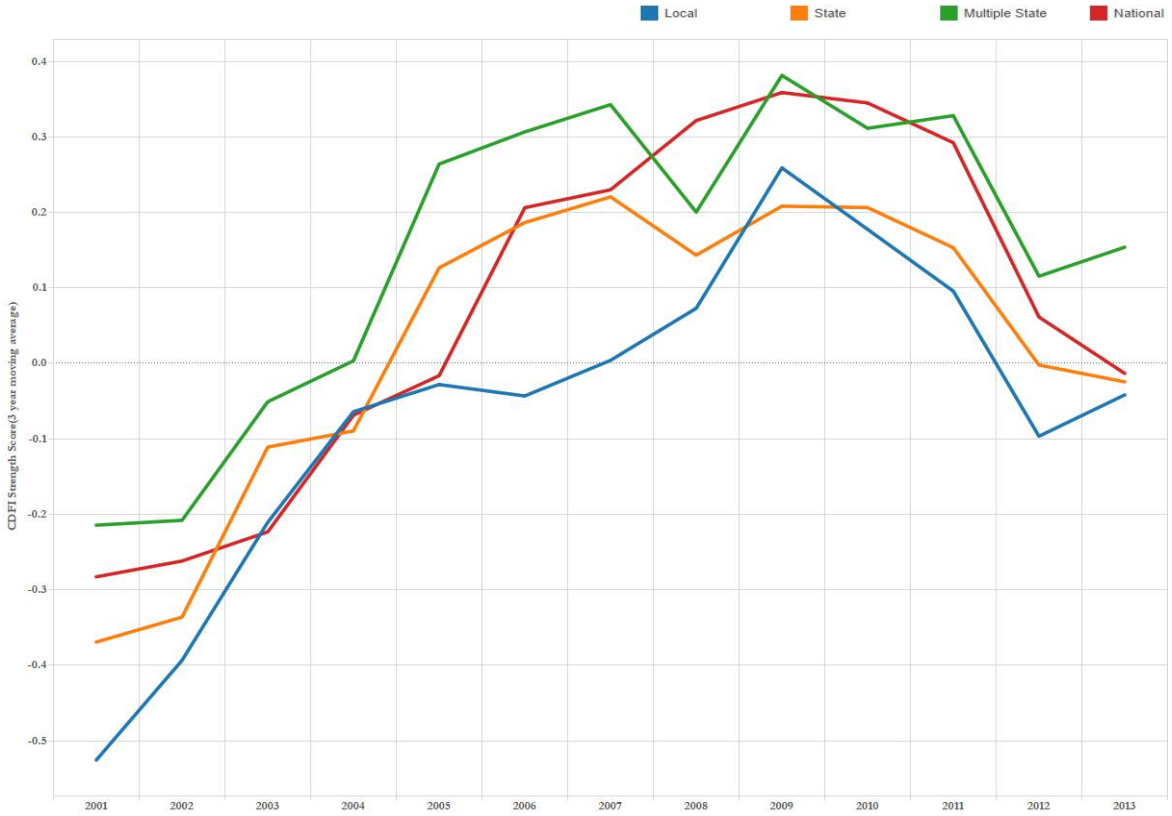
Geographical Coverage Cohorts as a Percentage of Overall Membership



