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FEDERAL RESERVE BANK OF SAN FRANCISCO

A Probable Future for the CDFI Banking Sector: Insights from Strategic Planning

National Community Investment Fund

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National Community Investment Fund

October, 2012

National Community Investment Fund (NCIF) is a nonprofit private equity trust fund established in 1996 to invest on- and off-balance private capital in mission-oriented institutions – primarily banks – that focus on economic and community development in low- and moderate-income communities. The views expressed in this paper are those of NCIF and may not reflect the views of the Federal Reserve Bank of San Francisco or the Federal Reserve System.

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Foreword

These are certainly challenging times. The recession continues to severely affect underserved low- and moderate-income communities. As a result CDFI Banks–which are banks certified as Community Development Financial Institutions (CDFIs) by the U.S. Treasury–have been severely impacted, affecting their ability to continue providing responsibly priced financial products and services in these communities. In these extraordinary times all stakeholders need to take extraordinary measures to ensure the strength and vitality of these CDFI Banks that represent over 50 percent of the total assets of the CDFI sector.

The public sector and the regulators need to consciously support them to ensure that capital and non-financial resources are made available to the institutions generating the maximum impact. While the Community Development Capital Initiative (CDCI) provided a significant injection of capital to the sector, a number of high impact financial institutions could not access these funds. The upcoming CDFI Bond Guarantee Program could be an important source of capital and liquidity and we need to ensure that regulations enable this. Most importantly, Congress needs to recognize the need to provide comprehensive support for this sector.

Similarly, private sector investors need to foster investments in the highest performing mission-oriented banks–CDFI Banks, CDBI Banks, and other institutions that are focused on underserved markets–to help them scale and enhance financial performance and social and community development impact. The 'winners' among these mission-oriented banks will be those institutions that are willing to look forward and evolve their business models to include technology and collaboration. Technological innovation has the potential to add channels of distribution, reduce costs, and increase product innovation. Greater collaboration and a highly networked CDFI Banking Sector can result in a powerful organizational model that generates sustainable, high quality earnings and impact. Greater collaboration could even take the form of collective ownership and operations among individual CDFI Banks. These winning institutions need to be supported with significant injections of capital and distribution support. In addition, we need to create a 'path' for other institutions to get the support of investors.

The purpose of the working paper is to explore these possibilities and propose one probable future of CDFI banking. It has been prepared by National Community Investment Fund (NCIF, www.ncif.org), the largest investor, in terms of numbers, in the CDFI Banking Sector. As part of its recent strategic planning exercise, NCIF engaged with forty-seven industry leaders to contribute their thought leadership and lay out strategic and aspirational goals to achieve that future.

We look forward to a continued dialog and focus on this sector, deemed by NCIF to be *Too Important to Fail* given its tremendous impact in underserved markets.

Saurabh Narain
Chief Executive
National Community Investment Fund

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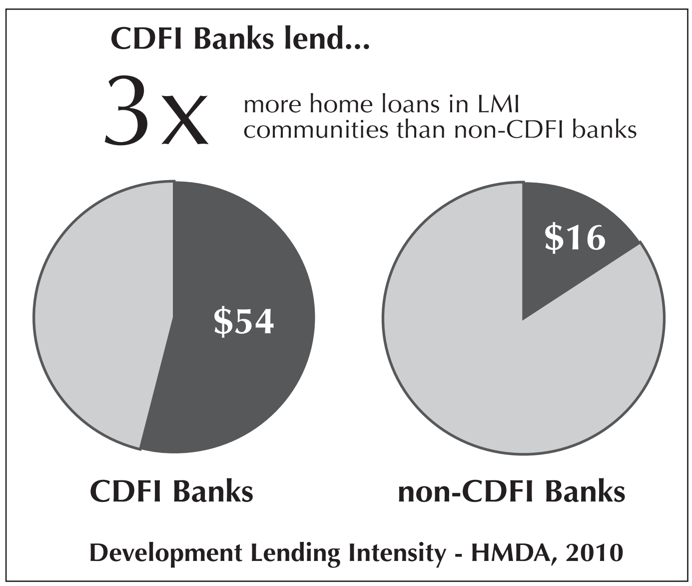
Introduction and Executive Summary

CDFI Banks[1] have a mission of meeting the financial services needs of low- and moderate-income (LMI) communities in a safe and sustainable manner. These banks choose to be located in economically disadvantaged neighborhoods, and to offer products and services that are tailored to meet the specific needs of the consumers and business owners that live and operate in these communities.

