CDFI Market Conditions
Second Quarter 2014

Report I - Results and Analysis
Published October 2014

The Opportunity Finance Network CDFI Market Conditions Report is based on a survey of community development financial institutions (CDFIs). Opportunity Finance Network began conducting these surveys in October 2008 to better understand the impacts of tight credit markets and the economic downturn on the opportunity finance industry. Through the first half of 2012, OFN conducted a survey each quarter and published four Market Conditions Reports each year. Beginning in the second half of 2012, OFN has conducted two quarterly surveys each year and published Market Conditions Reports semi-annually based on second and fourth quarter activity. Each report provides a view of CDFI responses to current market conditions, analysis of regional and primary financing sector differences, and analysis of important trends.

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EXECUTIVE SUMMARY[1]

In the second quarter of 2014 the national economy's gross domestic product (GDP) bounced back from a brief decline in the first quarter. In the second quarter, GDP grew by 4.2% following a decline of 2.4% in the first quarter. GDP had not contracted since the first quarter of 2011 when it fell by 1.5%.[2]

The unemployment rate hovered at around 6.7% through the first quarter of 2014 before dropping to 6.1% in the second quarter. This is an improvement from the 7%+ rates seen in most of 2013[3] but still above the unemployment rate of approximately 5% before the recession.

The percentage of FDIC-insured institutions that reported loans and leases 31 days or more past due decreased from 3.58% in the fourth quarter of 2013 to 3.05% in the second quarter of 2014.[4] According to the FDIC Quarterly Banking Profile, net charge-offs for all loans and leases remained below 1%.[5]

Another established economic indicator is the delinquency rate for mortgage loans on one-to-four-unit residential properties. This rate decreased to 6.04% (seasonally adjusted) of all loans outstanding at the end of the fourth quarter of 2013, the lowest level since the end of 2007.[6]

One hundred and thirty CDFIs responded to the Second Quarter 2014 CDFI Market Conditions Survey. Key findings follow.

Demand for Financing and Loan Originations

Demand for financing remains strong. In the second quarter of 2014, 55% of respondents reported an increase in the number of financing applications received year-over-year, down from the rate reported in the fourth quarter of 2013 (63%). Less than one-third (32%) of CDFIs stated that they are seeing a decrease in the number of financing applications.

Originations are strong. Nearly half (49%) of respondents reported year-over-year increases in loan originations in the second quarter of 2014. Although the pace of lending is very strong, it is down from 60% in the second quarter of 2013.

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[1] This report presents the results of the twentieth CDFI Market Conditions Survey. OFN conducted the survey in July - August 2014. The survey covers the second quarter (April - June) of 2014. Detailed data tables are provided in the companion report, CDFI Market Conditions, Second Quarter 2014, Report II - Detailed Tables.

[2] Bureau of Economic Analysis (www.bea.gov).

[3] Bureau of Labor Statistics (www.bls.gov).

[4] In the second quarter of 2014, 0.81% of loans and leases were 30 – 89 days past due and 2.24% were noncurrent, defined as 90 or more days past due or in nonaccrual. This information provided by Federal Deposit Insurance Corporation (FDIC) Quarterly Banking Profile (www2.fdic.gov/qbp).

[5] Year-to-date, annualized calculation. A description of the FDIC's annualization methodology can be found in the companion report, CDFI Market Conditions, Second Quarter 2014, Report II – Detailed Tables, Appendix I.

[6] Mortgage Bankers Association's (MBA) National Delinquency Survey (www.mbaa.org). The delinquency rate includes loans that are at least one payment past due but does not include loans in the process of foreclosure.

Capitalization and Liquidity

Capital constraints increased except in the South. Twenty-two percent of CDFIs reported that they are capital constrained, slightly higher than the 20% reported in the fourth quarter of 2013. Higher capital constraints were concentrated in the Midwest and the South: 26% of CDFIs in the Midwest and 23% in the South were capital constrained.

CDFIs could have made more than $64 million in additional loans in the second quarter of 2014 if financing capital had been available. The bulk of these additional loans were reported by four CDFIs, one of which accounts for more than 45% of the total ($30 million). In addition, CDFIs projected a $625 million shortfall in financing capital over the next twelve months.

Portfolio Quality

Portfolio quality improved. In the second quarter 2014, average portfolio-at-risk (greater than 30 days delinquent) fell from 5.6% in the fourth quarter of 2013 to 4.5%. These figures are significantly lower than the 7.6% average for the entire six-year period that we have been collecting these data. The average loan loss reserve of 8.1% is slightly lower than the 9% average for the five-year period we have been collecting these data.

