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# Credit Unions, Community Development Finance, and The Great Recession

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Community Development Credit Unions

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The views expressed herein are those of its author and do not necessarily reflect those of the Federal Reserve Bank of San Francisco or the Federal Reserve System

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# Executive Summary

## I. Introduction

Community development credit unions (CDCUs) have a long history of serving low-income and minority markets. They played an important role in the founding and leadership of the Community Development Financial Institutions (CDFI) Coalition, which successfully advocated for the establishment of the CDFI Fund and has monitored and supported the CDFI Fund throughout its history. Yet, the role of credit unions in the CDFI movement is often overlooked. The term, "CDFI" is frequently understood by researchers and policymakers to mean CDFI loan funds, the unregulated institutions that dominate the ranks of institutions certified by the CDFI Fund.

The universe of CDFIs is far larger than the roster of institutions certified by the CDFI Fund, which numbered less than a thousand as of October, 2011. For example, more than 1,100 credit unions have been federally designated by the National Credit Union Administration (NCUA) as "low-income." Many serve the target markets of the CDFI Fund, and would presumably qualify for CDFI certification, but only 202 credit unions are certified as CDFIs.

## II. The Credit Union Context

In order to understand the role and significance of credit unions in the CDFI movement, it is first necessary to understand the credit union movement in general – a movement that now numbers 7,400 separate institutions and that emerged more than 100 years ago precisely to serve populations that were not being served by commercial banks. Chapter II provides an overview of the history of the movement, along with its defining characteristics as nonprofit, democratically controlled institutions. In describing the relationship of credit unions to the low-income market, we explain the interrelationship of various credentials – CDFI certification, low-income designation, community development credit union.

## III. CDCUs and the CDFI Movement

The formal CDFI movement began in the early 1990s with the establishment of the CDFI Coalition. Among policymakers, the initial proposals for the CDFI Fund favored regulated depositories, but the CDFI Coalition successfully rejected this position, arguing that investment policies should be indifferent to institutional types. In the interests of Coalition unity, community development banks and credit unions subordinated their particular interests to the Coalition position. However, as the CDFI Fund evolved from 1995 to 2011, non-regulated CDFI loan funds came to dominate the ranks of certified CDFIs and, overwhelmingly, CDFI Fund financial assistance; an outcome not envisioned by the founders of the Coalition.

Chapter III explores the reasons for the predominance of non-regulated institutions among certified CDFIs, including the costs of applying, the absence of a grant-seeking culture among depositories, and their lack of capacity. These factors have been compounded by the low success rate of depositories that seek grant funds, which discourages many from applying. There was a substantial increase in the number of certified CDFIs in 2010 in conjunction with the Community Development Capital Initiative (CDCI), especially among depositories. However, after the intense pace of certification activity in 2010, certification has slowed to a crawl, with a backlog of applications going back many months – even as new programs have emerged that require CDFI certification.

Certification is an important function of the CDFI Fund, especially when access to funds is at stake. At this time, the CDFI field cannot be understood solely by looking at certified institutions, since hundreds of institutions that do the same work remain uncertified. Many of these uncertified CDFIs are fully self-sufficient without external funding – an important policy goal of the CDFI movement. The CDFI Fund has much to gain by including these institutions in their evaluations of the scale, scope and impact of the CDFI industry: a major expansion in the ranks of CDFI-certified credit unions and other depositories would change the profile, perception, political influence, and possibly funding patterns of the CDFI Fund itself.

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## IV. The Financial Crisis and the Credit Union Movement

Credit unions, like almost all depositories, suffered from the direct effects of the Great Recession, including devastating increases in unemployment and home foreclosures in the low-income communities they serve. The effects were more acute for CDFI credit unions than for other types of CDFIs that do not interface directly with consumers. Delinquency and charge-off rates rose for CDCUs, as well as for all credit unions.

The overall economic distress was compounded for credit unions by an industry-specific crisis: the failure of some large wholesale or "corporate" credit union as a result of soured investments in mortgage-backed securities. As participants in a cooperatively-funded deposit insurance system, credit unions of all types were obliged to pay increased deposit-insurance premiums as well as special assessments attributable specifically to corporate failures beyond their control. These charges seriously eroded the net income of all credit unions, and hit especially hard at low-income credit unions, which typically have a smaller capital cushion. Their net worth fell, which limited their ability to add deposits and brought increased regulatory pressure because of "Prompt Corrective Action" (PCA) regulations. Forced mergers increased.

Despite these negative forces, there were positive signs for the CDCU movement as a whole. For the 226 CDCUs analyzed by the National Federation of Community Development Credit Unions over 2008-2010:

- Membership increased by 122,576 (7.9%), to nearly 1.7 million as of 12/31/10.
- Assets increased by 19.7%, to $11.0 billion.
- The loan portfolio continued to increase, to $7.73 billion. While loan origination decreased over these years, there was an increase in used-car lending – an important product for low- and moderate-income consumers who need to commute to reach employment.

Regionally, CDCUs in the West – in California, particularly – experienced the greatest stress: asset growth was smaller, loan originations decreased more sharply and net charge-offs of loans were highest. Breaking down portfolio performance by size demonstrates a scale effect: the larger CDCUs generally fared better than smaller ones, in terms of asset growth and return on assets (ROA); proportionately fewer large credit unions were rendered unprofitable by the combined effects of the recession and the deposit insurance charges.

Mergers and liquidations troubled credit unions more than other types of CDFIs. The smallest institutions were especially hard-hit. While mergers with credit unions without a low-income mission likely resulted in lost services for this population, there were several positive consolidations: in California, with the newly formed Self-Help Federal Credit Union, and in the South, with Hope FCU (MS) and Shreveport FCU (LA). These mergers preserved and even expanded services to low-income communities.

There were significant differences in how the Great Recession affected CDFI depositories and loan funds. In contrast to many loan funds that experienced liquidity challenges or diminished access to bank and philanthropic support, the problem for CDFI credit unions and other depositories was not liquidity, but equity: the key regulatory ratio of net worth-to-assets was diluted by an influx of deposits. Since they dealt with hard-pressed consumers, many CDFI credit unions did not experience the increase in loan demand and, in some cases, the improved loan quality reported by CDFI loan funds.

## V. Access to Capital in the Great Recession

The damage inflicted on CDFIs of all kinds would have been far worse if not for the CDFI Fund and the Community Development Capital Initiative (CDCI) of the U.S. Department of the Treasury. Investments through these programs both alleviated short-term liquidity problems and helped strengthen the capital base of CDFIs, helping to ensure that the CDFI movement would continue to thrive.

The CDFI Fund provided record amounts of awards during 2009, thanks to a special $100 million infusion made available through the American Recovery and Reinvestment Act (ARRA). For FY 2010, which began October 1, 2009, the CDFI Fund received an appropriation of $246.75 million – the largest amount by far in its history. However, the greatest share of the Financial and Technical Assistance awards went to non-depository loan funds, as it has throughout the CDFI Fund's history. From 2008-2010 only 10% of the CDFI Fund awards went to credit unions, accounting

for 11.5% of the total funds awarded during this period. Excluding the Native American CDFI program (NACA), 41 different credit unions received awards, six of which were multiple winners. For those credit unions that were fortunate enough to receive awards, the assistance was invaluable. Most of these CDCUs used their awards to rebuild or expand their net worth, helping them to recover from the financial wounds of the recession and the crisis of the National Credit Union Share Insurance Fund. The impact of the CDFI Fund on the CDCU movement was deep, but narrow.

## VI. The Community Development Capital Initiative (CDCI)

The CDCI program provided the largest infusion of capital in the history of the community development credit union movement. Forty-eight credit unions received $69.9 million. However, investment did not take the form of grants – the main product of the CDFI Fund. Rather, it was made in the form of long-term, low-cost secondary capital loans, which low-income credit unions are permitted to count as regulatory net worth. The program was complex, and the TARP-based regulations extremely demanding, which discouraged many credit unions from applying. However, for dozens of credit unions, CDCI investment provided an invaluable bridge to recovery and growth. Because of their increased net worth, they were able to add deposits, sustain lending despite the recession, reach out to other underserved neighborhoods, and deepen partnerships within the nonprofit community. Importantly, the increased net worth helped them to avoid the possibility of harsh regulatory pressure under Prompt Corrective Action by the National Credit Union Administration.

The CDCI program was implemented under TARP authority. Although it constituted a miniscule portion of TARP funding, it came under partisan attack, including a poorly researched and grossly inaccurate study that alleged political influence in the investment process. On the positive side, CDCI greatly enhanced the profile of the CDFI Fund in the credit union world and was responsible for scores of new certifications of credit unions, including many larger CDCUs, some of which subsequently received CDFI Fund awards. The advent of these high-capacity institutions to the CDFI arena has the potential to change the positioning and perceptions of CDFI credit unions.

## VII. Looking Ahead: Prospects and Recommendations

The CDFI Fund is a unique, invaluable resource for the CDFI Field. It has the capacity, virtually unmatched in the federal government, to invest not only in programs or projects, but in institution- and field-building. By balancing its investment portfolio to foster the full range of CDFI types, enlarging its strategies, and exploring avenues to innovation, it can fulfill and even exceed the vision that brought about its creation nearly two decades ago.

We offer several sets of recommendations.

- **Increase investment in CDFI depositories.** The Fund has historically under-invested in credit unions and other depositories. CDFI credit unions and banks offer leverage, sustainability, and impact in ways that loan funds cannot. In order to achieve greater balance, the Fund should re-examine its application forms, scoring, review procedures, and allocation formulas to take into account the particular characteristics of each category of applicant to the CDFI Fund.
- **Improve and expedite certification procedures.** CDFI certification is the most important credential in the community development field and a prerequisite for accessing various funding sources, including the emerging CDFI Bond Guarantee program. The Fund should make certification a priority. An enlarged universe of certified CDFIs will enable the Fund to provide a much fuller, more comprehensive picture of the impact of CDFIs. A dramatically expanded roster of CDFI depositories will bring the Fund increased visibility and support in a time of federal budget cutbacks
- **Invest strategically to build the CDFI field, through new structures and new platforms.** The Great Recession demonstrated that different types of CDFIs have different, and sometimes complementary, needs and strengths: for example, loan funds needed liquidity, while depositories' greatest need was for equity. The Fund should explore supporting hybrid or complex institutions that combine the strengths of CDFI loan funds and CDFI depositories; the Center for Community Self-Help is one existing model, but others could fruitfully be encouraged and supported.

Critics of the CDFI movement often point to the lack of scalability and the unnecessary duplication of functions by all the separate institutions. The credit union movement has developed corporate forms – Credit Union Service Organizations, or CUSOs – to address common needs in areas such as mortgage and business lending. Moreover, the credit union model itself is scalable: for example, the largest credit union is Navy Federal CU (not a CDFI), with $45 billion in total assets and several million members. Nonetheless, credit unions and other CDFIs could undoubtedly benefit from access to common platforms and infrastructure for lending, compliance, investment, and other functions. Only the CDFI Fund has the capacity to finance such a broad initiative, either on a CDFI sector-by-sector basis or possibly by serving multiple sectors for specific functions. The CDFI Fund could support a research and development initiative for the field, which is an unfulfilled part of the vision of the founders of the CDFI movement.

## I. Introduction

Community development credit unions (CDCUs) have played a seminal, if often unrecognized role, in the community development financial institutions (CDFI) movement that they helped create. For decades preceding the establishment of the federal CDFI Fund, CDCUs pursued a mission of serving low-income, minority, and other excluded "target" populations. In the late 1980s and early 1990s, the National Federation of CDCUs was the first to advance the concept that was realized in 1994 with the establishment of the CDFI Fund, and since that time, the Federation has continually played a leadership role in the CDFI Coalition.

Notwithstanding the work that CDCUs and some community development banks have done for decades, and contrary to the intentions of the founders of the CDFI Coalition, the term "CDFI" has been equated with an institution that is certified by the CDFI Fund of the U.S. Treasury Department. More narrowly, in the understanding of many policymakers and researchers, "CDFI" is taken to mean a CDFI-certified loan fund. Among the nearly 1,000 certified institutions, non-regulated community development loan funds (CDLFs) predominate, numbering 593 of the 962 certified CDFIs (61%) as of October, 2011. Even more striking is their dominance of CDFI Fund monetary awards: over the past five years loan funds have received 80% of available funding, which is only slightly above their historic average.[1] It is not surprising, therefore, that this narrow understanding of the field has become widespread.

However, this perspective does not do justice to the history, breadth, and potential of the CDFI movement. There are many more "CDFIs" than are enumerated in the official Fund roster. Officially, there are approximately 200 CDFI-certified credit unions. But for a number of reasons identified in this paper, hundreds more eligible credit unions have not yet chosen to seek certification.[2] For credit unions that serve low-income communities, CDFI certification does not change the nature of their work; rather, certification opens doors to resources for community development.

A broader, more comprehensive view of the CDFI field would encompass a universe not of 1,000 but probably closer to 2,000 institutions, expanding the aggregate assets of the CDFI movement by tens of billions of dollars. An accurate definition of the field matters: if the numbers and aggregate assets of recognized CDFIs double, the political strength and community-level impact of the CDFI movement will expand proportionately.

This is a crucial time to examine the CDFI movement in depth – its definition, dynamics, and prospects. The opportunities and challenges are both large.

- **The CDFI movement has grown rapidly.** By the end of 1997, the recently established CDFI Fund counted 190 certified institutions; by the end of FY 2000, that number had more than doubled to 415.[3] As noted above, by August 2011, the CDFI Fund counted 962 certified institutions. Along with the numerical expansion of the field, many individual CDFIs have grown and matured, adding significant capacity and a new sense of possibility to the field.
- **A new generation of CDFIs and CDFI leaders is emerging.** Many new CDFIs have little connection to the historic roots of the CDFI movement. They represent a new source of energy and ideas, but a number of veteran practitioners have begun to debate whether the CDFI brand has been diluted by rapid expansion.
- **CDFIs are now the focus of federal initiatives beyond those of the CDFI Fund.** CDFIs were part of the Community Development Capital Initiative (CDCI) and the $30-billion Small Business Lending Fund, created by the Small Business Jobs Act of 2010, which carved out a window for CDFIs and established the unprecedented CDFI Bond guarantee program now under development.
- **CDFI certification has become a valued brand beyond the federal CDFI Fund.** The Fund's imprimatur now is required for a growing number of federal and state programs, such as those of the Small Business Administration, the Federal Home Loan Bank System, the Empire State Development Corporation's CDFI Program in New York, and more.
- **The CDFI movement has – so far – survived a "stress test."** The Great Recession has put great strains on the balance sheets of many CDFIs. There have been losses and retrenchments. But the movement as a whole has survived, demonstrating admirable resilience.

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1 Source: CDFI Fund Award Highlights for fiscal years 2007-2011 show that loan funds received $374.5 million compared to $64.9 million (14%) for credit unions, $19.0 million (4%) for banks, thrifts and depositories; and, $10.1 million (2%) for venture capital funds. Since the inception of the CDFI Fund Financial Assistance and Technical Assistance programs in 1996, loan funds have garnered 78% of total awards.

2 Similarly, a recent report from the National Community Investment Fund showed that many community development banks and thrifts also remain uncertified and unrecognized as CDFIs. See *Community Development Banking Institutions,* 2011 National Community Investment Fund.

3 CDFI Fund, *Performance and Accountability Report FY 2009,* p. 9.

Despite all these encouraging signs, the future of the CDFI movement is not assured. While economists declared the "Great Recession" over as of June 2009, economic pain has continued, with stubbornly high unemployment rates, vast numbers of foreclosures, massive deleveraging that has suppressed consumer loan demand, and millions of homeowners who are "under water" with homes that are worth less than their outstanding mortgage debt.[4] Whether or not a "double dip" recession exacerbates the current economic distress, a return to pre-2008 levels of prosperity and stability seems doubtful for years to come. CDFIs cannot be expected to solve the massive and complex problems of the economy– but in various ways, their mission is to try.

The political environment presents still more challenges for CDFIs. From 2009 to 2011, the CDFI Fund received unprecedented levels of regular and special appropriations. For fiscal year 2012, the Obama Administration showed strong support for the CDFI Fund in their budget request; the Senate Appropriations Committee recommended $200 million for the Fund;[5] and the House Appropriations Committee called for $183 million, which is still substantial by historic standards. For fiscal year 2012, at least, the Fund still has significant resources at its disposal. But after the strenuous battles over the national debt in 2011, the future prospects of the CDFI Fund and a host of other federal programs are uncertain.

The uncertainty over future federal support highlights a fundamental challenge for the CDFI industry: achieving sustainability. In the years ahead, a worst-case scenario is not inconceivable, shaped by:

- A CDFI Fund with much reduced appropriations – or none at all
- An ever-more concentrated banking industry operating under a weakened or non-existing Community Reinvestment Act (CRA), which historically has spurred bank investments in CDFIs
- Diminished philanthropic support, resulting from low returns on endowments, and flagging interest in the CDFI field

Under this scenario, the potential role of credit unions as CDFIs becomes especially important. The CDCU business model is predicated upon self-sufficiency and sustainability. CDCUs are not dependent on the CDFI Fund or other external sources for their core operations; in fact, only a minority of CDCUs has ever received support from the Fund, and the overwhelming portion of these funds are not for operating expenses. Rather, the financial basis of credit unions comes from:

- Insured deposits from members, which provides the funds needed for lending
- Loan and investment income and fees, which cover operating expenses and loan losses and build net worth, which in turn
- Enables credit unions to attract more deposits and grow toward scale.

That said, the CDFI Fund has played an indispensable role in helping CDCUs to take a quantum leap, adding services, members, and branches at a rate that would have been impossible to imagine and difficult to finance without access to external support. This role has been especially important during the Great Recession: the Fund provided capital to CDFI credit unions that strengthened their statutory net-worth ratios, without which deposit growth is greatly constrained.