CDFI Banks serve customers who are generally not served by major financial institutions or any other responsible providers. They provide credit to small businesses, churches, and nonprofit organizations that have often been turned down by larger regional and national banks. They lend to first-time homeowners and developers of affordable housing. They finance commercial projects and community facilities that generate jobs, provide social services, and catalyze additional economic activity in distressed communities. They also provide financial education classes along with deposit and checking services to promote wealth generation and asset accumulation as an alternative to check cashers and payday lenders. By providing this crucial access to credit and non-credit products and other financial services too frequently absent in lower-income communities, CDFI Banks are vital for economic growth.

Over the past ten years, the CDFI Banking Sector has realized both tremendous growth and social performance impact. At the end of 2001, only 39 banks were certified as CDFIs, and the industry controlled $5.2 billion in total assets. At the end of 2010, 85 banks were certified, serving low- and moderate- income communities (LMI) nationwide, and these 85 banks controlled over $25.8 billion in total assets, a 500 percent increase.

That growth remains focused on serving the needs of economically disadvantaged communities. For the median CDFI Bank in 2010, out of every $100 of home lending, $54 was being lent to borrowers in LMI areas. For the median non-CDFI Bank, only $16 went to the same underserved communities–the CDFI Banking Sector's percentage is more than three times higher. As these figures highlight, the overall CDFI Banking Sector continues to grow and generate a high level of impact, but the recession has resulted in ongoing threats to the sector.



The recession has disproportionately affected the LMI communities in which CDFI Banks serve and operate. To a greater degree than other communities, these neighborhoods are experiencing elevated unemployment rates and low real estate values. The result is that low-income borrowers, who have historically demonstrated strong credit performance, are now unable to make payments, and these local economies, including CDFI Banks serving these economies, are being hit hard.

During the crisis, ShoreBank and other CDFI Banks were closed, while several others continue struggling to meet the increased capital requirements stipulated by regulators, aggressive write-downs due to deteriorating market conditions, and increased operating costs.

1 CDFI Banks: Please note that while the statistics and charts in this white paper relate only to certified CDFI Banks, we believe that the same conclusions can be drawn for the larger sector of mission-oriented banks. For this reason, we use the term CDFI Banks broadly to include certified CDFI Banks as well as other mission-oriented banks that are strong financial performers and provide responsibly priced financial products and services in underserved markets and low- and moderate-income areas. NCIF refers to such institutions as Community Development Banking Institutions (CDBIs).

Aspirational and Strategic Goals

To overcome these threats and become stronger, the sector has identified an Aspirational Goal to become significantly larger and scaled. In addition, it has identified six Strategic Goals that will make CDFI Banks financially stronger and increase the impact of their work:

Strategic Goal 1: Generate superior Financial and Social Returns and become recognized as a Double Bottom-line Financial Services Leader

Strategic Goal 2: Promote Social and Community Development Impact Measurement and Certification and enhance the Brand

Strategic Goal 3: Promote High-Performance Collaboration within the CDFI Banking Sector

Strategic Goal 4: Promote Synergies with the Mainstream and Socially Responsible Investors

Strategic Goal 5: Use Technology to Increase Business Reach and Efficiency

Strategic Goal 6: Create an Investment Bank Focused on the CDFI Banking Sector

A Probable Future of CDFI Banking

There is recognition among CDFI Bank participants that perhaps they need to conceptualize and implement a new collaborative model allowing them to focus on their key strengths of access of and knowledge of local communities. Five collaboration strategies have also been identified in this probable future of CDFI banking. These are:

Collaboration Opportunity 1: Equity and Debt Capital Raising

Collaboration Opportunity 2: Deposits Raising

Collaboration Opportunity 3: Shared Back-Office Platform

Collaboration Opportunity 4: Customer-Facing Technology

Collaboration Opportunity 5: Social Performance Metrics and Telling the Story

Even as the CDFI Banking sector reinvents itself, makes itself financially stronger, and demonstrates its impact to stakeholders, it is critical for all the stakeholders to recognize and formally support them. The sector is *Too Important to Fail.*

Programs like the Community Development Capital Initiative or the CDFI Bond Guarantee Program need to be implemented in a manner that is most helpful to the sector. While new regulations like Basel III are important to create a strong capital cushion, regulators need to ensure that there are no unintended consequences around the mission-oriented banks. Finally, the Community Reinvestment Act (CRA) needs to be strengthened and, perhaps, reinvented to ensure that capital and investment continues to flow into low- and moderate-income communities. The growing Socially Responsible Investor community needs to support CDFI Banks by providing capital and support to institutions that are offering responsibly priced financial products and services to the underserved.

The State of the CDFI Banking Sector

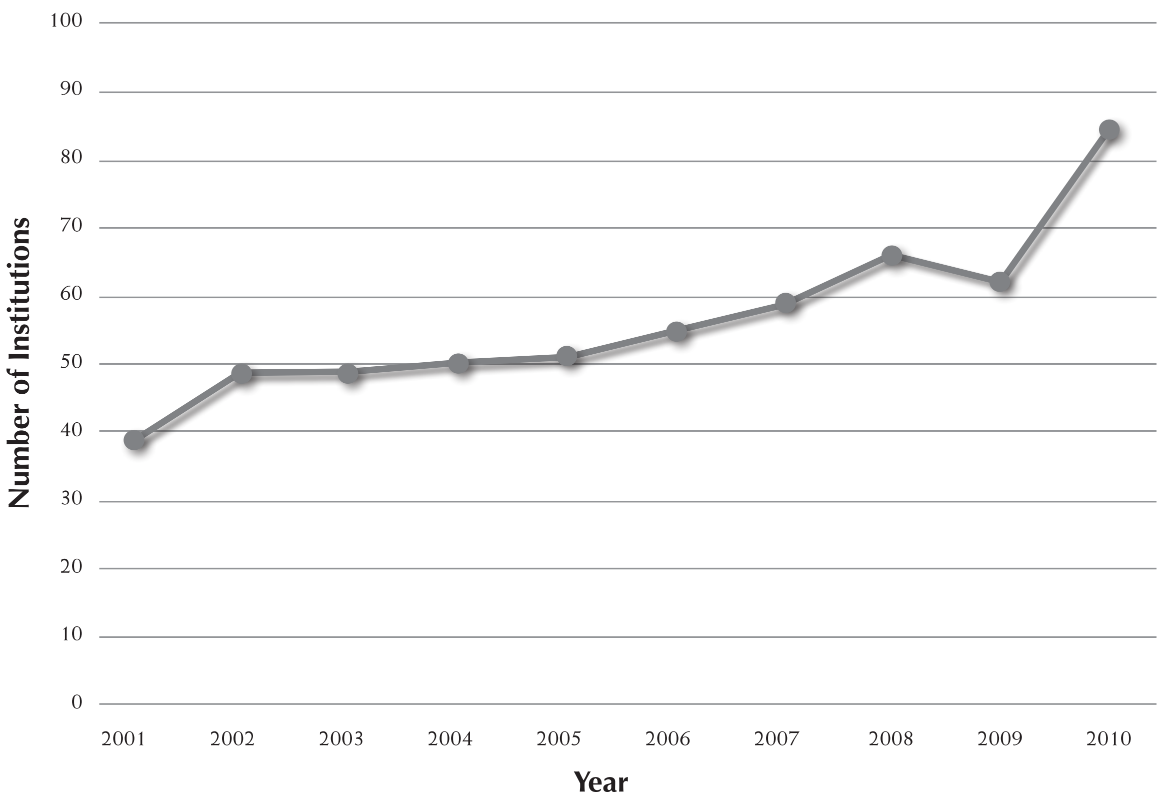
The CDFI Banking Sector generates unparalleled positive impact in underserved markets.