CDFIs are optimistic about the future. As in previous periods, the vast majority of CDFIs expect portfolio quality to either improve (35%) or stay the same (62%) in the next quarter.

Expectations

The majority of CDFIs expect demand for their financing in the next quarter to increase. Eighty percent of CDFIs state that they anticipate an increase in financing for the third quarter of 2014. Eighteen percent estimate that demand for financing will remain the same and only 2% anticipate a decrease. On a regional basis, the percent of those anticipating an increase in financing range from 71% in the Northeast to 84% in the South.

Among the survey respondents who believe their financing will increase in the third quarter of 2014, the responses vary across the primary financing sectors:

Business

"The economy that supports small local businesses is gaining strength, resulting in healthier borrowers."

"With the continued regulations placed on the banks, we expect to continue receiving referrals from the banks and don't expect a decline in these referrals over the next year."

"Our TA partners have been submitting increasing amounts of referrals for strong loan clients."

"There has been in increase in loan demand driven from two factors: an improving economy and better public brand awareness."

"We have seen an increase in the number of inquiries for our gap financing, as there seems to be a climate of business expansion."

Commercial Real Estate

"Businesses in general are getting more comfortable with the economy. Thus, it appears this is leading businesses to make capital investments that may have been deferred."

Community Services

"We expect an increase in financing requests in new markets as business development efforts provide new opportunities, particularly in Detroit."

"Increase is due to demand for leverage loans as part of the NMTC program and release of pent up demand awaiting NMTC program announcements."

Consumer

"We are expecting an increase due to the increase in loan advertising as well as the recent decrease in our interest rates."

Housing to Individuals

"Home prices are rising but still more affordable to build new construction than buy one already built."

"We are receiving a growing number of referrals from banks and regional economic development agencies."

"We are experiencing increased need in the area of REO/foreclosed/abandoned properties that are taken into receivership for comprehensive rehab."

Housing to Organizations

"We are starting to see increased demand for our energy retrofit product."

"Closing of the Bond Guarantee Program allows us to provide a broader range of loan products."

"Rules for use of HOME funds have changed; demands for CDFI-related funding will increase as HOME fund usage decreases."

"There's an increased interest in shared equity lending nationally, particularly from limited-equity coops and co-housing projects."

"Volume always seems to be higher in the second half of the year for projects with Low Income Housing Tax Credits. Also, CDFI FA awards will be announced soon, increasing capital access."

Intermediary

"We are able to be more price competitive on core balance sheet lending as we increase scale via structuring deployment partnerships."

Microenterprise

" We *have become an approved SBA and USDA Microlender which has expanded our lending capacity and geographic scope."*

CDFI Market Conditions, Second Quarter 2014
Report I – Results and Analysis

I. DEMAND FOR FINANCING AND LOAN ORIGINATIONS

Detailed Results

In the second quarter of 2014, 55% of respondents reported an increase in the number of financing applications received year-over-year, down from the rate reported in the fourth quarter of 2013 (63%). Less than one-third (32%) of CDFIs stated that they are seeing a decrease in the number of financing applications.

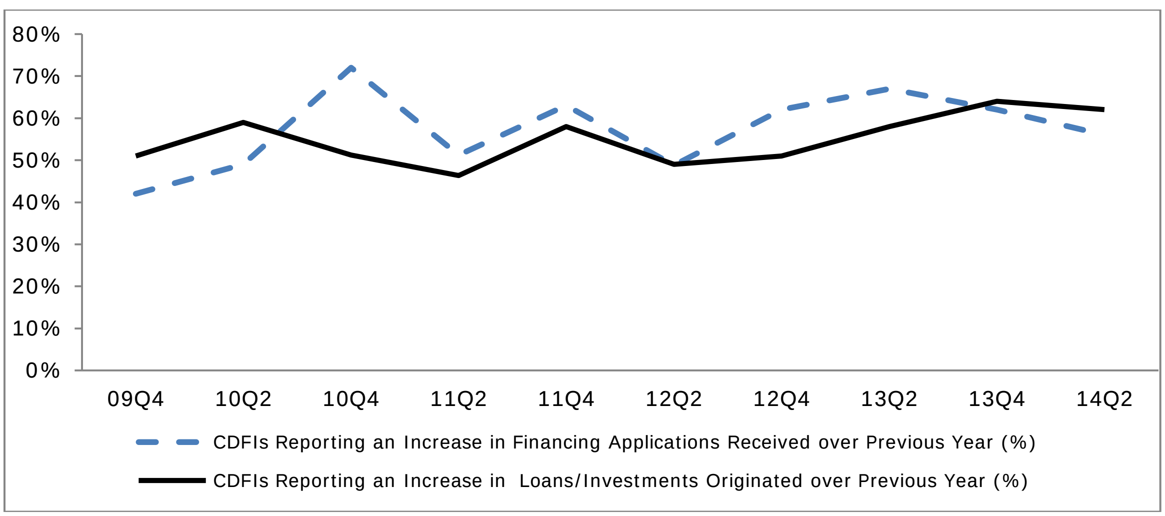
Except for Consumer CDFIs, which reported an increase of 33%, all other sectors had a 40% or more increase in the number of financing applications received.