The Great Recession was a stress test for credit unions, as for other CDFIs, testing their resilience. What lessons can be learned from their performance over the last several years? What role can CDCUs play in the changing financial system? What is the potential for new partnerships, alliances, and institutional combinations with other elements of the CDFI movement? How can public policy promote these developments?

In order to address these questions, this paper will:

- Examine the history and place of credit unions in the CDFI movement, including their instrumental role in the formation of the CDFI Coalition and campaign to establish the CDFI Fund.
- Analyze credit union financial performance over 2008-2010, a period marked by progress amid pain, with growth in membership, assets, and loan portfolios despite rising loan losses and delinquency, regulatory pressure, and margin squeeze.

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4 See Chapter V, "The Financial Crisis and the Credit Union Movement."

5 The Committee's language was as follows: "The Committee recommends $200,000,000 for the CDFI Fund, which is $26,546,000 below the fiscal year 2011 enacted level and $27,259,000 below the budget request."

- Assess the pattern and impact of federal investment in credit unions during these difficult years – not solely by the CDFI Fund, but also by the one-time-only Community Development Capital Initiative (CDCI), which supplied twice as much net worth to credit unions as did the Fund itself over 2008-2010.
- Explore the prospects and role of credit unions in the future development of the CDFI movement – a future that could include CDFI industry-wide platforms and the potential for multiple "hybrid" CDFI structures that marry the strengths of regulated CDFI banks and credit unions with those of unregulated CDFIs, especially nonprofit loan funds.

The full extent of damage inflicted by the Great Recession will not be understood for several years. However, low-income and minority communities have suffered disproportionately—and if past patterns prevail, their recovery will lag and fall painfully short. In any event, an interim assessment of the impact of the recession on credit unions over 2008–2010 can and should inform regulatory and financial policymaking for the challenging years ahead.

## II. The Credit Union Context

Community Development Credit Unions (CDCUs) stand astride two worlds. They played a key role in the emergence of the CDFI movement; in fact, the concept for the creation of the CDFI Fund was first developed by the National Federation of CDCUs in the late 1980s. But the core identity of CDCUs is as credit unions. To understand the CDCU role in community development finance, it is first necessary to understand their place in the credit union world.

### *Credit Unions 101*

Credit unions are the most widespread form of cooperatives in the United States, with a long history of serving financially and socially excluded people. In 2008 the credit union movement celebrated its one-hundredth anniversary in the United States. Inspired by the caisse populaire movement in Quebec, "La Caisse Populaire, Ste.-Marie"– later to be known as St. Mary's Bank – opened its doors in 1908 in Manchester, New Hampshire to serve immigrant Franco-American mill workers.[6] The credit union movement took shape steadily over the next quarter-century, through a state-by-state organizing campaign financed largely by Edward Filene, the famous department-store owner and philanthropist. In 1934, the Federal Credit Union law created a dual-chartering system unique to the United States: aspiring credit unions had the choice to incorporate either under state law (in most, not all, states) or under federal law. Today, approximately 60% of credit unions are federally chartered, while nearly 40% are state-chartered.[7]

### *Basic Characteristics of Credit Unions*

All credit unions in the United States are:

- Nonprofit cooperatives
- Exempt from income taxes (although they pay sales, real estate, and other taxes in many states) – but not classified as charities
- Owned by their members
- Governed on a strictly democratic basis: each member has one and only one vote for the governing board of the credit unions, regardless of whether she has $5 or $50,000 on deposit at the credit union.[8]
- Governed by volunteer boards of directors, drawn only from the membership, elected annually and serving without compensation
- Limited to serving people who fit within an officially approved a clearly established "field of membership" defined in their charter.

Historically, most credit unions were formed to serve employment or associational groups. Over the last 30 years, however, many have expanded far beyond those boundaries to serve the broader community.

### *Leverage and Sustainability: The Credit Union Business Model*

Credit unions are structured to be financially self-sufficient, sustainable cooperatives. As regulated depositories, loan capital is overwhelmingly provided by insured deposits from members. The income generated from lending and other activities is used to cover operating costs and build net worth. Unlike banks or for-profit enterprises, credit unions do not have external shareholders who are entitled to a return on their equity investments; net income can only be distributed as member dividends on deposits and loans or retained as net worth and reserves. This cooperative structure ensures that credit unions can only work for the benefit of their members, but it also can inhibit growth: in times of rapidly expanding assets, credit unions cannot raise equity by selling stock.

### *The Credit Union Landscape: Achieving Scale*

The credit union movement has been steadily consolidating for several decades. In 1969 the number of independently incorporated credit unions in the United States peaked at 23,866. By June 2011, that number had been

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6 Because it predated both state and federal credit union law, St. Mary's Bank is the only credit union in the country with "bank" in its name.

7 As of March 31, 2011, according to call report data of the National Credit Union Administration, there were 7,562 credit unions in the United States, of which 4,563 were federally chartered and insured; 2,729 were state-chartered and federally insured; and 270 were state-chartered and privately insured. There are almost exactly as many credit unions as banks and thrifts in the U.S., though the latter control many times more assets.

8 This is an important difference from other mutually owned financial institutions, which may allot votes according to amount of deposits or other financial stakes.

reduced to 7,380 credit unions.[9] While the number of credit unions has declined dramatically over time, the number of people served and the average size of credit unions has increased. Today, more than 90 million people are credit union members, and aggregate industry assets exceed $900 billion. The nation's three largest credit unions each have over $10 billion in assets; the largest, Navy Federal Credit Union, has more than $45 billion in assets and 3.8 million members. With the exception of certain capital-raising privileges enjoyed by low-income credit unions (described below), the smallest and largest of credit unions have identical legal structures. In other words, the credit union business model has clearly demonstrated scalability, an important point with broad strategic implications for the future of the CDFI movement.

### *Diversified Lending: The Credit Union Portfolio*

The consumer-focused roots of the credit union movement are reflected in the loan portfolios of credit unions to this day.

- Housing loans, primarily for single-family dwellings, have been a growing portion of the credit union portfolio, and today account for approximately 50% of the total amount of credit union loans outstanding industry-wide. Credit unions provide first mortgages and home equity loans, but most do not finance new or multi-family construction.
- Business lending is limited to 12.25% of portfolio for most credit unions. However, loans of less than $50,000 are not counted against this limit. Moreover, the limit does not apply to CDFI-certified and other low-income credit unions (as well as certain special-purpose institutions, such as those that specialize in taxicab medallion financing.) Since credit unions are not obliged to report on lending for small businesses and microenterprises in amounts less than $50,000, the extent of credit union financing in this arena has likely been greatly underestimated.
- Automobile lending was a historic staple of credit unions. In recent decades, captive finance companies of automobile manufacturers have gained market share at the expense of credit unions, often through the use of incentives that no other financing entity can match. However, the Great Recession has seen a marked increase in credit union lending for used automobiles, especially important for low- to moderate-income people who depend on cars to reach jobs.
- Personal lending is provided by credit unions through secured and unsecured loans, revolving and closed-end credit, and credit cards. Credit unions provide loans for security deposits, affordable alternatives to predatory payday loans, education loans, and credit for almost every credit need of low- and moderate-income households.

### *Credit Unions and Banks*

Some banks regard credit unions as unfair competitors because credit unions do not pay federal income taxes and are not subject to the Community Reinvestment Act (CRA);[10] as a result, these banks and their trade associations regularly attack credit unions. Banks opposition to credit unions might seem excessive, given the relatively small share of the deposit and lending markets held by credit unions – after all, the largest two or three banks in the United States individually control double the assets of the entire credit union industry combined.[11] But in many markets, credit unions offer better rates on savings and loans than banks, which puts downward pressure on the pricing and profitability of bank products in those markets.

Banks have opposed the expansion of credit union powers on a range of issues, including increases in the 12.25% portfolio limit on business lending, expansion of credit union fields of membership, and access to alternative or supplementary capital for credit unions. Bank opposition to credit unions may have played a role in the exclusion of credit unions from some major Obama Administration stimulus initiatives over 2009-2010, including TARP[12] and the Small Business Jobs Act of 2010.

Because they regard credit unions as competitors, many banks that invest in other types of CDFIs do not invest in credit unions. Nevertheless, most of the nation's largest banks continue to invest in CDCUs, either directly or through the National Federation of CDCUs. These banks are not concerned with the limited competition offered by

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9 "U.S. Credit Union Profile, Mid-Year 2011 Summary of Credit Union Operating Results," CYNA Economics and Statistics, September 5, 2011.

10 Several states including Massachusetts have CRA laws that apply to state-chartered credit unions; however, credit unions are not subject to the federal CRA regulations.

11 Bank deposits total approximately $10 trillion; the combined assets of all U.S. credit unions are approaching $1 trillion.

12 CDFI credit unions did, in fact, gain access to a window of TARP in 2010: the Community Development Capital Initiative (CDCI), discussed at length later in this paper.

credit unions in major markets; rather, they view CDCUs as useful bridges to reach low-income consumers, and thus to meet their CRA requirements.

### *Credit Union Deposit Insurance*

Credit unions typically refer to deposits from members as "shares," although they are not equity as conventionally understood. The terminology is a historical vestige dating from the time before credit unions obtained federal insurance on deposits in 1970; previously, these deposits/shares were at risk if a credit union failed. Today, approximately 96% of all credit unions in the United States are federally insured by the National Credit Union Share Insurance Fund (NCUSIF), administered by the National Credit Union Administration (NCUA), the federal regulator for the credit union industry.[13] NCUSIF, like the better-known FDIC, is backed by the full faith and credit of the United States Government, and credit union depositors enjoy the same protections as bank depositors.

To understand the credit union movement and its crisis during 2008-2010, it is important to bear in mind two facts. First, "full faith and credit" means that consumers will be protected regardless of the failure of any individual credit union; although a small number of credit unions became insolvent in the recession, no member lost a penny of their insured deposits. If the NCUSIF runs dry, it can borrow from the U.S. Treasury. Second, although NCUSIF has a federal guarantee, it is funded not by taxpayers, but by credit unions themselves. Credit unions fund NCUSIF in two ways: through an investment amounting to one-percent of their insured shares (deposits), and if necessary, by a premium assessed by NCUA. Since the "corporate" or wholesale credit union system crisis that unfolded in 2009, credit unions have been hit with substantial insurance premiums to replenish NCUSIF, the first such premium payments required in many years. Non-regulated, uninsured CDFIs were not subjected to these costs.

### *The Capital Structure of Credit Unions*

The NCUSIF premium payments struck at the financial heart of the credit union movement. Undivided earnings, patiently accumulated as cooperative equity, enable a typical credit union to leverage $10 or more of deposits for every $1 of net worth. By federal statute and regulations, credit unions must maintain a minimum ratio of 7% of net worth-to-total assets, in order to be categorized as "well capitalized" by their regulators. Below that level, they become subject to "Prompt Corrective Action" (PCA). If a credit union's ratio falls below 6%, the threshold to be classified as "adequately" capitalized, it faces increasingly stringent measures, up to and including removal of officials, suspension of dividends, and in extreme cases, conservatorship or liquidation.[14]

In general, credit unions build equity or net worth solely by generating earnings – the net income that remains after paying operating expenses, dividends on accounts, and interest. Unlike banks, credit unions cannot raise equity from capital markets. In contrast to nonprofit loan funds, the vast majority of credit unions never receive grant funds or donations for operations or to build their equity accounts.[15] Most enjoy little direct support or contact with foundations or bank CRA programs, although this has changed somewhat over the last two decades.[16] Rather, accumulating equity is a gradual, internal process: in good years, credit unions may achieve Return on Average Assets (ROA), or net income, of one-percent. The Great Recession brought two very bad years for credit unions, as for most banking institutions: in part because of the deposit insurance charges, ROA shrank to an average of 31 basis points in 2008, 15 basis points in 2009, and 50 basis points in 2010.[17]

### *Credit Unions and the Low-Income Market*

At birth and through much of its history, the credit union movement was a movement for the unbanked: people of "modest means" (a phrase that is embedded in federal legislation), especially working-class people who could not readily access credit from commercial banks. However, over the last several decades, as the U.S. became more prosperous, many credit unions followed a parallel trajectory. Today, the majority of credit unions serve solidly middle-class members; in general, they are not likely to have bricks-and-mortar presence in inner-city or depressed rural areas.

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13 A handful of states allow state-chartered credit unions to obtain private deposit insurance, which accounts for the remaining 4% of credit unions that are not federally-insured.

14 These requirements were introduced with the Credit Union Membership Access Act (H.R. 1151) in 1998.

15 In contrast, access to philanthropic and CRA contributions, as well as to the CDFI Fund, has enabled the typical loan fund to achieve an equity level of 20% or more.

16 Support to CDCUs, low-income credit unions, and organizations that support them have been recognized as eligible activities for bank CRA credit for more than two decades. See *Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment* (Federal Register, Vol. 75, No. 47, Thursday, March 11, 2010, Notices, p. 11648 and 11652.

17 Over 2000-2003, the net income-to-assets ratio of all credit unions ranged between 95 and 106 basis points. Thereafter, it declined steadily to 64 basis points in 2007. Source: Economics and Statistics Department, Credit Union national Association, Inc., *Operating Ratios and Spreads, 2010*.

**Three distinct but overlapping designations encompass credit unions operating in the low-income market.** None describes the entire universe of credit unions active in community development lending and finance. The first two are federally conferred; the third comes from the National Federation of CDCUs. As described later in this paper, all were important to credit unions seeking to access capital in the recession.

**Low-Income Designation.** While the majority of credit unions in the U.S. serve moderate- to middle-income members, there remains a substantial segment of the industry that serve a majority of low-income people.[18] As of October 2011, there were 1,128 institutions designated by the federal regulator as "low-income credit unions," or LICUs. This designation conveys several powers unavailable to "mainstream" credit unions.

- **Non-member deposits**. Low-income credit unions may accept outside funds in the form of insured "non-member deposits," in contrast to other credit unions, which can only raise deposits from a field of membership that has been approved by their regulator. This privilege was successfully obtained from Congress by the founders of the National Federation of CDCUs when deposit insurance for credit unions was first introduced in 1970. It recognizes the difficulty low-income credit unions faced in raising funds strictly from poor communities. Non-member deposits have come to low-income credit unions from bank CRA programs, religious investors, trusts, social investment funds, corporations, and individuals.
- **Secondary capital**. In 1996, the Federation won the exclusive right for LICUs to raise secondary capital – deeply subordinated debt that counts as net worth for regulatory purposes, subject to certain restrictions. First embodied in regulation, this right received explicit statutory recognition in 1998 in the Credit Union Membership Access Act (CUMAA). In the Great Recession, as credit unions saw their net worth ratios depleted through NCUSIF premium charges and surging deposits, secondary capital would prove crucial to the survival and expansion of many CDCUs.
- **Business lending.** Also through CUMAA in 1998, LICUs gained the right to make business loans above the statutory limit of portfolio concentration for other credit unions (12.25%).[19]

### *CDFI Certification*

The advent of the CDFI Fund in 1995 brought another important classification: namely, certification as a Community Development Financial Institution or "CDFI". It might seem logical that "low-income designation" from another federal agency, NCUA, would be adopted by the CDFI Fund. That was not the case: low-income designation does not automatically qualify a credit union for CDFI certification, although many – probably hundreds – would qualify. NCUA's standard of a simple majority of low-income members is not sufficient for CDFI certification. To be certified, an institution must demonstrate that at least 60% of its activities are directed to one or more of three "target markets," defined by the CDFI Fund as Investment Areas (counties and census tracts with high indicators of economic distress); Low-Income Targeted Populations (defined by income); and Other Targeted Populations (which can be any historically underserved group, such as ethnic and racial minorities, people with disabilities, and/or recent immigrants). So, CDFI certification is at the same time more demanding and expansive than low-income designation by NCUA. In practice, the CDFI Fund certification process is more onerous and, especially since the fall of 2010, has been plagued by lengthy delays. As a result, many eligible credit unions that far surpass the CDFI Fund requirements for certification remain uncertified.

### *Community Development Credit Unions (CDCUs)*

The term, "low-income credit union" is often used interchangeably with "community development credit union," but this is not entirely accurate. The term, CDCU, was coined by the Federation at its founding in 1974, and historically has been reserved for members of the Federation. CDCUs are defined and distinguished by their primary mission of community development and focus on serving communities and individuals who are overlooked and underserved by mainstream financial institutions including minority populations, recent immigrants, people with disabilities, and older adults. The great majority of CDCUs have low-income designation, and a majority are also CDFI-certified; in

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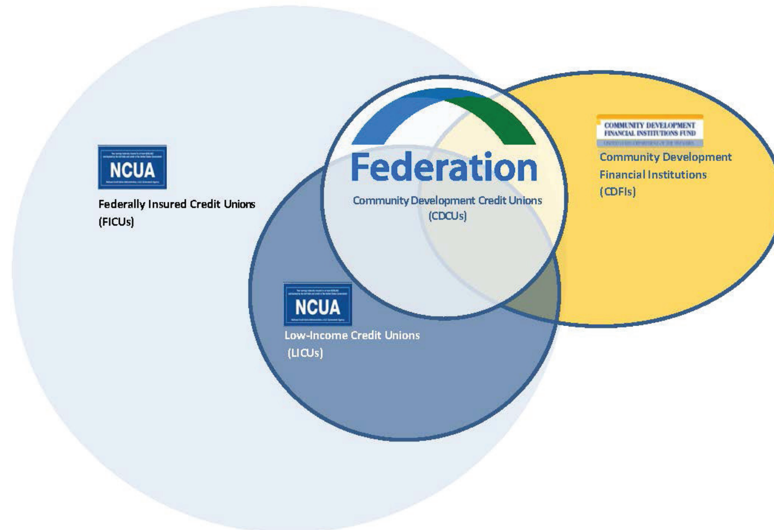
18 NCUA regulations define "low-income" as follows: "Low-income members are those members whose family income is 80% or less than the median family income for the metropolitan area where they live or national metropolitan area, whichever is greater, or those members who earn 80% or less than the total median earnings for individuals for the metropolitan area where they live or national metropolitan area, whichever is greater." *Code of Federal Regulations*, Title 12, Banks and Banking, Chapter VIII—National Credit Union Administration, Part 701.34.