First, as insured depositories, CDFI Banks leverage each dollar of equity up to ten times with deposits that generate loanable funds. Second, given their significant presence in LMI communities, these leveraged funds are likely to be invested in these economically vulnerable neighborhoods, where they are desperately needed. Third, these institutions do more than just provide credit services; they also provide much-needed depository and non-financial services. Finally, some of these financial institutions are the only responsible financial institutions in the area and as such become anchors for the community. They generate development impact over a long period of time and are essential in creating and retaining jobs, promoting small businesses and entrepreneurship, restoring a more normal market, and catalyzing continued vitality in the communities that they serve.

Growth and Impact of the CDFI Banking Sector

Over the past ten years, the growth and impact of the sector has been sizable. As detailed in Chart 1, since 2001 the number of certified CDFI Banks has grown from 39 to 85 at the end of 2010. Currently, CDFI Banks are located across the United States in 27 different states as well as in Washington, D.C.

Chart 1: Number of CDFI Banks



In addition, there are 483 banks that have substantial home lending and branch locations in low- and moderate-income communities, as measured by NCIF Social Performance Metrics, Quadrant 1,[2] which describes deposit intensity and lending intensity in LMI communities. This is explained in more detail below in the section entitled "Social Performance of the CDFI Banking Sector." NCIF has labeled these banks "Community Development Banking Institutions" (CDBI) and believes that these are potential candidates for CDFI certification in the future.

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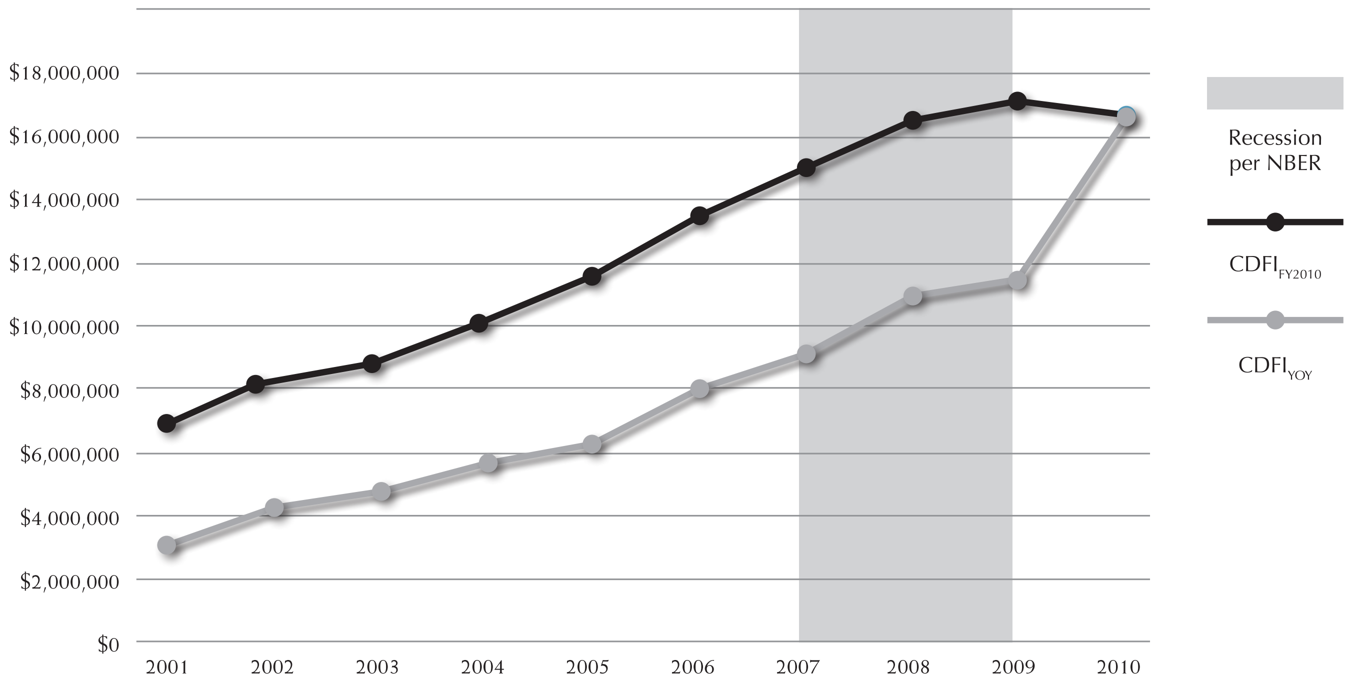
2 For a complete description of NCIF Social Performance Metrics, the Quadrants, and Community Development Banking Institutions, please visit our website: www.ncif.org.