Originations were also strong, with 49% reporting an increase in originations year-over-year. All sectors except Consumer (33%), Community Services (33%), and Microenterprise (39%) reported increases of 50% or more, with Commercial Real Estate reporting an increase of 67%.

Trend Results[7]

The subset of 39 CDFIs in the trend analysis exhibited slightly higher demand for financing and higher loan originations than all respondents in the survey. Fifty-six percent of those in the trend sample reported an increase in the number of financing applications received year-over-year and 62% reported an increase in originations over the previous year.

Figure 1. CDFIs in the Trend Sample Reporting an Increase in Financing Applications versus Loans/Investments Originated, % Change Over Previous Year (n=39)



Outlook

Eighty percent of all CDFIs expect financing to increase in the next quarter. Seventy-four percent of the 39 CDFIs in the trend sample expect financing to increase, up from the fourth quarter 2013 (69%).

[7] Complete findings for trend respondents are available in *CDFI Market Conditions, Second Quarter 2014, Report II – Detailed Tables*, Table V. The tables include the results of all quarterly surveys; the figures in Report I include results for only the 2nd and 4th quarters.

II. CAPITALIZATION AND LIQUIDITY

Detailed Results

Twenty-two percent of CDFIs reported that they are capital constrained, rising above the 20% reported in the fourth quarter of 2013. The percent of CDFIs experiencing capital constraints remains above the rates seen in 2012 (11% - 15%).

While Large and Medium CDFIs experienced a decrease or no change in capital constraints, Small CDFIs reported an increase.[8] The percent of Small CDFIs that reported capital constraints rose to 38% in the second quarter from 26% in the fourth quarter of 2013. On a geographical basis, in all regions except the South, an increasing percentage of CDFIs are experiencing capital constraints. In the Midwest, the percent of CDFIs that reported being capital constrained rose from 15% in the fourth quarter of 2013 to 26% in the second quarter of 2014. Increasing capital constraints are concentrated in three financing sectors: Consumer, Community Services, and Housing to Individuals; all other sectors experienced a decrease or no change.

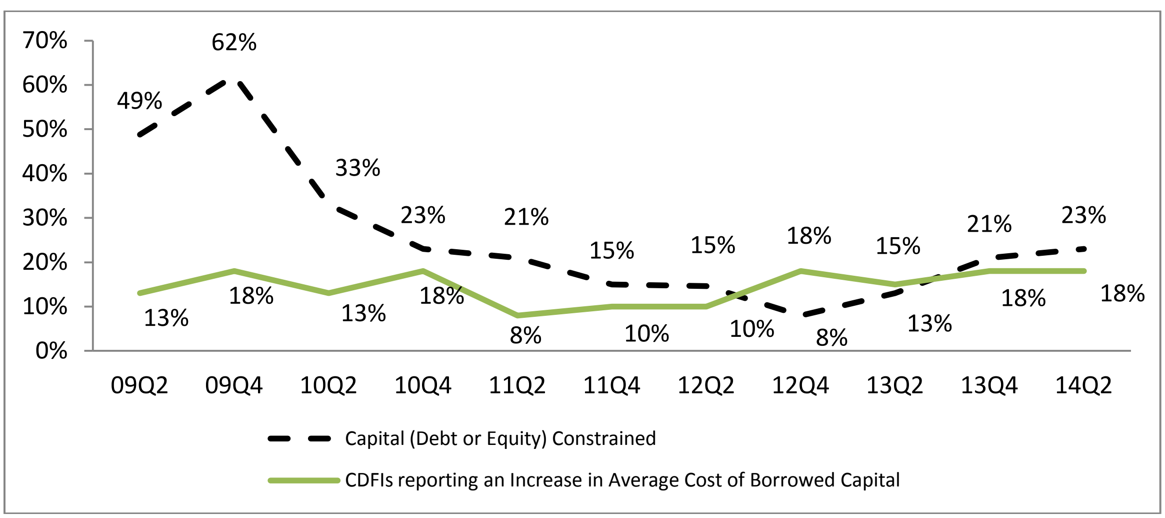
CDFIs could have made $64 million in additional loans in the second quarter of 2014 if financing capital had been available. The bulk of these additional loans were reported by 4 CDFIs, one of which accounts for more than 45% of the total ($30 million). The average shortfall was $13.3 million for Large CDFIs, $1.9 million for Medium CDFIs, and $800,000 for Small CDFIs.