19 LICUs also enjoy access to a loan and small technical assistance grant program operated by their regulator, NCUA. The Community Development Revolving Loan Fund which administers this was established in 1979 through the Federation's advocacy.

contrast, not all LICUs have the broader community-wide mission that defines CDCUs.[20] The Federation advocates not only for its members, but for all low-income credit unions – as well as CDFI-certified credit unions.

*Figure 1. Alphabet Soup: FICUs, LICUs, CDCUs and CDFIs*




The diagram above illustrates the respective sets of LICUs, CDCUs, and CDFIs.[21]

While these distinctions may appear unnecessarily confusing, they had very real consequences during the recession, when credit unions serving low-income communities were under great stress. In brief:

- Only credit unions that are certified by the CDFI Fund can receive awards from the Fund.
- Credit unions do not have to be designated low-income by NCUA in order to receive financial or technical assistance grants from the CDFI Fund.
- However, to receive equity-like secondary capital (described below) from the CDFI Fund or any other entity, a credit union must have low-income designation.
- When the Community Development Capital Initiative (CDCI) was launched in 2010, no credit union was eligible for these long-term, low-interest loans unless it had both low-income designation and CDFI certification.

20 In the early 1990s, the number low-income-designated credit unions shrank to about 140. A change in policy at the National Credit Union Administration resulted in hundreds of credit unions being designated even if they had not requested it, based on NCUA's data runs of their census areas. There is no association or organization for LICUs. The National Federation of CDCUs is the sole public-policy voice for this sector of the credit union movement.

21 As shown in the diagram, all LICUs are federally-insured credit unions, but not all CDCUs are FICUs – some are state chartered and privately insured and lie outside the FICU circle. As discussed earlier in this paper, most federally certified CDFIs are not credit unions, so the CDFI circle lies mainly outside the credit union circle.

## III. CDCUs and the CDFI Movement

### *Origins of the Movement*

The community development credit union movement, and specifically, the National Federation of CDCUs, played a seminal role in the creation of the organized CDFI movement. Formally established in 1974 but active as early as 1970, the Federation defined its membership of "community development credit unions" as financial institutions which served predominantly low-income households and communities. During the early 1980s, the New York City-based Federation observed first-hand the withdrawal of banking services from low-income neighborhoods, as banks introduced ATM machines and pruned their "bricks and mortar" branch networks by closing less profitable branch locations. The Federation responded by advocating for public-sector support for institutions like CDCUs, to increase the availability of credit and financial services to the low-income market. In 1985, it succeeded in getting the introduction of legislation in the New York State Assembly to create a New York State Corporation for Community Banking (A-8145), the first legislation of its kind anywhere.

In the summer of 1986, during the second Reagan Administration, the Federation extended this concept to the national arena. The White House Low-Income Opportunity Board was charged with formulating strategies to alleviate poverty and reform welfare by giving priority to private-sector and community self-help initiatives. Intrigued with the credit union approach, the Board invited the Federation to conduct a study and issue recommendations. The Federation examined five years of financial and statistical data about CDCUs, supplemented with a survey of nearly one-hundred low-income credit unions. Working with a representative of the community-services division of the Department of Health and Human Services, the Federation released a study on December 17, 1986 entitled "An Analysis of the Role of Credit Unions in Capital Formation and Investment in Low- and Moderate-Income Communities."

This study became a central piece of the policy agenda of the Federation over the next several years. In January 1989, I was appointed to the Consumer Advisory Council of the Federal Reserve Board. Addressing the Council in June, I delivered an address entitled "Financial Strategies for Unbanked Communities: CDCUs", which urged the creation of a national Neighborhood Banking Corporation. The Federation followed up by circulating a concept paper among community development advocates.

The report was greeted skeptically by advocates for the Community Reinvestment Act (CRA), who feared that a federal support initiative would "let banks off the hook" from fulfilling their CRA requirements. The Federation opened discussions with the National Association of Community Development Loan Funds (NACDLF, later known as the National Community Capital Association and now, the Opportunity Finance Network). Key leaders of NACDLF expressed reservations of a different kind. In particular, Chuck Matthei, a passionate, eloquent, and widely respected leader of the loan fund and community land trust movements, argued that tying the fate of loan funds to a governmental funding source would inevitably put them on a slippery slope towards regulation and threaten the core principles of the emerging loan fund movement.

Matthei's view did not prevail and, over the course of 1991, NACDLF joined the Federation in working to elaborate and refine the concept of a national fund to support community development lending. Joined by the Center for Community Self-Help, the Financial Democracy Campaign, the Woodstock Institute, Community Capital Bank and – with reservations – South Shore Bank, they formed a loose coalition to explore the creation of a new, "public-purpose banking system" that would strengthen CDCUs and other community lenders. The Public Purpose Lenders Group, as the loose coalition became known, began a campaign to raise public awareness about the causes of the recent and continuing Savings and Loan disaster, and also focused on the Federation's proposal to create a "Neighborhood Banking Corporation" – initially, a federally-funded, $100-million institution that would provide grants, loan capital, and technical assistance to CDCUs and other community-based financial institutions across the nation. This was the coalition that led the fight to establish the CDFI Fund.

In Congress, Senator Don Riegle of Michigan was leading the Banking Committee on a parallel track, exploring the creation of a $30-million pilot program that would be based in the Department of Housing and Urban Development (HUD). At the same time, then-candidate Bill Clinton spoke on the campaign trail about the accomplishments of South Shore Bank, Southern Development Bank Corporation, and the Arkansas-based Good Faith Fund, and promoted the idea of developing "a network of one-hundred community development banks" across the United States. After his election in November 1992, the CDFI Coalition, as it became known, worked closely with the Clinton Administration to develop what became the Riegle Community Development and Regulatory Improvement Act of 1994. The CDFI Fund commenced full-scale operations in the fall of 1995.

### *What Form CDFIs: "Banks"… or Not?*

Candidate Clinton's language talked about banks – not surprising, since CDCUs and loan funds alike were off the radar. Some policymakers also thought of community development finance in terms of banks. For example, early drafts of legislation in the House in 1993 would have limited funding for non-depositories to a maximum of $2 million, compared to $5 million for depositories.

From its start, the CDFI Coalition included representatives of credit unions, banks, and non-regulated nonprofit loan funds.[22] In fact, the label developed and adopted by the coalition – "community development financial institution" – was an attempt to reflect the variety of institutional forms of community lenders. One of the most crucial decisions made by the Coalition was to advocate for non-discrimination between regulated and non-regulated institutions: that is, the CDFI Coalition held that funding should be based on financing needs, institutional strategies, and the capacity of individual CDFIs, rather than their corporate form. In the interests of maintaining a united front within the Coalition, the depositories – banks and credit unions – rose above their own self-interest. It is likely that none of Coalition's members foresaw the outcome. Over some 15 years, nearly 80% of CDFI Fund financial and technical assistance awards have gone to non-regulated CDFIs; in some years, credit unions and banks together received as little as 10% of funding.

### *The CDFI Universe: What's In, What's Not*

Over the course of the 1990s, new institutions and new types of institutions joined the CDFI movement, including community development venture capital funds and the exploding number of microenterprise funds. Many organizations that had not primarily been in the financing business began to reposition themselves as CDFIs. As noted earlier, the result was rapid growth: between 1998 and 2000 the number of certified CDFIs grew from 190 to 415, and by October 2011 the ranks had more than doubled again to 962.[23]

The political climate and the availability of funding undeniably have played a role in the growing ranks of certified CDFIs. The CDFI Fund went through challenging times in the middle of the first decade of the 21st century, as repeated efforts were made to reduce or eliminate funding altogether. The proposed "Strengthening America's Communities Initiative" in 2005 threatened to consolidate or wipe out a host of community development programs, including the CDFI Fund. That proposal was quickly killed due to bipartisan Congressional opposition. But the future of community development finance was perceived as highly doubtful by many of its advocates.

The picture changed after the election of 2008 and over the course of the Great Recession. On September 30, 2008 there were 808 certified institutions, a number which actually decreased by 10 as of September 30, 2009. But in the following 12 months, the CDFI Fund added 131 newly certified institutions, an increase of 16.4% and the largest one-year jump since 2001-2002. This sudden growth in certification was triggered by an increase in the CDFI Fund's annual appropriation augmented by supplemental funding through the American Relief and Recovery Act (ARRA).

Today, the Fund's roster includes credit unions, banks, loan funds, microfinance institutions, community development venture capital funds, and intermediaries that serve each type of CDFI. Among the 962 CDFIs listed as certified in October, 2011, the categories break down as follows:

22 Neither the Community Development Venture Capital Alliance nor the Association for Enterprise Opportunity existed at that time.

23 Source: CDFI Fund, *Performance and Accountability Report, FY 2010*.

| Table 1: Certified CDFIs by Type (as of October 2011) | | |
|---|---|---|
| **Type of CDFI** | **Number of Certified Institutions** | **Percentage of Total** |
| **Unregulated CDFIs** | | |
| Loan Funds | 593 | 62% |
| Venture Capital Funds | 25 | 3% |
| **Regulated CDFIs** | | |
| Credit Unions* | 203 | 21% |
| Banks and Thrifts | 87 | 9% |
| Depository Holding Companies | 54 | 5% |
| ***Total*** | **962** | **100%** |

* As of October 15, 2011 the CDFI Fund listed 203 certified credit unions, but 7 of the CDCUs on the list no longer exist due to merger, acquisition or liquidation.

The numbers show clearly that non-regulated institutions dominate, accounting for 65% of all certified CDFIs. The current imbalance is even more noteworthy since it follows a surge in CDFI certifications of credit unions and banks in 2010, as will be discussed later.

### *Redefining the CDFI Universe*

It is common practice to equate "CDFIs" with institutions certified by the CDFI Fund. As we have argued earlier, this equation is inadequate at best, misleading at worst, and has a significant impact on social investment and public policy. The CDFI universe is broader and has far greater potential than that of certified CDFIs alone. Moreover, the current distribution of certified CDFIs, heavily weighted towards non-regulated institutions, wrongly suggests that most CDFIs are under-leveraged and grant-dependent institutions.[24]

### *What accounts for this situation?*

First, it is important to recognize that CDFI certification is essentially a doorway to resources and recognition for financial institutions. Certification does not imply any assurance of quality or performance: as the Fund's literature states, "Certification does not constitute an opinion by the Fund as to the effectiveness or financial viability of the certified organization." Obtaining certification – much less competing for a Financial Assistance award – can be a laborious, expensive process. In a typical year, only one-third of all applicants will win awards; some never do, despite repeated applications. In short, the odds of success can be long, and the cost, significant.

Second, it is important to consider the type of institutions that are best positioned and equipped to pursue certification and compete for awards. Among the ranks of certified CDFIs, the strongest candidates are clearly nonprofit organizations that already are in the "grant-seeking business," with experienced development staff and grant writers. While it cannot readily be proven, it is likely that the CDFI universe includes nearly all the nonprofit revolving loan and microenterprise funds that would qualify for certification.[25] For many community development organizations that depend on grant funding, the CDFI Fund has become their single most important source of financial support.

By contrast, regulated depositories and venture capital funds are not by nature grant-seekers. Their core business and strengths lie in using capital raised from depositors and investors to make loans and investments; grant-seeking is not part of their culture. These credit unions, community development banks and venture capital funds are not by nature experienced or equipped to compete as successfully as their nonprofit colleagues. Not surprisingly, as shown in Table

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24 A draft *CDFI Industry Analysis* by the Carsey Institute, commissioned by the CDFI Fund, finds that the median loan fund will leverage only $1.10 in liabilities for every dollar of net worth, compared with $9.40 leveraged by the median CDFI bank and $9.91 leveraged by median CDFI credit union. The draft also analyzes "whether CDFIs can obtain self-sufficiency," which is an important issue for unregulated CDFIs, but is irrelevant for financially self-sufficient and sustainable CDFI banks and credit unions.

25 Data on unregulated loan funds, microenterprise funds, and venture capital funds is difficult or impossible to obtain. The draft *CDFI Industry Analysis* by the Carsey Institute cites the lack of data on CDFI Loan Funds in its findings.

2, below, loan funds apply in greater numbers and succeed at significantly higher rates than any other type of CDFI, resulting in a massive imbalance in financial assistance.

**Table 2: Comparative Success Rates for Loan Funds and Other CDFIs**
**Combined Results for CDFI Fund Awards, Fiscal Years 2007-2011**

| Source of Applications | Success Rates for Applicants | | | Dollars Awarded | |
|---|---|---|---|---|---|
| | # Applications | # Awards | Success Rate (Awards/ Applications) | Total Dollars Awarded | Percent of Total Dollars Awarded |
| Loan Funds | 1,178 | 487 | 41% | $376,447,365 | 80% |
| All Other Types of CDFIs | 351 | 114 | 32% | $94,037,376 | 20% |
| **Totals** | **1,529** | **601** | **39%** | **$470,484,741** | **100%** |

This track record has given rise to a troubling perception among credit unions and possibly other depositories: that the primary purpose of the CDFI Fund is to support loan funds, and that other types of CDFIs are less likely to be certified or funded. As a result, many institutions that would be strong candidates for CDFI certification have chosen not to apply.

Credit unions are almost certainly the largest segment of the non-certified universe of CDFIs: as noted previously, there are 1,100 credit unions officially designated as low-income, some 900 of which have never sought certification, although hundreds would likely qualify. With few exceptions, they are solvent, established financial institutions that intersect with the certified CDFI space; some of them are among the largest, most successful CDCUs, with levels of performance that exceed those of certified institutions, but so far have not needed CDFI funding nor cared to incur the costs of certification. In short, these are self-sufficient, sustainable community development financial institutions operating without CDFI funding. As such, they exemplify one of the original goals in the creation of the CDFI Fund: to foster an industry that could stand on its own without perpetual federal support.

Thus, to base research and policy recommendations on the sample of certified CDFIs alone does not and cannot capture the scope, impact, or key operating characteristics of the CDFI industry, encompassing all institutions that intentionally provide responsible credit and financial services to low-income communities and other targeted populations.

### *CDCUs and CDFI Certification*

Membership statistics for the National Federation of CDCUs and the CDFI Fund illustrate the gaps in CDFI certification among community development credit unions. More than 90% of the Federation's membership consists of credit unions that have official low-income designation from their regulator and thus would be highly likely candidates for certification. Indeed, no Federation member that has applied for CDFI certification has ever failed, which reflects the alignment between the CDFI Fund's core requirements for certification and the Federation's requirements for membership. Nevertheless, only 64% of the member CDCUs of the Federation (152 of 237) are CDFI-certified. Of the 85 CDCUs that are not certified, 75% are officially designated as low-income.

**Table 3: CDCUs with CDFI Certification and Low-Income Designation**
(as of October 2011)

| Type of CDCU | Number | Percentage |
|---|---|---|
| **Total Number of CDCUs** | **237** | **100%** |
| With low-income designation | 219 | 92% |
| With CDFI certification | 152 | 64% |
| Non-CDFI certified | 85 | 36% |
| Non-CDFI certified with low-income designation | 64 | 27% |

Why have more CDCUs not sought CDFI certification, despite its potential value in obtaining resources and recognition?

As cited above, cost, capacity, and culture are some of the reasons. Some CDCUs are small institutions, which cannot afford the services of a grant-writer; some are large enough and believe they have sufficient assets and capital to serve their low-income populations without seeking additional funds and compliance burdens. Some have been discouraged by the low proportion of credit unions winning CDFI Fund awards. And some, such as many church-based credit unions, have memberships that have dispersed beyond the inner-city neighborhoods where the churches are housed; that is, some have become "commuter congregations." Demonstrating that they serve a "target population," which is a required for certification, can be difficult for credit unions that do not generally classify or track their members and activities in terms of CDFI Fund Target Markets.

Credit unions were further discouraged in 2009, when the CDFI Fund, fueled by a record high appropriation plus additional ARRA funding, awarded an unprecedented $145 million in financial and technical assistance grants. CDFI certified credit unions were strongly encouraged to apply in that historic year, but were stung by the results, recording the lowest ever success rate for credit unions; only 17% of credit union applicants received awards in 2009, compared with an average of 32% for all CDFI applicants and a 36% success rate for loan funds. Overall, credit unions received just 12.6% of the grant dollars awarded in that high-profile year. For those who had long maintained that the CDFI Fund was more cost than benefit for credit unions, 2009 seemed to validate their belief.

