

CDFI Market Conditions Third and Fourth Quarters 2011

Report I - Results and Analysis Published April 2012

The Opportunity Finance Network CDFI Market Conditions Report is a quarterly publication based on quarterly surveys 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. Each report provides a near-real-time view of market conditions and CDFI responses, analysis of regional and financing sector differences, and analysis of important trends.

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EXECUTIVE SUMMARY¹

Through the third and fourth quarters of 2011, the national economy and employment continued to show improvement. Gross domestic product (GDP) grew at an annual rate of 1.8% in the third quarter and 3% in the fourth quarter. These rates were higher than the 1% achieved in the second quarter of 2011. In the third quarter, the unemployment rate remained unchanged from the second quarter at 9.1%, before dropping to 8.7% in the fourth quarter.

The percentage of FDIC-insured institutions that reported loans and leases 31 days or more past due showed a slight decrease from 5.75% in the second quarter 2011, to 5.59% in the third quarter and 5.44% in the fourth quarter.² Non-current loans (90 or more days past due or in nonaccrual) also showed a slight decline. The delinquency rate for loans on one-to-four-unit mortgages decreased to a seasonally adjusted rate of 7.99% of all loans outstanding as of the third quarter of 2011, a decrease of 45 basis points from the second quarter of 2011. The delinquency rate also decreased during the fourth quarter to a seasonally adjusted rate of 7.58%, a decrease of 41 basis points from the third quarter.³

The key findings from the third and fourth quarter 2011 CDFI Market Conditions Surveys show robust increases in demand and originations, as well as continuing improvements in capitalization, liquidity, and portfolio quality.

Demand for Financing and Loan Originations

Growth in demand for financing has been strong for three consecutive quarters. The percentage of respondents experiencing an increase in the number of financing applications received year over year was above 50% in each of the last three quarters of 2011. This consistent level of demand has not been seen since the second half of 2009 and the first quarter of 2010.

Loan originations have likewise been strong for three consecutive quarters. The percentage of respondents reporting an increase in loan originations year over year was 54% or higher in each of the last three quarters of the year, rates not seen in any previous quarter since we began conducting the survey in 2008.

Seventy percent of respondents expect demand for financing to increase in the next quarter. The most common reasons respondents expect demand for financing to increase are the improving economy and federal and state budget cuts.

1 This report presents the results of the thirteenth and fourteenth consecutive quarterly CDFI Market Conditions Survey conducted in October through November 2011 covering the third quarter (July – September) of 2011 and in January through February 2012 covering the fourth quarter (October - December). Detailed data tables are provided in the companion report, CDFI Market Conditions, Third and Fourth Quarters 2011, Report II - Detailed Tables. Please note that we have adjusted some responses that were presented in the detailed tables in earlier reports.

2 In the third quarter 1.37% of loans and leases were 30 – 89 days past due and 4.22% were noncurrent, defined as 90 or more days past due or in nonaccrual. In the fourth quarter, 1.35% of loans and leases were 30 – 89 days past due and 4.09% were noncurrent. Federal Deposit Insurance Corporation (FDIC) Quarterly Banking Profile.

3 Mortgage Bankers Association's (MBA) National Delinquency Survey. 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 continue to loosen. At year-end, 16% of CDFIs reported that they were capital-constrained. This is slightly lower than year-end 2010 (18%) and significantly lower than year-end 2009 (50%). In addition, during the third quarter, 52% of CDFIs reported increased access to capital year over year; 48% of CDFIs reported increased access to capital in the fourth quarter.

Notwithstanding the fact that few CDFIs reported capital constraints, those that are constrained could have made an additional \$52 million in loans in the third quarter and an additional \$44 million in loans in the fourth quarter if financing capital were available. Respondents project a \$694 million shortfall in financing capital over the next twelve months.

Few CDFIs expect an unrestricted loss in the current fiscal year. As of fourth quarter 2011, the percentage of CDFIs expecting a decline in unrestricted net assets remains low at 14%, slightly higher than at year-end 2010.

Portfolio Quality

Portfolio quality continued to improve in the second half of the year. In the third quarter, average loans more than 30 days past due held steady at 6.8% (compared to 6.5% in the second quarter). As expected portfolio-at-risk fell in the fourth quarter with a rise in year-end charge-offs and restructures: portfolio-at-risk fell to 5.8%, net charge-offs rose to 1.3%, and restructures increased from 5.0% in the third quarter to 7% in the fourth quarter. With the exception of net charge-offs, these statistics are better than year-end 2010; net charge-offs were 1.0% at year-end 2010.