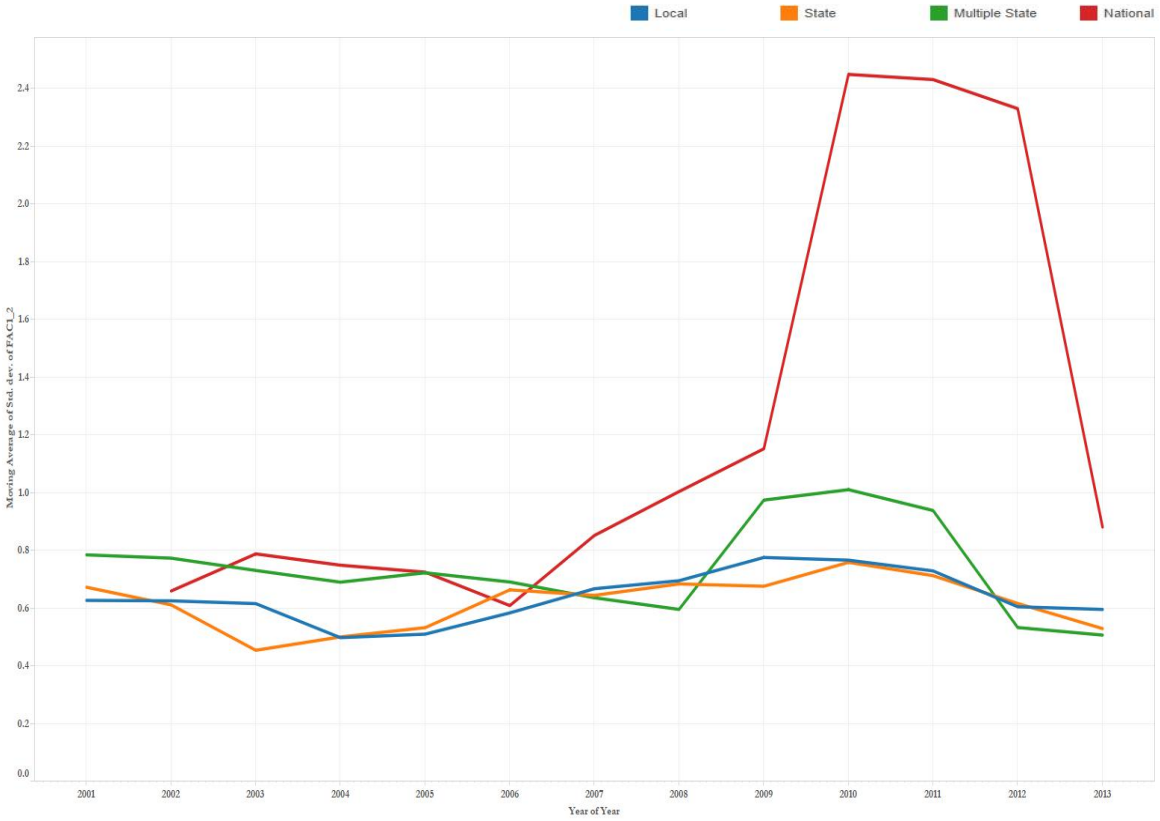
Geographical Coverage as a Percentage of Membership Assets