Yet despite the setbacks of 2009, many credit unions saw a new reason to pursue certification in 2010, with the advent of the Community Development Capital Initiative (CDCI) discussed at length later in this paper. Thanks in part to a strong commitment from the CDFI Fund to facilitate CDCI eligibility, scores of credit unions were certified in less than six months. However, after September 30, 2010, when the CDCI program drew to a close, the Fund's pace of certification slowed markedly.[26] This untimely loss of momentum was deeply unfortunate, as many credit unions were discouraged from seeking certification at a moment of great opportunity and visibility for the CDFI movement.[27]

### *Why it Matters*

CDFI certification matters. It is one of the most valuable credentials available to community development organizations. But there are many institutions without the credential whose mission and practice is the same as those of certified CDFIs: they lend to, invest in, and provide responsible financial services to low-income, minority, and other underserved communities. While they may not be eligible for or seek investments from the CDFI Fund, the CDFI industry cannot be properly understood without them. Investors, researchers, and policymakers need to understand that the universe of CDFIs is far larger than the universe of certified institutions. This position is consistent with the original principles formulated by the multi-sector CDFI Coalition in its earliest years, which held that the CDFI movement could not and should not be defined by any government entity.[28]

In this context, the CDFI Fund's policies and procedures regarding certification have important consequences. They affect not only perceptions of the field, but the allocation of the Fund's and other federal resources. For example, the CDFI Fund has justified its heavy allocation of awards toward loan funds in terms of the high proportion of loan funds among all certified CDFIs. A major influx of hundreds of credit unions would change that calculus, but unfortunately, the certification process has slowed to a crawl. This may be partly explained by the pressures and constraints faced by the Fund during a contentious period of budgetary uncertainty. However, certification is a crucial function that must be a priority for the CDFI Fund, because access to federal resources (such as the emerging CDFI Bond Guarantee program) depend on it.

The CDFI Fund itself may suffer the most from its narrow focus on a small segment of CDFIs. Limiting the data set to certified CDFIs means that the dimensions of the CDFI industry are significantly underestimated; moreover, the problem is compounded by the CDFI Fund's even narrower approach to evaluating impact. The CDFI Fund gener-

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26 As of September 2011, some credit unions have waited for more than a year without action on their certification applications.

27 The Federation has worked closely with the CDFI Fund to identify specific sources of delay for CDCU applicants. As of February 2012, the CDFI Fund is taking concrete steps to resolve these issues and greatly improve the speed and consistency of the certification process. These welcome changes are critically important, as CDFI Certification will be required for CDCUs to participate in new initiatives such as the multi-billion-dollar Community Development Financial Institutions Bond Guarantee program.

28 At the time of its formal establishment in 1974, the Federation defined "community development credit union" as an institution that serves predominantly low-income people and neighborhoods. While a strong majority of CDCUs do, in fact, enjoy CDCU certification, the Federation defines all CDCUs as CDFI credit unions, regardless of their certification status.

ates impact reports from data collected through its Community Investment Impact System (CIIS), but only certified CDFIs that receive financial assistance awards are required to file CIIS reports, and then only for limited periods of time. The most recent impact report from the CDFI Fund for fiscal years 2007-2009 was based on CIIS data drawn from only 94 CDFIs for all three years of the study – including only 8 credit unions.[29] Policy makers are unlikely to understand the scale, scope and directions of the CDFI industry when presented with data from less than 10% of all certified CDFIs – including less than 3% of all CDCUs. By contrast, the analysis in the following chapter of the performance of credit unions in the Great Recession is based on three years of data from 226 CDCUs that belong to the National Federation of Community Development Credit Unions.

29 "The Financial Crisis and CDFIs: A Brief Look at 2007-2009 CIIS Data", available from the CDFI Fund website: www.cdfifund.gov/impact_we_make/research/.

## IV. The Financial Crisis and the Credit Union Movement

According to the National Bureau of Economic Research, the Great Recession began in 2007 and lasted through June 2009.[30] However, the full force of the economic hurricane began to hit the country in the last few months of 2008. On September 7, 2008, Fannie Mae and Freddie Mac, the giant government-sponsored secondary housing markets, were put into conservatorship. On September 15, 2008, Lehman Brothers filed for bankruptcy. On October 3, the Emergency Economic Stabilization Act (EESA), which created the Troubled Assets Relief Program (TARP), was passed, providing billions of dollars of relief to banks. During the week of October 6, the Dow Jones Industrial Average declined more than 18%, kick-starting a period of intensified volatility and losses that lasted for months.

### *Crisis of the Credit Union System*

When the financial crisis hit in the fall of 2008, the credit union movement was a mature, stable cooperative system, serving some 90 million people. Credit unions generally did not engage in the toxic sub-prime mortgage lending that fueled the crisis; only a small number provided interest-only, stated-income, or other such loans. But credit unions were not insulated from the economic damage that ultimately engulfed much of the country. It was worse in what came to be known as the "sand states" – California, Nevada, Arizona, and Florida. Housing values in overheated markets crashed, devaluing loan portfolios. Unemployment rates rose catastrophically in areas like the Central Valley of California, which meant not only housing loans went bad, but also consumer loans to people who could no longer pay for their car loans or other obligations. The service economy, which supports many low-income members of CDCUs, was badly hit.

Adding to the direct damage to their portfolio from the recession, credit unions suffered from a systemic failure triggered by the mortgage crisis: the crisis of the wholesale, or "corporate," credit union network.

The corporate credit union network took shape in the 1970s, as credit unions sought to alleviate their dependence on banks for services such as payment processing, liquidity, and investments. They developed their own, cooperatively owned financial network of correspondent institutions. As of 2008, there was a three-tier system in the credit union movement.

- Local, "natural-person" credit unions directly served member-consumers.
- There were more than 20 statewide or regional corporate credit unions serving natural-person credit unions.
- At the top was a national entity, U.S. Central Credit Union, founded in 1974.

Tens of billions of dollars of the surplus liquidity of natural-person credit unions – cash that was not immediately needed to fulfill loan, clearing, and withdrawal demand – flowed upward, to second-tier corporates, and a portion of these fund flowed further upward to the top-tier U.S. Central CU.[31] These corporate credit unions invested the aggregated funds of their member credit unions in securities, taking advantage of economies of scale and specialized investment expertise.

The crisis began to unfold in January, 2009, when U.S. Central Credit Union, the apex of the credit union system, announced massive losses on their holdings of "highly rated" mortgage-backed securities.[32] Two months later, on March 20, 2009, the National Credit Union Administration (NCUA) announced that it had taken into conservatorship not only the $34-billion U.S. Central Federal Credit Union, but also the $23-billion Western Corporate FCU, the second-largest corporate, in order "to stabilize the corporate credit union system and resolve balance sheet issues." NCUA noted that "securities held by US Central and WesCorp deteriorated further since late January 2009, contributing to diminished liquidity and payment system capacities, as well as further loss of confidence by member credit unions and other stakeholders." Over the months that followed, NCUA seized three additional corporate credit unions.

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30 "Cambridge. September 20, 2010—The Business Cycle Dating Committee of the National Bureau of Economic Research met yesterday by conference call. At its meeting, the committee determined that a trough in business activity occurred in the U.S. economy in June 2009. The trough marks the end of the recession that began in December 2007 and the beginning of an expansion".

31 Investments in corporate were, of course, only a portion of the surplus liquidity of credit unions. Other funds were invested in securities or even commercial banks.

32 A comprehensive description of the causes and effects of the failure of, for example, U.S. Central FCU goes beyond the scope of this paper. For an authoritative analysis, please see the report of the NCUA Office of Inspector General, "Material Loss Review of U.S. Central Federal Credit Union," report #OIG-10-17, October 18, 2010. One key finding was that the credit union was "exposed…to excessive amounts of financial risk due to significant holdings of private label mortgage-backed securities including subprime and ALT-A related securities" (p.10). http://www.ncua.gov/about/Leadership/CO/OIG/Documents/OIG201017MLRUSCentral.pdf.

U.S. Central, WesCorp, and other wholesale credit unions were federally insured by the National Credit Union Share Insurance Fund (NCUSIF), managed by NCUA. NCUSIF, though backed by the full faith and credit of the U.S. government, is funded by the deposits invested, and, as necessary, the premiums paid by all federally insured credit unions. The insolvency of the corporates inflicted enormous losses on NCUSIF, which meant that all federally insured credit unions had to ante up to replenish the insurance fund. In 2009, credit unions had to begin paying an annual premium – for the first time in many years – to replenish NCUSIF.

To better manage the potential losses from the corporates over time, NCUA obtained authority from Congress to create the Temporary Corporate Credit Union Stabilization Fund, and with it, the authority to borrow up to $6 billion from the U.S. Treasury. [33] These borrowings will be repaid through annual assessments on federally insured credit unions through 2021. In 2009, credit unions paid a total of 15 basis points for NCUSIF and the Stabilization Fund; in September 2010, NCUA announced that the combined premium for NCUSIF and the Stabilization Fund would total 26 basis points for the year. On August 29, 2011, the National Credit Union Administration's board approved an assessment of 25 basis points on all federally insured shares toward the expenses of the Stabilization Fund, amounting to $1.96 billion; no separate assessment for the NCUSIF was announced.[34] For 2012, NCUA has projected assessments of 8 to 18 basis points for the combination of the Stabilization Fund and NCUSIF. The range of estimates for future assessments for the Stabilization Fund was broad: from $1.9 billion to $6.2 billion.[35]

The losses to credit unions did not stop there. As has been noted, corporate credit unions are cooperatives, owned by their member credit unions. Many credit unions were required to make permanent or long-term capital investments in their corporates, usually as a condition of obtaining services. Unlike "natural person" credit unions, corporates are allowed to accept contributed capital from their member-owners, which are available to absorb losses. When the corporates failed, many credit unions lost some or all of their investments – losses that amounted to tens of millions of dollars across the industry.

Thus, for the vast majority of credit unions in the United States, the economic pain of the recession, reflected in mounting loan losses and higher delinquency, was compounded by the losses of investments in their corporates and the imposition of additional deposit insurance premiums by NCUA. The pain was especially acute for many CDCUs, which typically had a thinner cushion of equity to absorb the losses and assessments than their non-low-income peers. Moreover, compared to other credit unions that were generally larger and served more prosperous members, CDCUs served communities with unemployment and poverty rates far above the national averages.

### *The Impact on CDCUs: 2008 - 2010*

The dual crises facing credit unions – the Great Recession and the crisis of the corporate credit union network – put enormous stress on CDCUs. Their struggle was compounded by heightened regulatory pressure: determined to minimize additional losses, NCUA assumed an aggressive stance in examining credit unions, pressing for write-downs of loan portfolios and implementing "Prompt Corrective Action" (PCA) when credit unions sank below the statutory "well capitalized" standard of 7% net worth-to-assets.

The toll has been great, as reflected in the increased numbers of liquidations or forced mergers of CDCUs, further decreasing services to low-income communities.[36] But there was a positive side: despite formidable economic and regulatory pressures, many CDCUs not only survived, but grew over 2008-2010. They were aided by widespread public revulsion at the bailout of the largest banks, which prompted calls by social media and even mainstream financial publications to "move your money" into local credit unions and banks. Even more important, many CDCUs were aided by the programs of the U.S. Treasury Department and the CDFI Fund. Thus, the picture of the CDCU movement that emerges from the years of economic crisis is decidedly mixed: success amid adversity and pain.

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33 Public Law 111-22, Helping Families Save their Homes Act of 2009, created the fund. The purpose was "to accrue corporate credit union system losses, and over time, to assess the credit union system for uncoverable losses" (Stability through the Crisis: National Credit Union Administration 2008-09 Annual Report). Losses from the Temporary Corporate Credit Union Stabilization Fund have been segregated from the losses incurred by the NCUSIF on failures from other, "natural-person" credit unions. Federally insured credit unions are required to pay premiums or assessments for both of these funds.

34 NCUA Board Action Bulletin, August 29, 2011.

35 One trade association, NAFCU, estimated that the assessment would decrease to 13 basis points in 2012 and 9 basis points for 2013 and each year until 2021. (data from NAFCU letter, May 26, 2011).

36 See Table 18.

### *Key Indicators*[37]

Table 4 below shows key financial indicators for the years ending December 31, 2008 through 2010. The picture is mixed: despite balance-sheet pain, CDCUs showed promising signs of growth. In particular:

- Membership in CDCUs grew by some 122,576 (7.9%).
- CDCU assets grew by approximately $1.8 billion (19.7%) to $11.0 billion.
- The CDCU loan portfolio increased by more than $525 million, to $7.773 billion.
- Aggregate net worth of CDCUs increased by approximately $157 million (16.7%).

*On the negative side:*

- Annual loan origination decreased from 2008 to 2010, by approximately $193 million, to $2.88 billion.
- In aggregate, the ratio of CDCU net-worth to total assets declined significantly in 2009, although it rose in 2010 to 9.98%.
- Similarly, the aggregate Return on Average Assets (ROA) declined in 2009 but increased in 2010 to 0.59%.

**Table 4: The CDCU Movement at a Glance, 2008-2010**

| CDCU Data | 2010 | 2009 | 2008 | Change 2008 - 2010 | % Change |
|---|---|---|---|---|---|
| **Membership** | 1,667,394 | 1,600,872 | 1,544,818 | 122,576 | 7.9% |
| **Assets** ($ billions) | $11.00 | $10.38 | $9.20 | $1.8 | 19.7% |
| **Loans Outstanding** ($ billions) | $7.77 | $7.43 | $7.25 | $0.52 | 7.2% |
| **Loans Originated** ($ billions) | $2.88 | $2.93 | $3.07 | ($0.19) | (6.3%) |
| **Net Worth** ($ billions) | $1.10 | $0.98 | $0.94 | $0.16 | 16.7% |
| **Net-worth Ratio** (NWR), aggregate | 9.98% | 9.41% | 10.23% | (0.26) | |
| **Return on Avg. Assets** (ROA), aggregate | 0.59% | 0.28% | 0.43% | 0.17 | |
| **ROA** (median) | 0.17% | -0.05% | 0.38% | (0.22) | |

These figures suggest that on the whole, the greatest impact of the dual crises was felt in 2009, when the aggregate net-worth ratio and Return on Average Assets each declined substantially. By the end of 2010, some improvement was evident. On the whole, the CDCU movement was profitable throughout 2008-10. However, aggregate figures do not tell the full story. The "typical" (median) CDCU experienced a decline of 43 basis points in ROA from 2008 to 2009, to -0.05%. In other words, over half of all CDCUs were unprofitable. In 2010 the median improved by 22 basis points to +0.17%, indicating that half of CDCUs or more were once again profitable, but this figure was still below historical levels.

As shown in Table 5, however, results varied significantly by asset size. Generally, the trend lines were parallel over the three years: a dip in ROA in 2009, followed by recovery in 2010.[38] But throughout 2008-2010, smaller CDCUs were almost always more likely to be unprofitable than larger CDCUs. The size-based difference was less pronounced in 2008, when all but the largest CDCU groupings ($100 million and up) showed unprofitability in the range of 28% to 36% of the cohort. It was most pronounced in 2009, when the small and medium-asset groups ($2 million through $50 million) all showed unprofitability rates of 50% or more, while those credit unions with assets upward of $50 million showed no more than 21.43% of their cohort unprofitable in either year. In short: asset size mattered in surviving the recession.

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37 The data used in this section is drawn from a set of 226 credit unions that were Federation-member CDCUs and reported data for each of the fiscal years 2008-2010.

38 The exception was for the small cohort of 14 CDCUs of $50 - $100 million, which showed improvement in 2009 over 2008 and a slight retreat in 2010. This may have been attributable to CDFI Fund awards.

| Assets (millions) | # of CDCUs (2010) | # of CDCUs (2009) | Median ROA (2010) | Median ROA (2009) | Median ROA (2008) | CDCUs with negative ROA (2010) | CDCUs with negative ROA (2009) | CDCUs with negative ROA (2008) |
|---|---|---|---|---|---|---|---|---|
| **< $2** | 84 | 80 | 0.07% | -0.30% | 0.39% | 46.43% | 61.25% | 34.94% |
| **$2 - $5** | 26 | 30 | 0.12% | -0.35% | 0.63% | 38.46% | 56.67% | 28.00% |
| **$5 - $10** | 26 | 25 | -0.14% | -0.37% | 0.33% | 50.00% | 68.00% | 32.14% |
| **$10 - $50** | 55 | 54 | 0.19% | -0.01% | 0.27% | 41.82% | 50.00% | 35.71% |
| **$50 - $100** | 14 | 15 | 0.86% | 1.13% | 0.45% | 21.43% | 13.33% | 35.71% |
| **$100+** | 21 | 19 | 0.61% | 0.38% | 0.59% | 14.29% | 21.05% | 12.50% |
| *All CDCUs* | *226* | *223* | *0.17%* | *-0.05%* | *0.38%* | *40.27%* | *52.02%* | *27.79%* |

Table 5: Return on Average Assets (ROA) by CDCU Size

Along with ROA, net-worth ratio is one of the vital signs for a credit union. As noted previously, since the Credit Union Membership Access Act of 1998, credit unions have been subject to mandatory minimum ratios of net worth-to-total assets. Credit unions with ratios above 7% are classified as "well-capitalized"; below that level, they are classed as "adequately capitalized"; if they fall below 6% they are classed as undercapitalized, or if they fall even further, critically undercapitalized.

The great majority of CDCUs are well capitalized, although at a slightly smaller percentage than credit unions in general. But as illustrated in Table 6 below, the number of credit unions that fell in the danger zone below the 7% threshold increased significantly over the three years: in 2008, only 18 were below 7%, while by 2010, the number had increased to 28. More distressing, by the end of 2010 the number that fell below 6% – the zone when regulatory pressure becomes more and more intense – rose from 10 in 2008 to 18, accounting for nearly 8% of all CDCUs.

For credit unions (and banks), the consequences of decreased net worth are far harsher than for non-regulated CDFIs. Credit union examiners apply increased pressure; they may urge devaluation of loan portfolios, contraction of lending (especially to "high risk" low-income borrowers), elimination of services, reduction of staff, and even change of management. In some instances, these measures produce a self-fulfilling downward spiral leading to forced mergers or liquidation. If a CDCU is unable to lend or provide services to its low-income members, it loses both its capacity to generate net earnings (ROA) and its reason for being.