CDFI Banks have also demonstrated growth in the amount of loans outstanding over the past ten years, illustrating that these institutions continue to lend to their communities despite the economic downturn. Chart 2 highlights the loan growth of the 85 CDFI Banks certified as of December 31, 2010 (black), as well as the assets of the CDFI Banks that were certified at the end of each year (gray) for the past ten years. The black line represents the current CDFI Banks and their growth over time, whereas the gray line represents a snapshot of the CDFI Banking Sector at the end of each year.

Chart 2: Total Loans & Leases for CDFI Banks ($000)



Total loans and leases outstanding for the CDFI Banks as of FY 2010 was $16.6 billion, which is up from $7.1 billion in 2001. This represents a Compound Annual Growth Rate (CAGR) of 9.90 percent over the ten-year period.

The story is more compelling when looking at the loans outstanding at CDFI Banks certified as of 2001; the total loans and leases of the industry has grown to $16.6 billion from $2.9 billion, which results in a CAGR of 21.2 percent.

Even during the midst of the current financial crisis, CDFI Banks continued to be active lenders. Based on HMDA reporting, CDFI Banks originated or purchased $740 million of housing loans in low- and moderate-income communities in 2010, a significant increase from the $597 million lent in 2009.

As many other lenders reduced their credit lines during the recession, particularly in the hardest-hit communities during the recession, CDFI Banks continued to spur economic development by lending. These loans are crucial to the continued development and viability of the communities served by CDFI Banks.

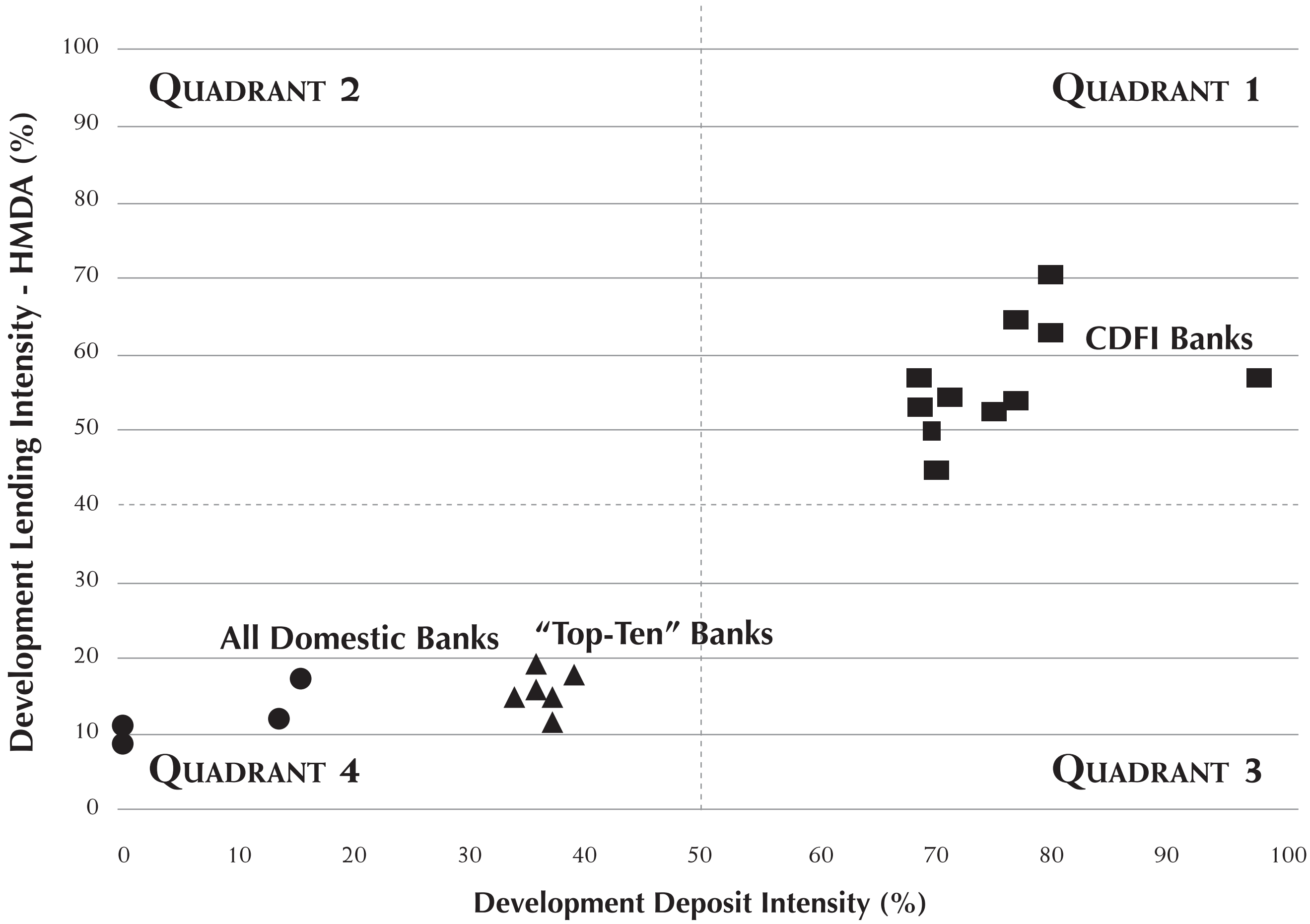
Social Performance of the CDFI Banking Sector