Strength Trajectory for CDFIs Based on Common Geographical Coverage

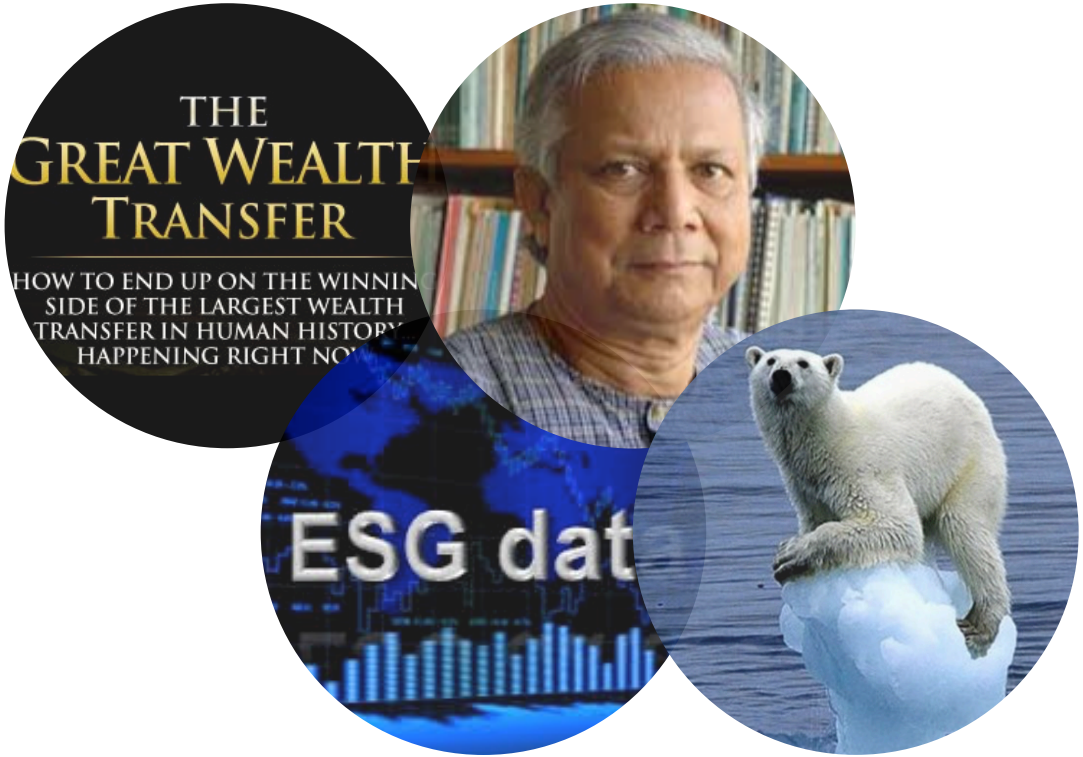


Moving Average of Standard Deviation of Factor Scores for Each Geographical Cohort



Chasing the Impact Investment Brand

Convergence of Social and Economic Spheres



Disconnections and Connections Between CDFIs and Non-CDFI Impact Investment Field

Divergence

Debt	vs	equity
Concessionary	vs	market rate
Public	vs	entrepreneurial brand
Disintermediation	vs	institution building
Community development	vs	global and environmental
Practitioner-driven	vs	wealth-holder driven

Convergence

- Social metric focused
- Poverty alleviation interest
- Some common investors but different sides of the house
- CDFIs *are what we got*
- Capital appetite/demand

Brand, Marketing, Platform, and Products

- Impact has a simpler and more universal brand than community development; so use it
- Market CDFI investments as domestic impact funds
- Challenge the part of the impact field that has *profit maximization* only narrative
- CDFI brand needs a theory of subsidy and public support: why does it need it and how does it generate impact
- New capital intermediation as in MacArthur Foundation's work to structure new products and platforms for donor advised funds and high net worth individuals,
- Invest in platforms that market domestic impact through CDFIs (e.g. ImpactUS Marketplace)
- Adopt uniform accounting standards for non-depository CDFIs and uniform impact standards
- Cultivate family office and hacker philanthropy relationships

DISRUPTION

FinTech

What is FinTech?

- The transformation of financial services through software platforms that disrupt banking architecture
- The dominance of engineering and data science over traditional underwriting processes and relationships.
- Ongoing historical transformation of boutique processes into commodities

To what extent will it succeed?

- It all depends on your belief in the algorithms, the role of regulation, generational change in behavior, performance history, and the ability of banks to change old habits.

Is any of FinTech predatory?

- Some of it appears to be, based on pricing information, particularly for some small business lending.

Does this assume a new kind of consumer: digital bundler of a personalized cafeteria of choices?

- Yes

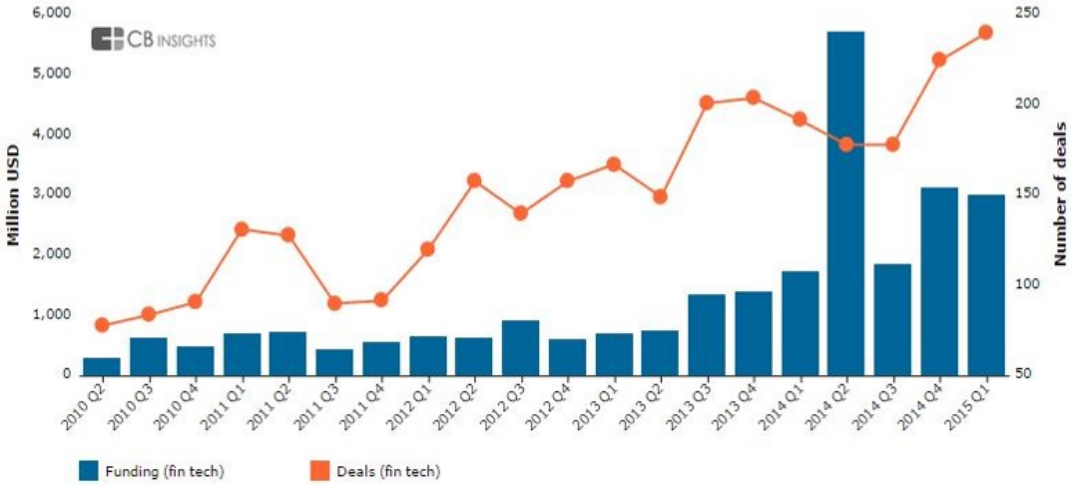
Will the banks just watch their market erode?