Moreover, diminished net worth may limit access to investment. The CDFI Fund does not identify credit unions that unsuccessfully apply for funding, and so it is not possible to determine whether those CDCUs that were rejected were ones with reduced net worth as a result of the recession and the credit union-wide industry crisis.[39] Nor is there definitive data for credit unions that were discouraged from pursuing or else rejected by Treasury for the Community Development Capital Initiative (CDCI).[40] But it is highly likely that the analysis and ratings of credit unions by their regulator/insurer, NCUA, weighed heavily in the case of unsuccessful applicants. In any event, the denial of badly needed capital to some CDCUs is very likely to reduce the availability of financial services in their low-income communities.

39 The Federation has unsuccessfully requested such data pursuant to the Freedom of Information Act.

40 The Federation gathered partial information through its own inquiries of credit unions, but it is insufficient to generalize.

| Table 6: Net Worth Ratios of CDCUs, 2008-2010 | | | | | | |
|---|---|---|---|---|---|---|
| **Net-Worth Ratio** | **2010** | | **2009** | | **2008** | |
| | **# of CDCUs** | **% of CDCUs** | **# of CDCUs** | **% of CDCUs** | **# of CDCUs** | **% of CDCUs** |
| **7% or above** | **198** | **88%** | **193** | **87%** | **204** | **92%** |
| **6% - 6.99%** | **10** | **5%** | **18** | **8%** | **8** | **4%** |
| **Below 6%** | **18** | **8%** | **12** | **5%** | **10** | **4%** |
| *Total* | *226* | *100%* | *223* | *100%* | *222* | *100%* |

***Asset Growth***

For the CDCU movement as a whole, there was considerable balance-sheet growth over 2008-2010. Asset growth over this period was 19.7%. This rate exceeded that of the entire credit union movement, which recorded an increase of 12.21% over this period. Here, too, growth was uneven: the largest CDCUs fared best, as shown in Table 7 below.

| Table 7: Growth of Deposits, Assets, and Loans by CDCU Size 2008 – 2010 | | | | |
|---|---|---|---|---|
| **Assets (millions)** | **# of CDCUs** | **Deposit Growth** | **Asset Growth** | **Loan Portfolio Growth** |
| **< $2** | 84 | 3.95% | 2.77% | 8.51% |
| **$2 - $5** | 26 | -0.46% | -0.45% | 3.10% |
| **$5 - $10** | 26 | -8.88% | -11.32% | -13.75% |
| **$10 - $50** | 55 | 1.03% | -0.95% | -5.91% |
| **$50 - $100** | 14 | 6.19% | 4.41% | -8.75% |
| **$100+** | 21 | 29.63% | 27.53% | 12.27% |
| ***All CDCUs*** | ***226*** | ***21.65%*** | ***19.67%*** | ***7.25%*** |
| **All FICUs** | **7,491** | **15.26%** | **12.21%** | **-0.40%** |

***Lending***

The loan portfolio outstanding for the CDCU movement increased by 7.25% – a modest figure, but markedly higher than for the entire credit union movement, which saw a shrinkage of its portfolio by 0.40%. Here, too, growth was concentrated among the largest CDCUs; there were decreases in each of the categories comprising credit unions from $5 million to $100 million in assets.

Notwithstanding the growth in their loan portfolios, CDCUs saw their pace of origination decrease. In 2010, CDCUs originated some $193.44 million less in loans than they had two years earlier. To varying degrees, the decrease was evident in every category but one (small credit unions of $2 to $5 million in assets). Likely explanations for the decrease include:

- The voluntary deleveraging of consumers, including low-income consumers anxious about their ability to manage increased debt.
- Widespread decline in credit scores among American consumers, which shrank the pool of qualified borrowers.
- Examiner pressure on credit unions to reduce perceived risk of lending to members with lower credit scores.

| Assets (millions) | # of CDCUs 2010 | Loan Originations (millions) | | | Change 2008-2010 | |
|---|---|---|---|---|---|---|
| | | 2009 | 2008 | Amount (millions) | Difference | Percentage Change |
| **< $2** | 84 | $15.4 | $16.7 | $15.7 | -$.36 | -2.3% |
| **$2 - $5** | 26 | $31.1 | $29.4 | $27.8 | $3.34 | 12.0% |
| **$5 - $10** | 26 | $39.1 | $47.1 | $53.4 | -$14.30 | -26.8% |
| **$10 - $50** | 55 | $369.4 | $412.1 | $426.6 | -$57.19 | -13.4% |
| **$50 - $100** | 14 | $242.7 | $281.1 | $305.8 | -$63.06 | -20.6% |
| **$100+** | 21 | $2,183.9 | $2,144.9 | $2,245.8 | -$61.86 | -2.8% |
| ***Total*** | ***226*** | ***$2,881.6*** | ***$2,931.3*** | ***$3,075.1*** | ***-$193.44*** | ***-6.3%*** |

**Table 8: Loan Origination by CDCU Size, 2008-2010**

The portfolio performance of CDCUs is presented in Table 9 below. Virtually throughout the credit union movement, the recession caused delinquency and charge-off rates to rise well above historic averages. Over the course of the recession, CDCUs showed higher rates of delinquency (60 days or more) than other, non-low-income credit unions. This is consistent with historic patterns; in fact, elevated delinquency is a basic characteristic of credit unions that by definition serve the most economically vulnerable population. However, it is striking that the charge-off rate of CDCUs in the aggregate was actually slightly better than that of other credit unions. Unfortunately and ironically, as broad swaths of the American population saw their finances decimated by the recession, the performance of all credit unions in the recession came to more closely resemble that of CDCUs. For portfolio performance, as for other indicators, size mattered: larger CDCUs generally fared better, usually showing substantially lower charge-off rates than smaller CDCUs.

### *Mortgage Lending*

Over the past decade, mortgage lending has grown in importance in the overall credit union portfolio, even as lending for new automobiles has declined. As Table 10 shows, mortgage and other real estate lending by CDCUs has brought portfolio concentration to approximately 50%, echoing a trend of the broader credit union movement.

**Table 9: Portfolio Performance by CDCU Size**

| Assets (millions) | # of CDCUs | Delinquency Rate (60 days+) | | | Net Charge-Offs / Average Loans | | |
|---|---|---|---|---|---|---|---|
| | | 2010 | 2009 | 2008 | 2010 | 2009 | 2008 |
| **< $2** | 84 | 6.83% | 7.34% | 7.50% | 1.46% | 1.88% | 1.72% |
| **$2 - $5** | 26 | 4.21% | 3.75% | 3.55% | 0.61% | 0.78% | 1.35% |
| **$5 - $10** | 26 | 4.65% | 3.57% | 3.22% | 2.40% | 1.58% | 0.98% |
| **$10 - $50** | 55 | 3.48% | 3.62% | 2.88% | 1.28% | 1.17% | 1.08% |
| **$50 - $100** | 14 | 2.10% | 1.69% | 4.13% | 0.97% | 1.17% | 1.08% |
| **$100+** | 21 | 2.66% | 2.41% | 1.92% | 0.96% | 1.15% | 0.69% |
| ***Total CDCUs*** | ***226*** | ***2.76%*** | ***2.53%*** | ***2.33%*** | ***1.02%*** | ***1.16%*** | ***0.79%*** |
| **All FICUs** | 7,491 | **1.76%** | **1.83%** | **1.37%** | **1.14%** | **1.21%** | **0.81%** |

Table 10 also shows that there was an increase in first-mortgage origination by CDCUs in 2009, followed by a decline in 2010 which nonetheless left originations 7.1% higher in 2010 than in 2008. Other real estate loan origination, which includes home equity loans and second mortgages, declined both in 2009 and 2010: the two-year decrease amounted to more than 43%. Possible explanations for this sharp decrease include the perceived riskier nature of these loans; lower home equity of borrowers and/or lower credit scores of borrowers; regulatory pressure with respect to this category of loans; and borrower reluctance to increase debt.

| Item | 2010 | 2009 | 2008 | % Increase 2008 - 2010 |
|---|---|---|---|---|
| **First Mortgages Originated** | $821.96 | $883.24 | 767.50 | 7.10% |
| **First Mortgages Outstanding** | $3,023.40 | $2,703.98 | 2,574.46 | 17.44% |
| **Other R.E. Originated** | $186.44 | $228.49 | 327.90 | -43.14% |
| **Other R.E. Outstanding** | $994.56 | $982.00 | 945.39 | 5.20% |
| **Total R.E. Outstanding** | $4,017.96 | $3,685.98 | 3,519.85 | 14.15% |
| **Total R.E. Originations** | $1,008.40 | $1,111.73 | 1,095.39 | -7.94% |
| **R.E. outstanding as % of total CDCU loan portfolio** | 51.69% | 49.58% | 48.56% | +313 b.p. |

Table 10: CDCU Mortgage and Real Estate Lending

Modifications of CDCU mortgage loans were minimal in 2008 (see Table 11). CDCUs sharply increased their pace of mortgage modification in 2009, and the growth continued in 2010, albeit more modestly. The increase in 2010 was entirely attributable to CDCUs with $100 million or more in assets, which tended to be the most active lenders. Over three years, $183.32 million in mortgage loans were modified by CDCUs. This compares to a first-mortgage portfolio of just over $3 billion at the end of 2010. This suggests that approximately 6% of CDCU mortgages were modified.

Table 11: CDCU Mortgage Loan Modifications, 2009-10

| CDCU Assets (millions) | Loan modifications (millions) | | | Change 2008-2010 |
|---|---|---|---|---|
| | 2010 | 2009 | 2008 | |
| **$10 - $50** | **$9.37** | $12.24 | $0.48 | 1,851% |
| **$50 - $100** | **$5.01** | $7.05 | $4.18 | 20% |
| **$100+** | **$73.74** | $58.38 | $12.88 | 473% |
| *Total* | **$88.12** | $77.66 | $17.54 | 402% |

### *Automobile Lending*

Lending for new automobiles was historically a key part of the overall credit union portfolio, although it has declined over the last decade as "captive" automobile finance companies associated with manufacturers won greater market share through special low-cost financing. The catastrophic failure of the U.S. auto industry during the recession, combined with consumer reluctance to increase their debt burden, had a striking effect on credit union automobile lending over 2008 – 2010. The credit union industry overall showed a 23% decline in loan volume over these two years, while the CDCU decline was about one-third less sharp, at just under 15%. Both CDCUs and credit unions in general showed an increase in lending for used vehicles, with CDCUs slightly exceeding industry averages (7.65% to 7.43%).

Automobile lending is not viewed by some researchers and policymakers as a component of "community development lending." However, in a country where public transportation is inadequate outside major population centers – and lacking even in some of these – automobile ownership is essential to holding a job. This is all the more true in times of recession, when people require maximum flexibility to maintain or pursue employment.

| Table 12: Credit Union Automobile Lending 2008-2010 | | |
|---|---|---|
| Type of Credit Union | Change in Volume from 2008 to 2010 | |
| | New Vehicles | Used Vehicles |
| CDCUs | -14.97% | +7.65% |
| All Credit Unions | -23.16% | +7.43% |

*Regional Patterns*

CDCUs vary substantially across the United States in their financial and demographic characteristics. Table 13 below shows the variation in CDCU asset size across the four Federation regions (see Appendix).

**Table 13: Regional Variation in CDCU Asset Size, 2010**

| Region | # of CDCUs | % of CDCUs | Total Assets (millions) | Percentage of Assets | Median Assets ($million) |
|---|---|---|---|---|---|
| **Northeast** | 66 | 29.2% | $1,638 | 14.9% | $1.12 |
| **Southeast** | 51 | 22.6% | $2,541 | 23.1% | $5.66 |
| **Mid-West** | 64 | 28.3% | $3,854 | 35.0% | $3.37 |
| **West** | 45 | 19.9% | $2,972 | 27.0% | $18.65 |
| *Total* | *226* | *100%* | *$11,005* | *100%* | *$5.51* |

By far, the smallest credit unions are concentrated in the Northeast, where the median size is only $1.12 million; this is a region with the heaviest concentration of faith-based credit unions, especially long-standing African-American institutions. There are more CDCUs in the Northeast than any other region (66), but they collectively accounted for only 14.9% of total CDCU assets. In contrast, CDCUs in the Western region are far larger, though less numerous: 45 Western CDCUs have a median asset size of more than $18 million. The Midwestern region has a substantial number of small credit unions with median assets just above $3 million, but it also includes the largest CDCU, GECU of El Paso, with $1.7 billion in total assets at the end of 2010; its numbers heavily affect statistics for the region as a whole.

**Table 14: Growth of CDCU Assets by Region, 2008 -2010**

| Region | # of CDCUs | Total Assets (millions) | | | Change (millions) | Change (percent) |
|---|---|---|---|---|---|---|
| | | 2010 | 2009 | 2008 | | |
| **Northeast** | 66 | $1,638 | $1,568 | $1,389 | $249.5 | 18.0% |
| **Southeast** | 51 | $2,541 | $2,315 | $1,859 | $682.1 | 36.7% |
| **Mid-West** | 64 | $3,854 | $3,602 | $3,178 | $675.7 | 21.3% |
| **West** | 45 | $2,972 | $2,894 | $2,770 | $201.8 | 7.2% |
| *All CDCUs* | *226* | *$11,005* | *$10,380* | *$9,196* | *$1,809.1* | *19.7%* |

The Great Recession had uneven effects across the United States, as reflected in the differential impacts on CDCUs. There was wide variation in asset growth. The Western region of CDCUs saw the smallest increase over 2008 – 2010: a scant 7.2% (Table 14); the Southeast, in contrast, saw growth of nearly 37%. Similarly, the West – the region arguably hardest hit by the recession – saw the sharpest decrease in loan origination (24.9%). As shown in Table 15, the Northeast and Southeast showed smaller declines, while the Midwest showed an increase in originations of 7.3%.

| Table 15: CDCU Loan Origination by Region | | | | | | |
|---|---|---|---|---|---|---|
| Region | # of CDCUs | Loan Originations (millions) | | | Change (millions) | Change (%) |
| | | 2010 | 2009 | 2008 | | |
| **Northeast** | 66 | $346.6 | $368.9 | $365.2 | -18.63 | -5.1% |
| **Southeast** | 51 | $460.7 | $445.9 | $514.9 | -54.25 | -10.5% |
| **Mid-West** | 64 | $1,420.4 | $1,354.3 | $1,324.2 | 96.22 | 7.3% |
| **West** | 45 | $654.0 | $762.2 | $870.6 | -216.58 | -24.9% |
| *All CDCUs* | *226* | *$2,881.6* | *$2,931.3* | *$3,075.1* | *-193.24* | *-6.3%* |

Table 16 analyzes portfolio performance by region over 2008 – 2010. Here, too, the impact on CDCUs in the West is strongest: the charge-off rate of Western CDCUs exceeded that of all CDCUs each year from 2008 through 2010. Delinquency, as well, was higher in 2008 and 2010, though it dropped below the CDCU average in 2009. Except for the Midwest, delinquency rose in each region in 2009 and 2010.

| Table 16: CDCU Portfolio Quality by Region | | | | | | |
|---|---|---|---|---|---|---|
| Region | Delinquency Rate (60 days+) | | | Net Charge-Offs /Loans | | |
| | 2010 | 2009 | 2008 | 2010 | 2009 | 2008 |
| **Northeast** | 2.35% | 2.10% | 1.55% | 0.98% | 0.90% | 0.73% |
| **Southeast** | 4.27% | 5.02% | 3.35% | 1.19% | 1.22% | 0.89% |
| **Mid-West** | 1.39% | 1.61% | 1.77% | 0.73% | 1.00% | 0.69% |
| **West** | 3.71% | 2.27% | 2.71% | 1.31% | 1.45% | 0.88% |
| *All CDCUs* | *2.76%* | *2.53%* | *2.33%* | *1.02%* | *1.16%* | *0.79%* |

The toll of the recession was evident in profitability, as well. As shown in Table 17, the West had the lowest ROA in 2008, improving by a scant two basis points by the end of 2010; in every year, it was worse than the overall CDCU average. The Midwest fared best, never falling into negative territory. The drop in ROA was most pronounced, however, in the Northeast: a 46-basis point decline from 2008 to 2010. While none of the ROA results were good by historic norms, the Northeastern and Western credit unions barely exceeded break-even, with median ROA of less than one-tenth of one percent in 2010. Until and unless this rate increases, it will be extremely difficult for these credit unions to build strength and grow.

| Table 17: Median Return on CDCU Assets (ROA) by Region | | | | | |
|---|---|---|---|---|---|
| Region | # of CDCUs | Median ROA | | | Change 2008-2010 |
| | | 2010 | 2009 | 2008 | |
| **Northeast** | 66 | 0.09% | -0.31% | 0.37% | -46 b.p. |
| **Southeast** | 51 | 0.19% | -0.06% | 0.56% | -37 b.p. |
| **Mid-West** | 64 | 0.36% | 0.22% | 0.52% | -16 b.p. |
| **West** | 45 | 0.05% | -0.17% | 0.03% | +2 b.p. |
| *All CDCUs* | *226* | *0.17%* | *-0.05%* | *0.38%* | *-21 b.p.* |

### *Consolidation Trends, 2008-2010*

The enormous stress on depository balance sheets accelerated the trend toward mergers and liquidations. Credit unions were not unique. The banking industry saw 140 failures in 2009 and 157 in 2010 during this period, while there were 31 credit union failures in 2009 and 24 in 2010.[41] Ordinarily, bank mergers are motivated by the desire to increase market share, increase efficiency, and raise profitability; similarly, during "normal" times, credit unions may also merge to achieve greater economies of scale and expand their markets, or fields-of-membership. However, during the Great Recession, mergers or "purchase and assumption" deals among credit unions typically involved failed or failing institutions, sometimes with the aid of regulatory assistance in the form of cash assistance to the credit unions that acquired the failed institutions.