CDFIs are optimistic about the future. As of the end of the fourth quarter, nearly half (45%) of respondents expect portfolio quality to improve in the next quarter, the highest percentage since we began collecting these data and a jump up from the third quarter when 35% of CDFIs expected improved portfolio quality.

Among the survey respondents who commented on their expectations for the next quarter, the responses vary across regions and sectors:

“Demand is stronger than ever. Loan capital availability is tighter than ever. Competition for Federal funds is heating up. Banks are loosening in lending a bit, but not impacting much of our market. Foundations seem to be taking a renewed interest in what we are doing.”
(Business CDFI, located in the West)

“Indian Country is not completely isolated from the general market but it does not see as many highs and lows in the market. It is underserved and needs new partners but the partners it does have remained pretty constant.”
(Intermediary CDFI, located in the Midwest)

“No change in outlook unless the CDFI Bond Guaranty Program becomes active. Then, we would increase loan production substantially.” (Housing to Organizations CDFI, located in the Northeast)

“Recent Quarter: We saw strong demand for loans in the 4th quarter as the lowering of our interest rates continues to take hold in the market. Future Outlook: A declining subsidy environment, and weaker nonprofit capacity after the recession, is resulting in fewer financeable projects. There also will continue to be strong competition among CDFIs for loan opportunities in many areas. We believe that early lending for LIHTC transactions, and educational facilities lending will remain strong, with potential growth in the area of leveraged lending for community health centers.”
(Housing to Organizations CDFI, located in the Northeast)

“Outlook is more positive than at any time in the past four years. Quality of inquiries very good, strong pipeline; still taking more time than it once did for projects to come together. 2011 and especially the 4th quarter, was the best performance since 2007.”
(Housing to Organizations CDFI, located in the West)

CDFI Market Conditions, Third and Fourth Quarters 2011

Report I – Results and Analysis

I. DEMAND FOR FINANCING AND LOAN ORIGINATIONS

Detailed Results

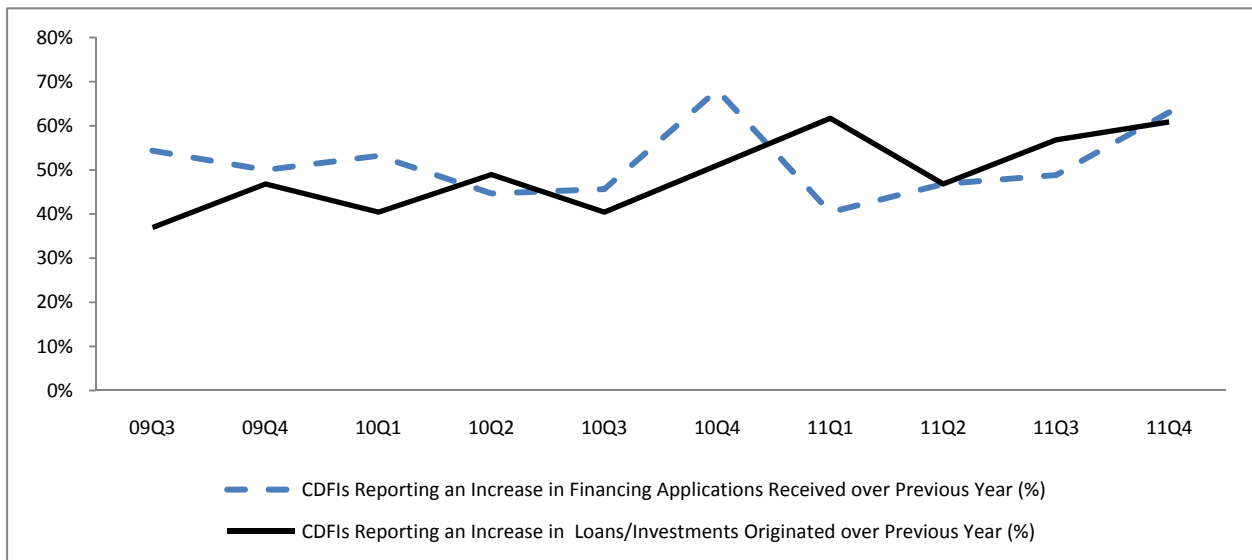
Growth in demand for financing continued to strengthen through the third and fourth quarters of 2011. The percentage of respondents experiencing an increase in the number of financing applications received year over year increased from 56% in the third quarter to 57% in the fourth quarter. In all sectors, more than 50% of CDFIs reported an increase in the number of applications received in the third or fourth quarter year over year. The biggest increases were reported in the Consumer (88% reported an increase in the fourth quarter), Housing to Individuals (86% of CDFIs in the third quarter), and Commercial Real Estate (75% of CDFIs in the fourth quarter) sectors.