- Some will have no choice but many will invest in FinTech (they already are), buy the technology, transform parts of their lending operations, private label FinTech processes, and substitute technology platforms for branches.
- Some products continue to function in more boutique manner.
- Banks bundle services (cross-sell) and FinTech unbundles unbundles, so success of various models and institutions will depend on consumer behavior and choice.

FinTech Unbundling of Banking

Growth of FinTech investments by Capital and Deals

$13.7bn	+45.83%	821	+16.41%
Funding in last year	YoY Funding Growth	Deals in last year	YoY Deal Growth
150	**$1.31bn**	**Q2'14**	**Q1'15**
Avg Deals per Quarter	Avg Funding per Quarter	Biggest Quarter ($ Funding)	Biggest Quarter (# of deals)



FinTech

Does FinTech matter for CDFIs?

- **It depends on customer base and point of view!**

- FinTech has most important implications for CDFIs involved in small business lending and basic consumer services, it may be particularly relevant for credit unions and microenterprise funds.

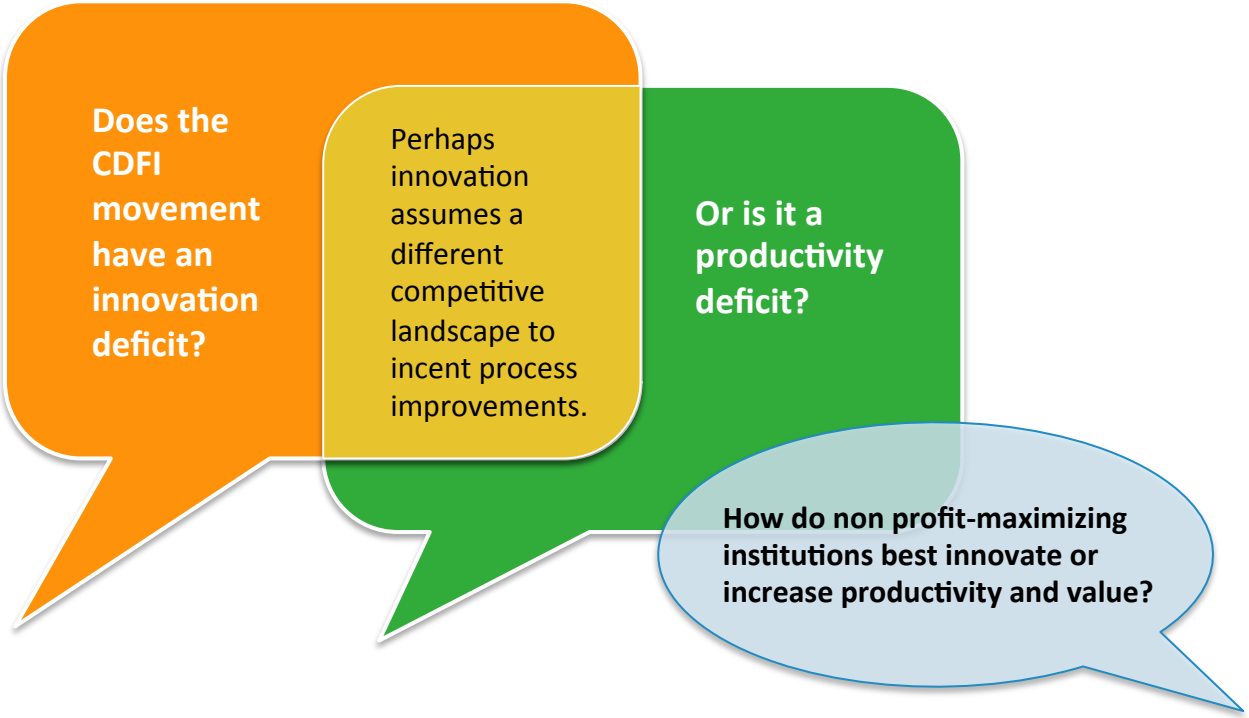
- For CDFIs that focus on high transaction cost projects with multiple layers of financing and public subsidy or tax credits, FinTech may be largely irrelevant.