CDCUs in particular experienced high rates of distress-driven mergers or purchases and assumptions during the recession. Some CDCUs that agreed to be merged were solvent but struggling institutions; they were worn down in the face of regulatory pressure or frustrated by their prospects of maintaining mission and services in their communities. Liquidations occurred when a credit union was insolvent or nearly so, geographically isolated, or had a membership that was so very low-income that regulators could not find a merger partner.

Mergers and liquidations of CDCUs during these years are summarized in Table 18 below. For the most part, the institutions were small: among merged credit unions, median membership was 1,170 and median assets, $2.14 million; among liquidated credit unions, median membership was 821 and median assets $841,245. However, over 2009-2010, there were four CDCUs with assets ranging from $30 million to nearly $80 million, with as many as 24,000 members, that were merged. The very low average assets-per-member is striking: $1,827 for merged credit unions and only $1,025 for liquidated credit unions. While it is possible that some members with higher assets withdrew funds before the merger or liquidation, deposit insurance generally prevents any "run on the credit union." There is little doubt that these vanishing institutions served predominantly low- or very-low-income populations – hardly an attractive franchise for prospective merger partners.

**Table 18: Mergers and Liquidations of CDCUs, 2008 – 2010**

| Year | Total | Merged | Assets | Members | Liquidated | Assets | Members |
|---|---|---|---|---|---|---|---|
| 2008 | 18 | 15 | $27,415,415 | 15,099 | 3 | $27,771,617 | 6,159 |
| 2009 | 15 | 12 | $190,025,213 | 59,983 | 3 | $1,122,446 | 1,337 |
| 2010 | 14 | 8 | $50,348,126 | 18,058 | 6 | $16,732,353 | 7,123 |
| *Total* | *47* | *35* | *$267,788,754* | *93,140* | *12* | *$45,626,416* | *14,619* |
| ***Median*** | | | ***$2,137,072*** | ***1,170*** | | ***$841,245*** | ***821*** |
| ***Assets per member*** | | | ***$1,827*** | | | ***$1,025*** | |

When CDCUs are merged into other credit unions without a similar mission, there is little evidence that the low-income population continues to receive comparable service. A "mainstream" credit union absorbing a low-income credit union typically closes the low-income branch either immediately or after a year or two; moreover, the loan underwriting criteria of the mainstream credit unions are usually less conducive to lending to low-income members. In order to ensure continued access to appropriate services for low-income people, the Federation has advocated with the regulators to give preference to merging CDCUs with like institutions. This has not consistently been the case: in some instances, geographical, financial, or other considerations prevailed instead. But there were important counter-examples over 2008-2010.

Table 19 below summarizes the pattern of mergers among CDCUs over 2008 – 2010. Overall, less than 30% of the mergers combined CDCUs with other CDCUs. By proportion of members absorbed into other CDCUs, the figure is a somewhat more encouraging 41%. Some mergers by and among CDCUs achieved high impact, preserving services to very-low-income communities and even expanding the reach of the CDCU movement by absorbing other types of credit unions, as well.

41 Source: www.cuinfosecurity.com/articles.php$art_id=1681 (for 2009) and www.cuinfosecurity.com/articles.php?_art_id=2092 (for 2010).

| Table 19: CDCU Merger Patterns, 2008 – 2010 | | | | | |
|---|---|---|---|---|---|
| Year | All CDCU Mergers | Mergers with CDCUs | % of Mergers with CDCU | # of Members Merged into CDCUs | % of Members merged into CDCUs |
| 2008 | 15 | 3 | 20% | 4,848 | 32.1% |
| 2009 | 12 | 3 | 25% | 20,079 | 33.5% |
| 2010 | 8 | 4 | 50% | 12,992 | 69.1% |
| *Total* | 35 | 10 | 28.6% | 37,919 | 40.7% |

### *California and North Carolina: The Expansion of Self-Help*

The recession wrought economic havoc on the Central Valley of California: skyrocketing foreclosures, plummeting real estate values, and huge increases in unemployment – 20% or more – especially though not only among the service, agricultural, and construction industries that employed large numbers of immigrant and other low-wage workers. A number of long-established CDCUs serving predominantly Latino members were badly damaged by the economic distress that their members experienced. Had they dissolved or been merged into other less mission-driven institutions, they would have left a large vacuum in low-income communities. Fortunately, the Center for Community Self-Help (CCSH), based in Durham, NC was able to step into the breach.

Self-Help Credit Union, a state-chartered institution established in 1983 to serve North Carolina, has long been one of the most prominent CDCUs in the country, with several hundred million dollars in assets. In 2008, CCSH, the original nonprofit sponsor of Self-Help Credit Union, chartered a companion institution, Self-Help Federal Credit Union (SHFCU) to serve California, as part of a strategic initiative to combat predatory lending. As shown in Table 20 below, in 2008 it merged with one small CDCU, People's Community Partnership FCU in Oakland. In 2009 it added Community Trust CU in Modesto, and in 2010 it added three credit unions, including Kern Central CU in Bakersfield, El Futuro CU in Porterville, and United Savings FCU in Antioch. Together, in 2010 these credit unions added nearly $65 million in assets and more than 15,000 members to SHFCU, which ended the year with more than 30,000 members and over $200 million in assets. This dramatic growth was enabled by major investments of equity-like secondary capital supplied by the Ford Foundation and channeled through CCSH as the nonprofit parent of the credit unions.

| Table 20: Self-Help FCU (California)Before and After Mergers | | |
|---|---|---|
| | Assets (millions) | Members |
| **Before: Self-Help Federal Credit Union, December 2008** | **$8.1*** | **2,981** |
| **Merger Partners** | | |
| People's Community Partnership FCU (2008) | $3.7 | 2,767 |
| Community Trust Credit Union (2009) | $40.7 | 11,826 |
| Kern Central Credit Union (2010) | $34.3 | 8,288 |
| El Futuro Credit Union (2010) | $6.9 | 2,946 |
| United Savings Federal Credit Union (2010) | $23.6 | 4,047 |
| **After: Self-Help Federal Credit Union, December 2010** | **$209.8** | **30,664** |

* People's Community Partnership FCU is included in the December 2008 figures.

Meanwhile, the original Self-Help Credit Union was also expanding significantly in its home state. In 2009 it brought in Carolina Mountains CU (Penrose, NC), with 7,089 members and $44.5 million in assets. In 2010, it grew further through the addition of two federal credit unions, Choice Community FCU (Greensboro, NC; 9,744 members, $46.3 million in assets) and Carolina Family FCU (Kinston, NC; 1,766 members and $10.9 million in assets).

*The South: Hope FCU and Shreveport FCU*

Hope FCU, a multi-state credit union headquartered in Jackson, MS grew from modest beginnings as a church-based credit union. With a strong and effective nonprofit sponsor, the then-Enterprise Corporation of the Delta (now Hope Enterprise Corporation), which made creative use of New Markets Tax Credits, it grew substantially, reaching $68.4 million in assets and 9,517 members by the end of 2008. Over the next two years, the mergers listed in the table below helped Hope FCU to reach $138.9 million in assets and 25,718 members.

**Table 21: Hope Federal Credit Union Before and After Mergers**

| Credit Union Activities | Assets (millions) | Members |
|---|---|---|
| **Before: Hope Federal Credit Union (December 2008)** | **$68.4** | **9,517** |
| **Merger Partners** | | |
| College Station Community Federal Credit Union (2009) | $0.9 | 600 |
| American Savings Credit Union (2009) | $43.0 | 18,000 |
| East Central Federal Credit Union | $2.9 | 3,000 |
| **After: Hope Federal Credit Union (December 2010)** | **$138.9** | **25,718** |

Shreveport Federal Credit Union in Northwest Louisiana began 2009 with just over $60 million in assets and 15,000 members. In 2010, it extended its reach to Mississippi by merging First Delta FCU in Marks, MS and Friendship Community FCU in Clarksdale. MS. It ended 2010 with more than $86 million in assets and nearly 20,000 members, having brought to the Mississippi communities the expanded range of services that a much larger CDCU could offer. First Delta, in particular, served one of the most impoverished rural regions in the country. It was not an attractive franchise for other credit unions; in fact, had Shreveport FCU not offered to take over the credit union, it is highly likely that First Delta FCU would have been liquidated, leaving thousands in a predominantly African-American rural area unserved.

**Table 22: Shreveport Federal Credit Union Before and After Mergers**

| Credit Union Activities | Assets (millions) | Members |
|---|---|---|
| **Before: Shreveport Federal Credit Union (December 2008)** | **$63.8** | **14,995** |
| **Merger Partners** | | |
| First Delta Federal Credit Union (2010) | $5.6 | 4,650 |
| Friendship Community Federal Credit Union (2010) | $0.9 | 1,100 |
| **After: Shreveport Federal Credit Union (December 2010)** | **$86.1** | **19,088** |

*The Impact of the Recession: Differences Between CDCUs and Non-Depositories*

The Great Recession had a dramatic impact on community development credit unions. Like all federally insured credit unions, they suffered not only from the direct effects of the recession on their communities, but from the costs imposed by the collapse of the corporate credit unions, which eroded their profitability and net worth. Some credit unions that had served low-income communities for decades went out of existence.

Some of the challenges brought on by the recession were felt by CDCUs and non-depositories alike. In general, both sectors experienced a decline in portfolio quality, reflected in increased delinquency and charge-offs. Credit unions, CDFI loan funds, and nonprofits in general often depend for a portion of their income on investment of liquid funds. The large drop in prevailing interest rates harmed all of these institutions that had not locked in long-term rates.

However, there were significant differences between depositories and unregulated CDFIs.

- **Liquidity constraints.** Many loan funds experienced liquidity challenges during the recession. CDFI loan funds often depend on loans and grants from banks. During the crisis, major banks like Washington Mutual and Wachovia failed and were absorbed by JP Morgan Chase and Wells Fargo respectively. Many banks reduced availability or raised the price for loans to CDFIs. Bank Community Reinvestment Act (CRA) units dissolved or were reorganized; grant availability was reduced.

  In contrast, liquidity was not the problem for credit unions (or for that matter, most community development banks). Very few CDCUs depended on banks either for investments or grants. Credit unions acquire liquidity primarily through deposits. As shown earlier (see Table 7 above), deposits and assets of CDCUs and other credit unions generally grew during the recession, as some consumers turned away from large banks and sought local institutions to place their funds.

  While liquidity in manageable quantities is essential, too much liquidity presents its own problems for a depository. In an ultra-low interest rate environment, depositories without strong, growing loan demand have no place to profitably invest their funds. They face unenviable options, including reducing the interest they pay to savers, turning away additional deposits, and thereby curtailing future growth possibilities.
- **Equity constraints.** The influx of deposits puts pressure on depository balance sheets: absent strong profitability and infusions of equity, the net-worth ratios of these institutions shrink, with adverse regulatory consequences. Equity, not liquidity, is the problem. While equity can be a concern for non-regulated CDFI loan funds as well, they typically have net assets (net worth) of 20% or more. Many loan funds have minimum equity covenants with their investors, including foundations, banks, and the CDFI Fund, and some loan funds experienced problems during the recession. But the consequences of non-compliance with a funder covenant are generally far less harsh than, for example, a credit union that falls below the statutory "well capitalized" standard of 7% and faces increasingly harsh regulatory strictures. During the Great Recession, equity constraints may have been a problem for some CDFI loan funds; for some CDCUs, they were a crisis.
- **Loan demand.** Surveys by Opportunity Finance Network indicated that many loan funds experienced a growth in loan demand during the recession; some saw improved quality of applications as borrowers who had previously been "banked" were turned away by their former lenders. In general, this was not the case for credit unions. There was widespread fear among consumers about adding more debt. Credit scores dropped, as unemployment increased and as lines of credit were reduced. As a consequence, some credit unions faced regulatory or internal pressures to curtail lending to this population.

To address their various dilemmas, depository and non-depository CDFIs alike looked to the U.S. Treasury Department and the Community Development Financial Institutions Fund.

## V. Access to Capital in the Great Recession

The damage inflicted on CDFIs of all sectors would have been far worse if not for the CDFI Fund and the Community Development Capital Initiative (CDCI) of the U.S. Department of the Treasury. Investments through these programs both alleviated short-term liquidity problems and helped strengthen the capital base of CDFIs, helping to ensure that the CDFI movement would continue to thrive. Financial Assistance awards from the CDFI Fund in 2009 and 2010 added permanent capital and loan loss reserves to scores of institutions. Investments through the CDCI provided the largest infusion of capital in the history of the community development credit union movement.

### *CDFI Fund Investments in Credit Unions, 2008 - 2010*

The CDFI Fund fared well in the first years of the Obama Administration: the regular appropriation to the Fund rose modestly from $99.4 million in FY 2008 to $109.4 million in FY 2009. That same year the CDFI Fund also received a special $100 million infusion made available through the American Recovery and Reinvestment Act (ARRA). For FY 2010, which began October 1, 2009, the CDFI Fund received an appropriation of $246.75 million – the largest amount by far in its history.

Aided by ARRA funding, the CDFI Fund provided record amounts of awards during 2009. The "ARRA round" of $90 million was announced on June 29 and disbursed in record time, within 60 days, an extraordinary performance for any federal agency. The "regular" FY 2009 appropriation (described in CDFI Fund literature as the "Supplemental Round"), announced on October 2, 2009, provided $52.7 million to CDFIs. In addition, the Fund made $2.4 million in Technical Assistance Awards.[42] The total for calendar year 2009 thus exceeded $145 million, excluding Bank Enterprise Awards and Native American CDFI Awards (NACA).[43]

Table 23 summarizes the Financial and Technical Assistance Awards made by the CDFI Fund in the calendar years 2008 through 2010.[44] Overall, both by number of awards and dollar amounts, credit unions received a small share of funding. By dollars, the cumulative total of $34.9 million over these three years was only 11.5% of the total; the credit union share varied from a low of 8.5% of dollars in 2008 to a high of 19.1%. By number of awards, credit unions received 10.1% of the total, with a peak of 15.3%.[45]

**Table 23: CDFI Fund Financial and Technical Assistance Awards, 2008-2010**

| Item | 2008 | 2009 ARRA | 2009 FA | *2009 TA* | *2009 Total* | 2010 | Total |
|---|---|---|---|---|---|---|---|
| Total Awards (millions) | $54.2 | $90.0 | $52.7 | *$2.4* | *$145.1* | $104.8 | $304.1 |
| Credit Union Awards (millions) | $4.6 | $17.2 | $0.9 | *$0.3* | *$18.3* | $12.0 | $34.9 |
| Credit Union share (%) | 8.5% | 19.1% | 1.6% | *12.7%* | *12.6%* | 11.4% | 11.5% |
| Total Number of Awards | 89 | 59 | 62 | *27* | *148* | 179 | 416 |
| Number of Credit Union Awards | 8 | 9 | 2 | *3* | *14* | 20 | 42 |
| Credit Union Share (%) | 9.0% | 15.3% | 3.2% | *11.1%* | *9.5%* | 11.2% | 10.1% |

*Note: 2010 totals include American Recovery and Reinvestment Act (ARRA), Financial Assistance (FA) and Technical Assistance (TA) awards.*

### *2009 CDFI Fund Investments in Credit Unions*

Credit union results were noticeably uneven in the various funding rounds during the critical calendar year 2009. By far, credit unions fared best in the ARRA funding round, when CDCUs received awards totaling $17.15 million, (19.1% of total dollars; 15.3% of the number of awards). Moreover, the average award size was high, with 8 of the 9

42 Financial Assistance awards, which have ranged in recent years up to $2 million, provide financing capital, loan loss reserves, capital reserves, or support for operations. Technical Assistance awards, which can be used for a range of purposes, are typically up to $100,000.

43 Source: CDFI Fund, 2009 Performance and Accountability Report.

44 Native American CDFI Awards are not included in this chart.

45 Over these three calendar years, the National Federation of CDCUs received three awards totaling $2.5 million for its Community Development Investment Program (CDIP), which invests secondary capital and purchases mortgages from CDCUs.

credit unions receiving the maximum award of $2 million each. In sharp contrast, the "regular" (Supplemental) round announced on October 2 provided very little for credit unions: two credit unions of the 62 recipients (3.2%) received $850,000 (1.6% of the total dollars). Only three of the 27 CDFIs (11%) that received Technical Assistance awards were credit unions, accounting for $299,963 of the $2,363,917 in awards (12.7%). Thus, in total, during calendar year 2009, credit unions received approximately $18.3 million of the $145.1 million total awarded, amounting to 12.6% of the dollars and 9.5% of the number of awards.

One factor that caused special concern among credit unions was the strikingly low success rate among CDCU applicants. As shown in Table 24, below, from 2008-2010 the typical CDFI applicant for financial assistance from 2008-2010 had better than one chance in three of receiving an award[46]. This remained true for other types of CDFIs in 2009, when 35% of all non-credit union applicants received an award. But for most credit unions, the results were a stunning disappointment; only 17% of credit union applicants received any amount of funding from the CDFI Fund in 2009. In a year of record resources and visibility for the CDFI Fund, an unprecedented 63 credit unions had submitted applications, but 83% were turned away.