Originations were up in the third quarter of 2011 with 61% of CDFIs reporting an increase in originations year over year before falling slightly to 60% in the fourth quarter. Among those CDFIs that reported that originations did not keep pace with financing applications in the fourth quarter, the primary reasons were weak application quality (24%) followed by increased due diligence (16%) and limited capital liquidity (12%). Sectors with the most robust increases in originations year over year are Microenterprise (93% of CDFIs in the third quarter), Commercial Real Estate and Consumer (75% of each in the fourth quarter), and Housing to Individuals (71% of CDFIs in the third quarter).

Trend Results⁴

In the fourth quarter of 2011, the demand for financing outpaced the rate of originations as shown in the subset of 47 CDFIs in the trend analysis. Sixty three percent reported increased demand for financing applications versus 61% who reported an increase in originations over the previous year. Originations were up for 57% to 61% of trend respondents in three of four 2011 quarters, a significant increase over previous years.

Figure 1. CDFIs Reporting an Increase in Financing Application versus Loans/Investments Originated, % Change Over Previous Year (n=47)



Outlook

Seventy percent of respondents expect demand for financing to increase in the next quarter. Only 4.7% of respondents (predominantly the Housing to Individuals and Microenterprise CDFIs) expect a decrease in demand for financing.

⁴ Complete findings for trend respondents are available in *CDFI Market Conditions, Third and Fourth Quarters 2011, Report II – Detailed Tables*, Table V, pages 50-53.

II. CAPITALIZATION AND LIQUIDITY

Detailed Results

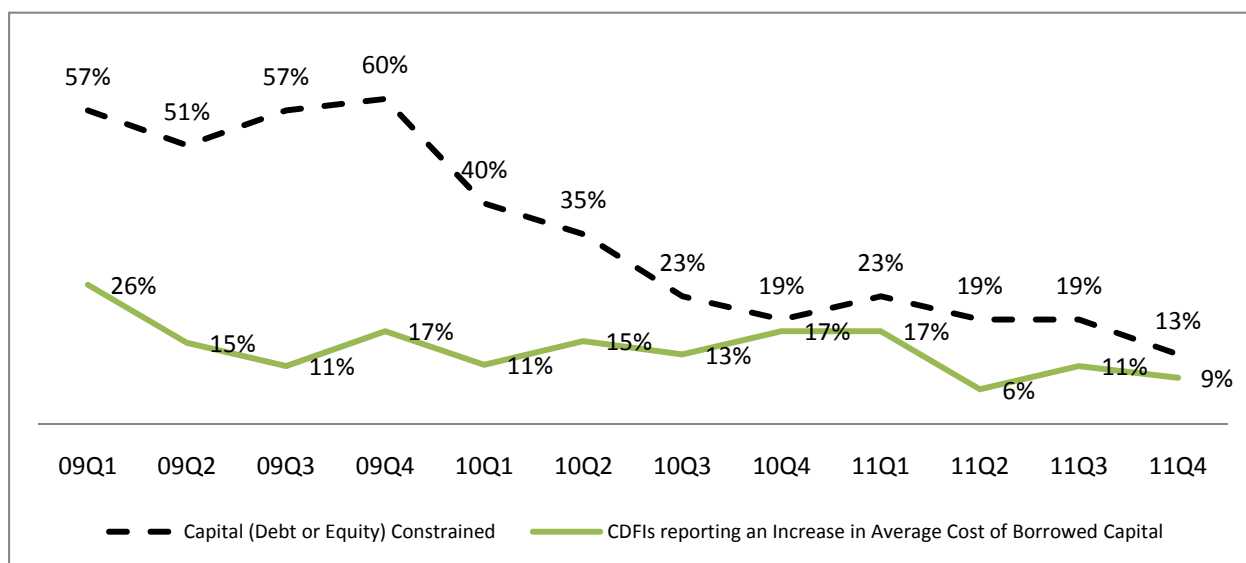
At the end of the fourth quarter, 16% of CDFIs reported that they are capital-constrained. This marks the eighth consecutive quarter that fewer than 30% of the survey respondents reported that they are capital-constrained. In the third and fourth quarter, 26% and 25%, respectively, of Small CDFIs (asset size less than \$10 MM) reported that they were capital-constrained in terms of debt, equity, or both. These rates are significantly higher than Large or Medium CDFIs. Of particular note, a significant portion of Microenterprise CDFIs (95% in the fourth quarter) reported that they did not face capital constraints.