On an annual forecast basis, CDFIs project a $625 million shortfall in financing capital over the next twelve months. By asset size, the projected average annual shortfall is $16.1 million for Large CDFIs, $4.3 million for Medium CDFIs and $1.5 million for Small CDFIs.

Trend Results

Both the trend sample and all CDFIs experienced a slight increase in capital constraints. The percentage of the trend sample reporting an increase rose from 21% in the fourth quarter of 2013 to 23% in the second quarter of 2014. The cost of capital has increased for a larger percentage of the trend than the percentage of all respondents. Eighteen percent reported an increase in the average cost of borrowed capital year-over-year compared to 15% of all respondents.

Figure 2. Capital Constraints and Borrowing Costs Reported in Trend Results, % Change Over Previous Year (n=39)



8 Small CDFIs are defined as those whose total assets are less than $10 million.

III. PORTFOLIO QUALITY

Detailed Results

In the second quarter of 2014, average portfolio-at-risk (greater than 30 days delinquent) fell from 5.6% in the fourth quarter of 2013 to 4.5%. These figures are low compared to 2008 when OFN first started collecting this information. The sub–6% average portfolio-at-risk was significantly lower than the 7.6% average for the entire six-year period that we have been collecting these data. The average loan loss reserve of 8.1% is slightly lower than the 9% five-year average.

Portfolio-at-risk was below 5% for Large and Medium CDFIs while Small CDFIs were at 6.1%. CDFIs located in the Northeast reported the highest portfolio-at-risk (5.7%) while CDFIs in the South reported the lowest (3.4%).

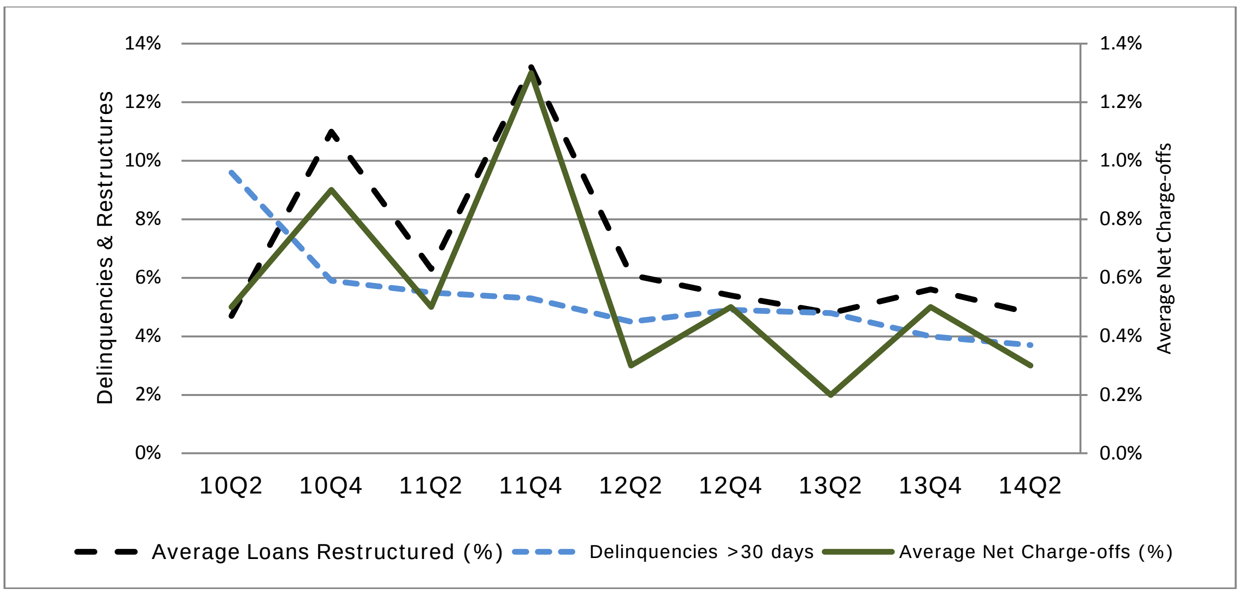
Across financing sectors, nearly all reported portfolio at risk in the range of 1% - 7%; the two exceptions are Microenterprise (7.7%) and Consumer CDFIs (9.2%).