**Table 24: Success Rates for CDFI Fund Applicants by Type**
Combined Results for FA and TA Awards, Fiscal Years 2008-2010

| Type of CDFI | Success Rates for Applicants | | | Dollars Awarded | |
|---|---|---|---|---|---|
| | # Applicants | # Awards | Success Rate (Awards/ Applicants) | Total Dollars Awarded | Percent of Total Dollars Awarded |
| Loan Fund | 828 | 340 | 41% | $247,306,647 | 81% |
| Credit Union | 163 | 47 | 29% | $34,880,353 | 11% |
| Banks, Thrifts & Depositories | 64 | 18 | 28% | $14,827,072 | 5% |
| CDVC | 29 | 11 | 38% | $7,080,340 | 2% |
| **Totals** | **1,084** | **416** | **38%** | **$304,094,412** | **100%** |

Despite the large amount of available funding in FY 2009, only about $2.4 million went for Technical Assistance, slightly more than the $2.0 million allotted in FY 2008 and less than half of the $4.9 million allotted in FY 2004.[47] This small allocation was of particular concern to CDCUs. Technical assistance grants have historically been the best opportunity for small CDCUs and other CDFIs that cannot compete for the larger Financial Assistance grants. These small grants are tightly focused on building institutional capacity -- vital for growth in the best of times, but a critical need in the depths of a recession.

Why did the CDFI Fund decide not to expand the Technical Assistance pool and number of awardees above recent levels? One possible explanation was the enormous work load and compressed timetables within which the Fund had to work during 2009: making fewer but larger awards was one way to manage its tasks. Nonetheless, the results of the 2009 rounds broadly disappointed credit unions and may have discouraged their continued engagement with the CDFI Fund.

### *2010 CDFI Fund Investments in Credit Unions*

In 2010, the CDFI Fund made $101,967,813 in Financial Assistance grant awards to 147 CDFIs, including 18 credit unions (12.2% of awardees) which received $11,784,539 (11.6% of total dollars). It made $2,865,949 in Technical Assistance-Only Awards, of which $197,024 (6.9%) went to credit unions; two of the 33 CDFIs were credit unions (6.1%). Total funding for the year (excluding NACA) amounted to nearly $105 million to 180 CDFIs. Credit unions accounted for 11.4% of the dollar amounts and 11.2% of the 180 awardees.

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46 Source: *CDFI Fund Award Highlights for Fiscal Years 2008, 2009 and 2010*.

47 Source: CDFI Fund, 2009 Performance and Accountability Report, p. 19.

### *CDFI Fund Awards 2008-2010*

Over these three years, CDFI Fund Financial Assistance and Technical Assistance awards were made to 41 different credit unions (excluding NACA); six received multiple awards. But the proportion of CDFI Fund dollars and the number of awards going to credit unions were consistently small; the total dollar share amounted to just 11.5%. The greatest beneficiaries of CDFI Fund awards over these years were non-regulated CDFI loan funds, which received 81% of the total amount awarded Other eligible categories of CDFIs – i.e., banks and venture funds – received even smaller shares than credit unions.[48]

For those credit unions that were fortunate enough to receive awards, the assistance was invaluable. Most of these CDCUs used their awards went to rebuild or expand their net worth, helping them to recover from the financial wounds of the recession and the crisis of the National Credit Union Share Insurance Fund and continue lending and serving disadvantaged communities at a high level. The impact of the CDFI Fund on the CDCU movement was deep, but narrow. Relatively few credit unions received capital at a critical time. That would begin to change with the Community Development Capital Initiative.

48 In 2009, for example, venture capital funds and banks/holding companies each received two ARRA round awards. In the regular (Supplemental) round, banks/holding companies received and 7 awards and venture funds 2 awards.

## VI. The Community Development Capital Initiative (CDCI)

In 2010, another major program for CDFIs came on line: the Community Development Capital Initiative (CDCI). Created under the Emergency Economic Stabilization Act's Troubled Asset Relief Program (TARP), CDCI ultimately provided the largest single infusion of capital into the CDCU movement in history.

### *Background of the CDCI Program*

In 2009, an informal group of CDFI leaders from various sectors began to press for access to the multi-billion-dollar TARP initiative. While the Treasury Department wrestled with the problem for months, it ultimately decided to invest only in CDFI-certified depositories. TARP was highly controversial and subject to intense public scrutiny. The CDCI program would inevitably be susceptible to this attention – even though it was minuscule in comparison to other TARP funding and was highly targeted to institutions that served "Main Street," not Wall Street. From the start, CDCI limited its funding to CDFI-certified credit unions and banks, gaining a measure of assurance from their respective regulators that candidate CDFIs were suitable for investment as well as mission-appropriate.

President Obama and senior administration officials announced the outlines of the CDCI program on October 21, 2009, at a briefing in a suburban Maryland records-storage warehouse that had been a recipient of a Small Business Administration (SBA) loan. The initial terms disappointed CDFI advocates: although the rate for the loans was favorable, the prospective amounts were too small to be of much use. Over the next few months, the Treasury Department elaborated and improved the terms. On February 3, 2010, at a small briefing attended by representatives of CDCUs and community development banks, Treasury Secretary Timothy Geithner announced a revised and improved CDCI program. Final details were completed over the next 60 days.

The CDCI program was not designed to be competitive. There was no ceiling on total available funding, but it was estimated that investments in banks and credit unions would total less than $1 billion. The basic terms with respect to credit unions were these:

- The form of the investment would be secondary capital – deeply subordinated debt that functioned as regulatory net worth, subject to certain conditions.
- CDFI certification was necessary, but not sufficient: low-income designation was also required. Only low-income credit unions are permitted to accept equity-like secondary capital; without the designation, a CDFI credit union would only have been able to obtain a two-percent loan that would add liquidity and thus dilute, rather than strengthen its capital position. Certification and designation are issued and administered separately by the CDFI Fund and NCUA respectively.
- All credit union applications had to be screened by NCUA before being submitted to the Treasury Department for investment decisions. All credit unions had to submit business plans for NCUA's approval.
- The cost of funds was set at two-percent for the first eight years. Thereafter, the rate would increase to nine-percent for an additional five years – a strong incentive to repay the funds by the eight-year mark.
- Eligible credit unions could apply for up to 3.5% of their total assets – i.e., $35,000 in secondary capital for every million in total credit union assets.
- Institutions whose financial position was deemed to be on the borderline of eligibility would have the opportunity to qualify by raising matching capital.

Unlike CDFI Fund Financial Assistance awards, which are mostly grants and can serve as permanent equity for a CDFI, the CDCI investments were loans. CDCI investments were to be rigorously and publicly monitored, constrained by TARP conditions and restrictions, and repaid to Treasury. In form, CDCI investments were obviously less valuable than CDFI grants. Nonetheless, these secondary capital loans that served as regulatory net worth came at a critical time in the life of CDCUs; though of limited duration, they provided much-needed help to heal financial damage and fuel future growth. Moreover, the amounts received by some of the larger credit unions far exceeded the top CDFI Financial Assistance awards.

### *Six Pressured Months*

The CDCI program unfolded under an extremely compressed timetable: all funds had to be disbursed by September 30, prior to the end of fiscal year 2010.[49] When the program was launched in February, many important details remained unresolved. For credit unions, no less than three government units were involved: the federal regulator and insurer, NCUA (and sometimes state regulators as well); main Treasury, which oversaw program design and made final decisions on investments; and the CDFI Fund, which was responsible for certifying or recertifying applicants.

One early obstacle was the structure of the secondary capital investment itself. To make the program work for CDCUs, existing secondary capital regulations had to be revised – and quickly. In early 2010, as the CDCI program was taking shape, credit unions benefited from an extraordinary level of cooperation from the National Credit Union Administration, which drafted, finalized and implemented revised regulations over the course of a few weeks. Without NCUA's rapid and well-fashioned regulatory changes, CDCI would never have worked for credit unions.

As the weeks passed, potential applicants learned of the complexity and restrictions that came with CDCI, which derived from provisions of the Emergency Economic Stabilization Act of 2008 (EESA) as amended. Employees and officials of even the smallest participating credit union were required to sign waivers designed to limit their compensation, just like the waivers of the highest-paid officials of the banks that received billions of dollars of TARP funding.[50] Recipients were required to obtain opinions of counsel both in their home state and in New York State, where contractual issues were to be interpreted and resolved. The barriers were daunting. Many of the credit unions that applied had neither in-house nor regular external counsel, and to engage this kind of legal help was potentially onerous and expensive.

The Federation found one solution through its longstanding relationship with the Lawyers Alliance for New York, which coordinates and provides pro bono legal services for New York City nonprofits, including low-income credit unions. The Lawyers Alliance enlisted pro bono counsel from 15 law firms in New York and around the country to work with 45 CDCUs. Without their assistance, which extended to the very last hours of closing investments, credit union participation and total investment would have been far less.

### *The Program Concludes*

Credit unions received their investments from the Treasury Department in the last days of September 2010 – in some instances, literally hours before the end of the fiscal year on September 30, when all funds had to be disbursed pursuant to legislative authority. In a press release on September 30, 2010, the Treasury Department announced the result of its funding: $570 million in 84 Community Development Financial Institutions in 26 states, the District of Columbia, and a U.S. territory, Guam. Some 48 credit unions received investments totaling $69.9 million. The bulk of the funding went to banks; by dollar amount, credit unions received 12.3% of the total. But by number, 57% of the 84 recipients of the program were credit unions.

"It's a common misconception that TARP funds only went to large Wall Street firms, but the CDCI program is yet another example of how TARP is providing critical assistance to Main Street financial institutions," said Herbert Allison, Treasury Assistant Secretary for Financial Stability.[51] Despite the complexity of the program, several of the smallest credit unions in the country participated: five faith-based, primarily African-American credit unions, all with assets less than $1.2 million; each received less than $32,000, with the smallest loan only $7,000. At the other end of the scale, the largest credit union investee $9.278 million. The median amount received was $743,000.

### *Impact on Participants*

The comments of three CDCI recipients were typical of the credit unions that successfully endured the strenuous six-month process.

- Bill Bynum is CEO of Hope Federal Credit Union (Jackson, MS), a CDCU with $129 million in assets and 24,000 members across Mississippi, Arkansas, Louisiana, and Tennessee. His was the first CDCU to be approved for CDCI funds. Bynum, who is also chairman of the CDFI Fund Advisory Board, called the

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49 To be precise, TARP authority to purchase investments actually ended on October 3, 2010.

50 "I acknowledge," the waiver stipulated, "that the Limitations may require modification or termination of the employment compensation, bonus, incentive, severance, retention and other benefit plans, arrangements, policies and agreement (including so-called 'golden parachute' agreements), whether or not in writing, that I may have with the Credit Union… ." The 25 highest-paid employees of the credit unions were obliged to execute this waiver. In fact, a number of participating credit unions had only a handful of employees, including tellers, so that even the lowest-level employees were obliged to sign the waiver if a credit union was to participate.

51 Press release, U.S. Treasury Department, September 30, 2010.

investment a breakthrough for low-income communities. "By investing in credit unions and other community development financial institutions, Treasury is supporting a key segment of the nation's finance sector," he said. "Hope [FCU] has experienced steady increase in demand for credit over recent years as many traditional lenders have restricted their lending."[52]

- Paul Phillips is CEO of Freedom First Federal Credit Union (Roanoke, VA), a credit union with $265 million in assets and 37,500 members. The credit union has developed extensive collaborations with local anti-poverty agencies. He commented that "the investment provided by the United States Treasury enables us to … deepen our partnerships with the non-profit community, all while building upon the financial strength of the credit union."[53]
- Melissa Marquez, CEO of a smaller CDCU in Rochester, New York ($9.5 million in assets and 2,647 members) highlighted how crucial the investment was to continuing its growth, given the balance-sheet constraints on credit unions. "Without this investment, Genesee Co-op FCU was trying to shed deposits, making it more difficult to lend since our loans-to-shares ratio was already at 80%. The $300,000 we received in CDCI secondary capital enables us to serve more members and reach out to other underserved neighborhoods in our community. We can increase our deposits and make affordable loans because our net worth is stronger as a result of this infusion of secondary capital." [54]

Although the CDCI investments were loans, as compared to CDFI Fund grants, CDCI investments exceeded the total CDFI Fund awards to credit unions over 2008-2010. The total of $69.9 million in CDCI investments was almost exactly double the $34.9 million that the CDFI Fund had invested over the previous three years. CDCI awards were made to 48 different credit unions; the Fund's Financial Assistance and Technical Assistance awards together went to 42 recipients, some of which were repeat winners. The CDCI program reached more of the very small credit unions, with less than $10 million in assets: In 2010, CDCI issued 18 secondary capital loans to CDCUs to credit unions of this size, while over 2008-20010, the CDFI Fund made 14 FA and TA awards to CDCUs with less than $10 million in assets.

### *Expanding the Ranks of CDFI Credit Unions*

The recession had taken a heavy toll on the balance sheets of many credit unions. Access to secondary capital through the CDCI program got the attention of scores of institutions that previously had little need for or even awareness of CDFI resources. The Federation worked intensively throughout the summer of 2010 to help dozens of credit unions in obtaining the necessary CDFI certification, and in some cases, low-income designation as well.

Overall, 43 credit unions were certified in 2010; all but four of these received their certifications between January and September. The newly certified credit unions accounted for 15 of the 48 credit unions that received CDCI investments (31%). Of the 39 credit unions that were certified over the first nine months of 2010, 38.5% received CDCI investments. Thus, the "new wave" of CDFIs played a significant role in the CDCI program.

### *Building the CDFI Brand*

These results also brought benefits to the CDFI brand. CDFI certification was a pre-requisite for participation, and so dozens of credit unions – many of which had not previously been aware of the CDFI Fund – sought and obtained certification. Portions of the CDCU movement that had been discouraged by the CDFI Fund's relative underfunding of credit unions drew encouragement from CDCI.

TARP had been widely and vehemently criticized as a bailout of Wall Street that ignored Main Street. CDCI was a significant effort to address that critique by investing in small institutions that served low- and moderate-income communities. But in a bitterly polarized country, even this effort – tiny compared to the massive TARP outlays – soon came under attack.

### *Backlash*

In late October, scarcely a month after the last CDCI dollar was disbursed, a researcher at the University of Louisiana at Lafayette issued a paper entitled "Political Influence and TARP Investments in Credit Unions." Assistant Professor Linus Wilson, who had previously conducted research on banks receiving TARP assistance, alleged that credit unions located in the districts of members of the House Financial Services Committee were three times more likely to receive TARP CDCI investments than other eligible credit unions and that political influence could have accounted for the skewing of Treasury investment.

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52 Press release, Hope Credit Union, September 17, 2010.

53 Press release, National Federation of Community Development Credit Unions, September 29, 2010.

54 Press release, National Federation of Community Development Credit Unions, October 1, 2010.

The hastily produced paper was breathtaking in its inaccuracies. As Wilson admitted in the paper, he did not and could not know the names of applicants or the disposition of CDCI applications; for reasons of confidentiality, neither the Treasury Department nor the NCUA released this information prior to announcing the final list of investment recipients. This methodological dilemma was compounded by erroneous assumptions about the applicant pool and investment decisions. He asserted that "roughly a quarter of the eligible credit unions, 48 out of 189," were selected to receive CDCI funds. In fact, NCUA reported that 111 eligible credit unions applied to the program before the deadline, and although 48 credit unions ultimately received CDCI funds, at least 72 of these credit unions were approved for CDCI investments – an approval rate of at least 65%, compared with the 25% rate that Wilson postulated.[55] This suggests that any credit union that had the persistence and appropriate financials to endure a lengthy, complex, multi-agency review was more than likely to win approval, regardless of what Congressional district it was located in.[56]

The headline allegation in this paper, widely reported in the trade press, was equally flawed. Wilson focused on the apparently alarming fact that "no credit unions receiving TARP funds were in districts of Republican members of the [House Financial Services Committee]." In fact, none of the eligible credit unions – i.e., credit unions with both CDFI certification and NCUA low-income designation – are headquartered in the districts of Republican HFSC members, so it is hardly surprising, then, that no CDCI loans landed in those districts.

The main lesson to be drawn is this: federal investment in low-income communities, even when extremely modest, can make a CDFI vulnerable to political attack. As Wilson himself notes, "Credit unions received $69.911 million dollars from the TARP or less than one 10,000-th of the monies authorized." It is hard not to conclude that the rush to publish such deeply flawed research reflects an overriding desire to discredit the TARP program – a program that spanned two presidential administrations.

### *The Changing Face of CDFIs and CDCUs*

The CDCI program changed the make-up of the universe of certified CDFIs and also changed the CDCU movement. As noted earlier, 43 credit unions obtained their CDFI certification in 2010, increasing the ranks of certified credit unions by approximately 25%.[57] The promise of access to CDCI funding was a primary reason that credit unions sought certification, although not all newly certified credit unions eventually applied, nor did all applicants receive funding. In fact, virtually none of the newly certified credit unions were new institutions; most were decades-old. The fact that so many long-established credit unions achieved certification in 2010 tends to validate the Federation's premise that there are large numbers of credit unions that do the same work and have the same characteristics as CDFI-certified credit unions, and that would readily qualify if they chose to apply.

The impact of the "year of CDCI" was reflected in the dramatic expansion of the CDCU movement. The 43 newly certified CDFIs overwhelmingly were or became members of the National Federation of CDCUs: 38 out of 43, or 88%. The aggregate assets of the CDCU movement increased from $4.57 billion in 2008, to $5.25 billion in 2009, to $11.01 billion at year-end 2010, while the number of CDCU members of the Federation increased from 1.018 million to 1.67 million over this period. The "new" CDCUs that joined the Federation tended to be larger than the previous CDCUs. Median asset size was $37.9 million, compared to $2.5 million for previous members (as of 12/31/09), while median membership was 4,720 compared to 1,324. Of the 43 new CDCUs, 11 each had assets over $100 million, including one that was slightly over $1 billion in assets, while four had assets between $50 and $100 million. Historically, small and very small credit unions have had a difficult time obtaining Financial Assistance awards from the CDFI Fund, a function in part of their limited staff capacity. Larger credit unions tend to have greater internal capacity as well as the ability to pay outside consultants to prepare grant applications; they also can justify larger award requests. This shift in the profile of CDCUs may be reflected in the future funding pattern of the CDFI Fund.[58]

Although economists declared the Great Recession "officially" over in June 2009, the pain of high unemployment and low economic growth continue, with no early end in sight. In September 2011, two former Census Bureau officials

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55 The Federation worked closely with virtually all the eligible CDCI applicants throughout the spring and summer of 2010. Based on individual contacts with the applicants, the Federation unofficially determined that 85 credit unions received positive recommendations from NCUA to Treasury, and that at least 72 credit unions were actually approved and offered CDCI investments out of the 111 applicants.