Across regions, 60% of CDFIs in the Midwest, followed by 54% in the West, 43% in the South and 40% in the Northeast reported an increase in their ability to access capital year over year in the fourth quarter of 2011. CDFIs in the West reported a sharp jump over the third (44%) and second (30%) quarters.

Trend Results

In terms of capital liquidity among the trend sample, in the fourth quarter 67% of the respondents saw an increase in capital liquidity year over year while 20% saw a decrease. Respondents reported similar numbers in the third quarter (61% saw an increase and 23% saw a decrease in capital liquidity).

Figure 2. Capital Constraints and Borrowing Costs Reported in Trend Results, % Change Over Previous Quarter (n=44)



Outlook

In the third and fourth quarters of 2011, 85% and 86% of respondents, respectively, reported that they had greater than 90 days operating cash on hand. This is lower than year-end 2010 (89%) and approaching the year-end 2009 level of 84%.

III. PORTFOLIO QUALITY

Detailed Results

As in the previous two years, year-end portfolio-at-risk (greater than 30 days delinquent) fell while restructures and charge-offs rose. In 2011, portfolio-at-risk increased from 6.5% in the second quarter to 6.8% in the third quarter and then fell to 5.8% in the fourth quarter. In the fourth quarter, 47% of the CDFIs responding to the survey reported a decrease in the delinquency rate over the previous year, with 56% reporting a decrease in the third quarter.

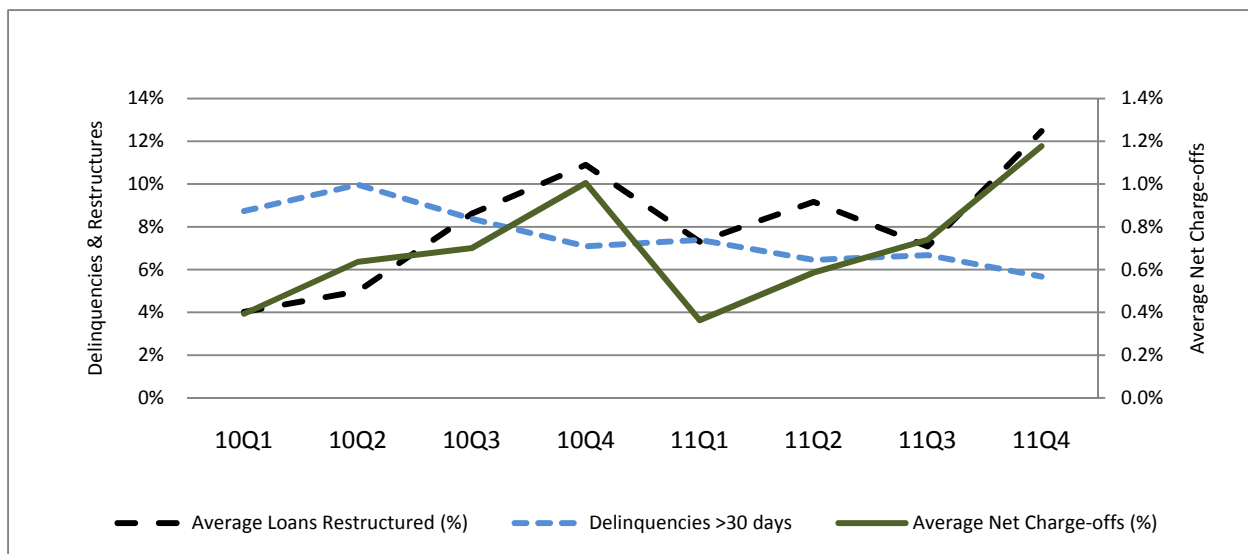
Average loans restructured were at 5% in the third quarter rising to 7% in the fourth quarter but ending the year lower than the 7.7% at year-end 2010. Average net charge-offs increased to 0.8% in the third quarter and 1.3% in the fourth quarter, ending the year slightly higher than the 1.0% reported at year-end 2010.