Trend Results

Within the trend sample, the average portfolio-at-risk fell from 4% in the fourth quarter of 2013 to 3.7% in the second quarter of 2014. This is the lowest rate we have seen since we started collecting these data.

Average loan loss reserves fell year-over-year, falling from 8% in second quarter 2013 to 7.5% in the second quarter of 2014, the lowest rate seen since the fourth quarter of 2009. Average net charge-offs increased slightly year-over-year, rising from 0.2% to 0.3%.

Figure 3. Average Trend Portfolio-at-Risk, Restructures, and Charge-offs (n=39)



Outlook

CDFIs are optimistic about the future as the vast majority expects portfolio quality to either improve (35%) or stay the same (62%) in the next quarter.

Comparison to FDIC-Insured Institutions

In the previous sections, we analyzed average portfolio quality using a methodology that weighs each CDFI equally regardless of size. In this section, to compare CDFI industry portfolio quality to FDIC-insured institutions, we use the FDIC's methodology of analyzing the portfolio quality of the respondents as a whole. This method gives greater weight to large CDFIs and lesser weight to small CDFIs.

Since 2009, CDFI industry delinquency (more than 30 days past due) has been higher than that of FDIC-insured institutions, sometimes approaching double the FDIC-insured rate. It reached its peak in the fourth quarter of 2009 at 11.9%. CDFI industry delinquency gradually fell through 2012, ending the year on par with FDIC-insured institutions at 4.75% delinquency.

In early 2013, however, CDFI delinquencies once again rose above those of FDIC-insured institutions. That trend continued through the first half 2014. In the second quarter of 2014, CDFI delinquencies were 3.85% compared to the FDIC-insured institutions' rate of 3.05%. Although CDFIs continue to experience weaker portfolio quality than FDIC-insured institutions, the gap is closing and CDFI delinquencies are at the lowest rate since the end of 2008 when we began collecting these data.

Table A: CDFI Industry Portfolio Performance, All Survey Respondents

	2014	2013		2012		2011		2010		2009		2008
	Q2	Q4	Q2	Q4	Q2	Q4	Q2	Q4	Q2	Q4	Q2	Q4
n=	119	130	133	122	96	130	122	99	97	104	110	97
Net Charge-offs, year to date (annualized)	0.88	0.80	0.64	1.28	0.97	2.14	1.49	2.85	2.04	1.74	1.20	0.93
% 31-90 Days Past Due	1.21	1.29	2.02	1.92	1.84	2.29	1.93	3.10	3.98	5.27	5.20	6.82
% >90 Days Past Due or in Nonaccrual	2.64	4.00	4.56	2.83	3.63	3.64	4.53	5.68	6.60	6.63	6.40	3.09
% >30 Days Past Due	3.85	5.30	6.58	4.75	5.47	5.93	6.46	8.78	10.57	11.90	11.60	9.91

Table B: FDIC-Insured Institution Industry Portfolio Performance on Loans & Leases (n=approx. 7,000)

	2014	2013		2012		2011		2010		2009		2008
	Q2	Q4	Q2	Q4	Q2	Q4	Q2	Q4	Q2	Q4	Q2	Q4
Net Charge-offs, year to date (annualized)	0.51	0.69	0.78	1.10	1.13	1.55	1.70	2.54	2.74	2.49	2.24	1.28
% 31-90 Days Past Due	0.81	0.96	0.98	1.15	1.11	1.35	1.38	1.61	1.69	1.93	1.85	2.01
% >90 Days Past Due or in Nonaccrual	2.24	2.62	3.09	3.60	3.89	4.09	4.37	4.87	5.21	5.37	4.35	2.93
% >30 Days Past Due	3.05	3.58	4.07	4.75	5.00	5.44	5.75	6.48	6.90	7.30	6.20	4.94