56 Wilson also attempted to argue that the results were "startling" and skewed because some credit unions had below- average loan-to-share ratios, and thus would only have received funds through political pressure. This argument was flawed on several grounds: credit unions with the highest loan-to-share ratios were likely to be most profitable and therefore in some cases *less* inclined to go through the onerous process of seeking Treasury funds.

57 The CDFI Fund listed 168 certified credit unions as of 2/28/10, although the Federation's research showed that 7 were no longer operational.

58 In the FY 2011 funding round, announced in July, 2011 at least four newly-certified CDCUs accounted for $5 million in awards, in what was an above-average year for funding of credit unions.

released a study that showed that median household incomes fell by twice as much in the two years after the official end of the recession than during the recession itself.[59] Acute distress continues to grow: Census figures released in November 2011 showed that 49.1 million people (16.1% of the population) had incomes below the poverty line, and more than 15 million were "near poor."60 Ironically, this suggests that end of the recession has expanded the target market for community development financial institutions.

59 Gordon Green and John Coder, "Household Income Trends During the Recession and Economic Recovery", Sentier Research, September 2011. The study is based on Census Bureau American Community Survey data and shows that median household incomes declined by 3.2% during the recession, beginning in December 2007, and fell by a steeper 6.7% from the official end of the recession in June 2009 to June 2011.

## VII. Looking Ahead: Prospects and Recommendations

Although economists have declared the Great Recession "officially" over, the pain of high unemployment and low economic growth are continuing, with no early end in sight. "Median Incomes Shrank Further After Recession," the New York Times reported in an article on October 10, 2011. Citing two former Census Bureau officials, it noted that household income fell 6.7% from June 2009, when the recession was officially declared over, to June 2011. This was more than double the decline of 3.2% from December 2007 to June 2009. Acute distress was growing: Census figures released in November 2011 showed that 49.1 million people (16.1% of the population) had incomes below the poverty line, and more than 15 million were "near poor."[60] Ironically, this suggests that the target market for community development financial institutions has expanded.

The CDFI movement has grown, but not nearly enough to slow or reverse the growth in poverty. But a sustainable, expanding CDFI movement can make a significant difference. CDFIs have a strong case for continued public-sector support; in turn, they can leverage these funds many times over with investments from the private sector and, especially in the case of CDCUs, deposits from low-income communities themselves.

In this paper, we have argued that the CDFI universe predates and extends beyond the CDFI Fund. However, the Fund is and will remain crucial to the development of the CDFI field over the next several years: it is, after all, the single most important investor in community development finance. It is imperative, therefore, that the Fund make every effort to ensure that its capital resources are deployed as strategically, fairly, and effectively in every sector of the CDFI Industry.

Accordingly, our recommendations fall into three main headings.

- Increasing investment in CDFI depositories.
- Improving certification policies and procedures to facilitate expansion of the ranks of officially recognized CDFIs.
- Investing strategically in broad initiatives to help scale-up and increase efficiency of the CDFI field, such as through the development of common platforms.

### Increasing Investment in Depositories

In the fall of 2011, as the Census Bureau released more discouraging news about declining income and rising poverty, many of the largest banks announced fee increases for using debit cards or for failing to maintain substantial account balances (one bank required a minimum balance of $15,000). The announcements fueled Occupy Wall Street, the growing, diverse and diffuse movement that featured angry critiques of the financial practices of the largest banks in the country. The "Move your Money" campaign had first been promoted by social media in 2009-2010. Now it gathered steam. The Credit Union National Association (CUNA) reported that hundreds of thousands of new credit union accounts were opened from September 29 through early November. Tens of thousands more consumers moved their money to local institutions on "Bank Transfer Day," November 5.[61]

In this environment, CDFI depositories are well positioned to play an increasingly important role. The CDFI Fund has an unprecedented opportunity to connect with and improve the lives of millions of Americans. If it seizes that opportunity, it can enhance its visibility, stature, and political prospects even in a period of fiscal austerity. To do so, the Fund needs to re-examine the policies and practices that have resulted in the undervaluing of financial services and the relatively small proportion of funding allocated to CDFI credit unions and banks through the Financial Assistance program.

The case for increasing CDFI Fund investment in depositories goes beyond equitable distribution of grant resources. It speaks to the need for leverage, impact, and sustainability.

**Leverage**. Credit unions and banks typically leverage every dollar of equity with $10 or more of deposits or debt – funds which typically do not come from federal sources, but rather the community and the private sector.[62] Credit unions cannot raise equity (net worth) through the capital markets; CDFI Fund grants are their only

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60 By the new "supplemental poverty measure," the poverty line for a family of four was $24,343.

61 While the influx of deposits and members might seem like nothing but good news, a major increase in deposits dilutes the net-worth ratio of a depository. The CDFI Fund, by making equity investments in CDFI credit unions and banks, can help address his paradoxical dilemma.

62 A draft *CDFI Industry Analysis* by the Carsey Institute, commissioned by the CDFI Fund, finds that the median loan fund will leverage only $1.10 in liabilities for every dollar of net worth, compared with $9.40 leveraged by the median CDFI bank and $9.91 leveraged by median CDFI credit union.

significant source for equity grants to accelerate the building of net worth. By increasing their grants to CDFI credit unions and other depositories, the Fund can help them take full advantage of the growing market for deposits among consumers disenchanted with the largest banks.

**Sustainability**. Given the enormous pressure to reduce the federal debt the CDFI Fund may not continue to enjoy relatively generous appropriations. The defining characteristic of credit unions and banks is their ability to fund their lending through deposits, which depend neither on federal nor philanthropic support. Moreover, because they offer federally insured deposits, credit unions and banks are more readily able to obtain funds from the growing socially-responsible investment movement. If sustainability is a key goal of the CDFI movement, depositories have a strong case for obtaining strategic investment from the Fund.

**Impact**. Traditionally, "community development" has most often been viewed as activities related to housing finance, small business, and commercial development. The metrics used by policymakers and researchers to assess impact typically include housing units constructed or rehabilitated, jobs created, and commercial square feet brought into service. All those are obviously important indicators. But such an approach tends to neglect or underestimate the positive impacts of CDCUs and other CDFI depositories.

The provision of financial services to low- and moderate-income households – access to credit, savings accumulation, and independence from high-cost check-cashers and payday lenders – is an essential component of asset-building and community development. High-cost, unregulated and sometimes predatory credit and financial services can drain wealth from low-income communities faster than it can be created, perpetuating and exacerbating the cycle of poverty. When the poor and near-poor pay more for finance, they can afford less for housing, food (health or otherwise), and the other goods and services provided by local businesses. The lack of financial services such as those provided by CDCUs significantly undermines community development.

The CDFI Fund does not adequately recognize the impacts of depositories in promoting savings, retaining disposable income, and minimizing the cost of debt for low-income communities. This works to the disadvantage of depositories applying for financial assistance, but it also hurts the Fund in capturing and telling the story of CDFI impact to policymakers and the public.[63]

To increase investment in depositories without unjustly penalizing other types of CDFIs, we recommend that the Fund level the playing field by re-examining its application forms, scoring, review procedures, and allocation formulas.

- First and foremost, the Fund should develop applications that are appropriate to the various types of CDFIs. Regulated credit unions and banks, and for that matter, venture funds have very different performance metrics and business strategies than loan funds, and have long argued that that the CDFI Fund's "comprehensive business plan" omits critically important aspects of their operations, simply because they are not shared by other types of CDFIs.
- The CDFI Fund should expand its recognition and support for specialized CDFI intermediaries. In this way, the Fund can deepen its understanding of the industry and increase capital penetration among CDFIs of all types. Otherwise, the CDFI Fund will be hard-pressed to underwrite and monitor an expanding number of awards and provide capacity-building services to an increasingly diverse industry; small CDFIs and financial institutions that have yet to be certified would remain largely beyond the reach of its programs. By leveraging its resources with the unique strengths of intermediaries, the Fund could significantly expand research about key sectors of the industry, achieve greater efficiency in its capital deployment, and amplify the public understanding of the powerful and positive impact of CDFIs across the country.

## Improving Certification Procedures: Expanding the Recognized CDFI Universe

While we have argued that the CDFI field is far broader than the Fund's roster, certification will continue to be crucial to policymaking and investment. For example, the three-year, multi-billion-dollar CDFI Bond Guarantee program scheduled to be implemented starting in 2011 will only be open to certified institutions. Accordingly, the Fund's certification policies and practices must be a top priority for 2012.

63 The Fund does ask for the number of accounts opened for "unbanked" people. But it does not address the number of people served, savings accumulation, or the estimated savings by providing reasonably priced loans.

The CDFI Fund itself has acknowledged that the certification process must be improved. Indeed, the impressive performance that the Fund demonstrated in 2010, when scores of CDFIs were successfully certified within the tight deadlines imposed by the CDCI program, should become the rule rather than the exception. The CDFI Fund recently added a new manager and other resources to the compliance and certification functions, and is moving to remove barriers that have long delayed CDCU certifications.

These changes are welcome and should greatly improve performance, but they are not enough. In the coming years the CDFI Fund can expect an exponential growth in workload, as the CDFI Bond Program and other initiatives generates hundreds of new applicants for certification and the Fund's responsibilities for compliance and CDFI recertification continue to grow apace. For this reason, and at the request of the CDFI Fund itself, the Federation and the CDFI Coalition have submitted a number of specific recommendations to increase the quality and efficiency of the certification process, including long-overdue investments to upgrade the Fund's decade-old information technology systems. These investments in building capacity and infrastructure today would pay dividends to the CDFI Fund and the CDFI field for years to come.

An expanding universe of certified CDFIs will bring both problems and potential. Quality control and brand dilution will be two major challenges: some practitioners have warned of the accretion of "CDFIs in name only." But on the positive side, if the CDFI Fund is able to substantially increase the ranks of certified credit unions, drawing upon the pool of hundreds of low-income credit unions, the Fund will elevate its importance in the broader credit union movement. To date, the National Federation of CDCUs has been the prime advocate for the Fund, with secondary support from two potent credit union lobbying organizations, the Credit Union National Association (CUNA) and the National Association of Federal Credit Unions (NAFCU). If the growing number of certified credit unions raised the importance of the CDFI Fund on the agenda of those organizations, the Fund could count on powerful political supporters as federal budget battles continue to rage in the coming years.

## Investing Strategically to Build the CDFI Field: New Structures, New Platforms

As discussed earlier, the recession affected depositories and non-depositories in different ways. Credit unions had no shortage of liquidity. In fact, as consumers deliberately reduced debt or could not access credit because of declining income and wrecked credit scores, loan demand decreased for many credit unions. Meanwhile, deposits increased for many credit unions as consumers became disillusioned with the largest banks and sought smaller, local institutions. The issue for credit unions became equity squeeze: their ratio of net-worth-to-assets shrank as deposits grew. Because low-income credit unions can count secondary capital (long-term subordinated debt) as regulatory net worth, the CDCI program played an important role in helping credit unions to bulk up their ratios, giving them breathing room to grow.

Loan funds were more likely to need liquidity and in some cases, operational revenue, which traditionally had come from banks and philanthropies. With few exceptions, their strong equity positions – typically, 20% or more – enabled them to avoid forced mergers, although many had to reduce their budgets. In contrast, a number of CDFI credit unions merged because of economic circumstances or regulator pressure.

The disparate impacts of the recession leads to an intriguing question: is it possible to combine the complementary strengths of CDFI loan funds and credit unions? Can the advantages of ready access to liquidity through a credit union, on the one hand, and the high levels of loan-fund equity be harnessed in a single entity – a complex or "hybrid" CDFI?

If the recession produced one possible answer, it came from Self-Help, an integrated, multi-unit CDFI that includes two credit unions (Self-Help CU in North Carolina and Self-Help Federal CU in California), Self-Help Venture Fund, a nonprofit CDFI loan fund, and associated nonprofit entities. Self-Help uses the widest array of financial resources both from public and commercial channels. Among other things, all three of Self-Help's CDFIs are members of the Federal Home Loan Bank system, and it has access to liquidity through corporate credit unions. It is a major recipient of New Markets Tax Credits.

As an institution with hundreds of millions of dollars of assets and complex needs for asset and liability matching, Self-Help had relationships with Wall Street firms for overnight and short-term borrowing. But its access to capital markets was disrupted by the demise of Lehman Brothers, as Wall Street reeled in shock and pulled back its credit lines. Liquidity would have become a huge problem for its loan fund. But because Self-Help is an integrated entity, it was able to shift some of the lending functions previously performed by its nonprofit loan fund to its credit unions, which had ample liquidity.

Few CDFIs have the scale or structure of Self-Help. But a number of credit unions have set up nonprofit affiliates, some of which have the capacity to lend, while some CDFI loan funds have sufficient net worth and management capacity to consider forming CDCUs. The CDFI Fund could spur innovation by supporting replication efforts and re-examining its policies to facilitate investment in consolidated loan fund/credit union "holding companies" or affiliated entities.

## Building Common Platforms

Critics of the CDFI movement often point to the lack of scalability of CDFIs and their unnecessary duplication of functions. Stand-alone institutions are inherently inefficient, they argue; if they combined their back-office operations, underwriting, and other functions, they would be much more productive and achieve greater impact.

In fact, solutions to these problems do exist in the credit union movement. The credit union model is, in fact, hugely scalable: the largest credit union in the country, Navy Federal Credit Union, has some $45 billion in assets and serves several million members, with the same legal structure as the smallest credit union. More directly relevant to the current discussion, the credit union movement has developed corporate forms to share functions such as mortgage origination and servicing, business loan underwriting and servicing, or core processing: Credit Union Service Organizations (CUSOs).[64]

For small credit unions – and indeed, small CDFIs – a similar approach may be the best path to survival and expansion. As we have described, the economic and regulatory pressures of the Great Recession have forced a number of CDCUs to merge or be liquidated. There are approximately 7,500 credit unions of all types in the United States today. Many observers project that within ten years, one-third of those institutions will be gone. Small and even moderate-sized credit unions that serve low-income populations will be especially vulnerable. Their disappearance would be a serious blow to the provision of financial services and credit to their communities. Nonprofit loan funds may not be under the same pressure today, but consolidation pressures may increase in this sector, as well.

Throughout its history, the CDFI Fund has focused its resources on financing individual CDFIs. Arguably, the Fund – and only the Fund – could finance a broad initiative to develop common infrastructures for CDFIs, on a sector-by-sector basis or possibly serving multiple sectors for functions such as mortgage origination or servicing. The CDFI Fund could, in effect, support a research and development initiative for the field. Such a vision was articulated early in the history of the CDFI Coalition, and has since been suggested from time to time by various researchers. There may be no better time to explore this idea than the present; in fact, given budget pressures, the window for an ambitious, large-scale initiative may be narrow, and may soon close. The potential rewards in terms of scale, standardization, transparency, and impact make it worth a serious effort.

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64 Internationally, there are even more comprehensive models of centralized or consolidated functions. The foremost example is the hundred-year old Desjardins credit union movement in the province of Quebec. A major force in provincial financial services, the movement has a central back office as the backbone for hundreds of branches, all of which operate with a common brand. Similarly, the most successful start-up credit union movement in recent decades is in Poland, where a unified system with branches across the country developed following the collapse of Communism two decades ago.

## Appendix

The Federation divides its membership into the four regions used for analysis in this report. The composition of the four regions is as follows.

**North East:** Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Puerto Rico, Rhode Island, Vermont, Virgin Islands, and Washington D.C.

**South East:** Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, and West Virginia.

**Mid-West:** Iowa, Illinois, Indiana, Kansas, Michigan, Minnesota, Missouri, North Dakota, Nebraska, Ohio, Oklahoma, South Dakota, Texas, and Wisconsin.

**West:** Alaska, American Samoa, Arizona, California, Colorado, Guam, Hawaii, Idaho, Montana, New Mexico, Nevada, Oregon, Utah, Washington, and Wyoming.

This definition differs from that of the National Credit Union Administration (NCUA). Currently, NCUA has five regional offices. However, the number and composition of these regions has changed from time to time in response to the changing demographics of the credit union movement and supervisory priorities. The financial crisis prompted several changes. Thus, for example, NCUA's Region 1, headquartered in Albany, NY includes the states from New York north, but also Michigan and Nevada; California was added to NCUA's Region II, the Capital District, headquartered in Alexandria, VA.

## About the Author

*__Clifford Rosenthal__ is President and CEO of the National Federation of Community Development Credit Unions, which he has served since 1980. The Federation provides capital, management support, regulatory advocacy, program development, and research to more than 200 credit unions serving low-income communities across the United States. The Federation co-founded and has continuously served in the leadership of the Community Development Financial Institutions (CDFI) Coalition. The Federation also established and manages the New York State CDFI Coalition, which has successfully advocated for investment in CDFIs through the Empire State Development Corporation. For more information: www.cdcu.coop.*

*A historian by training, Mr. Rosenthal has written articles and monographs about credit unions serving low-income communities, as well as co-authored Organizing Credit Unions: A Manual, a comprehensive guide for developing a CDCU. His work in helping low-income communities to empower themselves through credit unions has been recognized by awards from the National Credit Union Foundation, Lawyers Alliance for New York, Opportunity Finance Network, Network of Latino Credit Unions and Professionals, and others.*