CDFIs in the Northeast reported the highest average portfolio-at-risk at 7.6% of the loan portfolio in the fourth quarter. In the sector breakout, Microenterprise (9%) and Housing to Individuals (8.7%) CDFIs reported the highest average portfolio-at-risk at year-end.

Trend Results

The percentage of CDFIs in the trend sample reporting an increase in delinquency over the previous year remained at 27% in the third quarter before rising to 37% in the fourth quarter. The graph below shows the gradual decline in average delinquencies greater than 30 days over the past eight quarters and the uneven increase in restructures during the same period. The figure also shows average net charge-offs increasing steadily during the four quarters of each year, with year-end 2011 ending higher than year-end 2010.

Figure 3. Average Trend Portfolio-at-Risk, Restructures and Charge-offs (n=47)



Outlook

Most respondents expect portfolio quality to either improve (45%) or stay the same (48%) in the next quarter. The outlook on portfolio quality has improved greatly over the life of the survey, with the percentage of CDFIs in the trend sample expecting deterioration falling from 45% in the fourth quarter of 2008 to 7% in the fourth quarter of 2011.

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 larger CDFIs and lesser weight to smaller CDFIs.

CDFI industry portfolio quality improved slightly in the fourth quarter, with loans more than 30 days past due at 6.46% in the second and third quarters and 5.93% in the fourth quarter. (See Table 1.)

Looking back, 2010 was the first year that the CDFI industry ended the year with higher net charge-offs than FDIC-insured institutions (2.85% vs. 2.54%). While annual net charge-offs fell in 2011 for both the CDFIs industry and FDIC-insured institutions, CDFIs again ended the year higher than FDIC insured institutions (2.14% vs. 1.55%).

Table 1: CDFI Industry Portfolio Performance, All Survey Respondents⁵													
	11Q4	11Q3	11Q2⁶	11Q1	10Q4	10Q3	10Q2	10Q1	09Q4	09Q3	09Q2	09Q1	08Q4
n=	131	100	123	132	100	107	98	89	104	107	109	101	99
% Net Charge-offs, year to date (annualized)	2.14	2.16	1.49	1.47	2.85	2.23	2.04	1.21	1.74	1.35	1.20	1.15	0.93
% 31-90 Days Past Due	2.29	1.67	1.93	4.09	3.10	2.94	3.98	4.95	5.27	4.43	5.20	4.52	6.82
% >90 Days Past Due or in Nonaccrual	3.64	4.79	4.53	6.19	5.68	5.93	6.60	7.85	6.63	5.94	6.40	4.44	3.09
% >30 Days Past Due ⁷	5.93	6.46	6.46	10.28	8.78	8.87	10.57	12.8	11.9	10.36	11.60	8.96	9.91
Table 2: FDIC-Insured Institution Industry Portfolio Performance (n=8,000+)													
	11Q4	11Q3	11Q2	11Q1	10Q4	10Q3	10Q2	10Q1	09Q4	09Q3	09Q2	09Q1	08Q4
% Net Charge-offs, year to date (annualized)	1.55	1.61	1.70	2.55	2.54	2.59	2.74	2.84	2.49	2.38	2.24	1.94	1.28
Loans and Leases													
% 30-89 Days Past Due	1.35	1.37	1.38	1.52	1.61	1.68	1.69	1.92	1.93	1.92	1.85	2.04	2.01
% >=90 Days Past Due or in Nonaccrual	4.09	4.22	4.37	4.71	4.87	5.12	5.21	5.45	5.37	4.94	4.35	3.76	2.93
% >=30 Days Past Due	5.44	5.59	5.75	6.23	6.48	6.80	6.90	7.37	7.30	6.86	6.20	5.80	4.94

⁵ More information on calculations and methodology for the above analysis can be found in the companion report, *CDFI Market Conditions, Third and Fourth Quarters 2011, Report II – Detailed Tables* in Appendix I page 54.

⁶ Please note that the first and second quarter 2011 rates have been adjusted to correct for a calculation error and therefore do not match the rates in the first and second quarter 2011 reports.

⁷ Prior to the first quarter 2010, the Market Conditions Survey did not ask CDFIs to report Additional Nonaccruals that they had not included in their greater than 90 days past due category; therefore, delinquencies prior to the first quarter 2010 do not include nonaccruals for some CDFIs.