- Place agnostic, cost-effective, distributive technologies ought to solve and not just exacerbate finance and banking inequities

If FinTech Matters, Then a CDFI Has Four Options

1. Do nothing and assume you can keep and expand your customer base through existing channels and incremental change in process
2. Build your own technology platform designed to deepen customer base, automate customer interface and underwriting, and build distribution channels
3. Private label an existing platform that licenses those capacities
4. Create referral relationships with FinTech companies to support CDFI market acquisition

Innovation and Productivity



Innovation Strategies Need Focus

Accelerator Model: Competitively select cohorts: mentor, invest, graduate based on stage-gate strategy

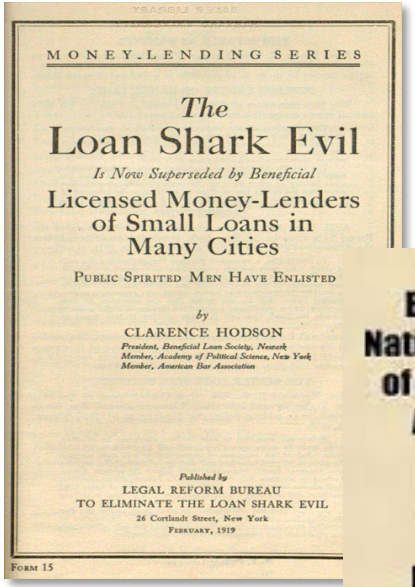
Prize Model: High-profile recognition of existing innovations to allow for scaling

Research and Development Lab Model: Provides capital support for small and large-scale applied and basic research

Collaborative Platform Model: Centralized data and technology with open source uses and decentralized exploration

Seed Fund/Equity Investor Model: Ongoing fund that specializes in early-stage prototyping with follow-on investment capacity

History of Finance and Social Reform: Good Money Strategies



MONEY-LENDING SERIES

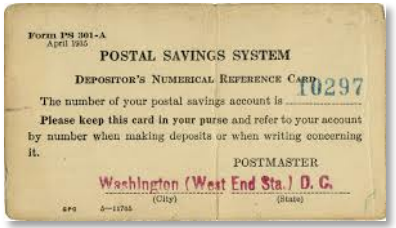
The
Loan Shark Evil
Is Now Superseded by Beneficial
Licensed Money-Lenders of Small Loans in Many Cities

PUBLIC SPIRITED MEN HAVE ENLISTED

by
CLARENCE HODSON
President, Beneficial Loan Society, Newark
Member, Academy of Political Science, New York
Member, American Bar Association

Published by
LEGAL REFORM BUREAU
TO ELIMINATE THE LOAN SHARK EVIL
26 Cortlandt Street, New York
FEBRUARY, 1919

FORM 15



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DEPOSITOR'S NUMERICAL REFERENCE CARD
The number of your postal savings account is 10297
Please keep this card in your purse and refer to your account by number when making deposits or when writing concerning it.
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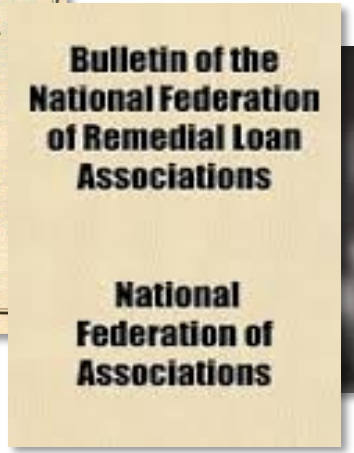

Bulletin of the National Federation of Remedial Loan Associations

National Federation of Associations

Nov. 18. 1903
The Bridgeton Building and Loan Association

History of Finance and Social Reform: Struggles for Economic Inclusion

BND
Bank *of* North Dakota

What does American History Tell Us About the Intersection of Finance and Social Reform?

- Significant role in private institution-building which becomes part of mainstream banking and finance and often loses its connection to early social mission
- Driver of legislative and regulatory reform nationally and state-by-state
- Play important roles in financial innovation related to requirements of lower- and middle-income borrowers (e.g. housing finance: early building and loan societies)
- Major economic disruptions realign banking industry but are also characterized by new reform institutions
- Balancing act of mission and margin has always been difficult

What are Reflections from that History for Work Today?

- Practitioner-focused industry needs theory of public investment and public regulation
- Good-money access and bad-money regulation work best when tied together in social reform movements
- Existing networks and trade group systems critical to first stages but deeper support infrastructure needed for more complex innovation and change
- Policy strategy has to come to terms with limits of financial solutions in poverty reduction: lack of income and degraded public goods cannot be fixed with over-reliance on debt