In addition to the strong growth detailed in the previous section, CDFI Banks remain committed to serving LMI communities. This can be illustrated using NCIF's Social Performance Metrics, a transparent and easily communicated measure of the percentage of every domestic bank's activity in LMI areas. There are two core Social Performance Metrics. First, Development Deposit Intensity (DDI) captures the percentage of a bank's branches that are located in LMI census tracts. Second, Development Lending Intensity HMDA (DLI-HMDA) captures the percentage of HMDA-reported home lending that a bank originates and purchases in LMI communities.

NCIF then plots the entire universe of 7,666[3] banks into one of four quadrants that are determined by threshold levels (40 percent for DLI-HMDA and 50 percent for DDI). Quadrant 1 represents those institutions that score above the threshold values for both DLI-HMDA and DDI, demonstrating a high level of activity within low- and moderate-income communities. Chart 3 plots the median DLI-HMDA and DDI for CDFI Banks, All Banks, and "Top-Ten" Banks over a ten-year period to help visualize the consistently high impact of CDFI Banks.

This chart highlights the fact that CDFI Banks have consistently scored higher on the DDI and DLI-HMDA metrics relative to the peer groups over the last ten years.

Chart 3: Ten-Year Quadrant Chart CDFI Banks and Peer Groups



This confirms again that CDFI Banks are focused on meeting the needs of the consumers and businesses located in low- and moderate-income communities as evidenced by their home-lending activity and their branch presence. Hence the assertion that they are *Too Important to Fail*. To sustain their mission, they require extraordinary support from the public and private sectors, particularly given that the current times are *extraordinary and unprecedented*.

3 As of December 31, 2010.

Challenges Faced by the CDFI Banking Sector

The CDFI Banking Sector needs to plan in order to counter the impact of the following challenges.

Prolonged Recession

CDFI Banks provide credit and non-credit financial services in low- and moderate-income communities that have been disproportionately affected by the recession. Effects of the recession include severe stress among key customers, reduction in economic activity, and decline in real estate values. A double-dip recession or continued overall economic weakness will likely contribute to ongoing difficulties for their LMI communities and hence for the sector as a whole.

Increased Capital Requirements

In an effort to strengthen the banking industry, regulatory agencies are requiring Tier 1 leverage ratios of at least 8 percent, and more likely 9 percent. As of FY 2011, 33 of the 85 certified CDFI Banks had a leverage ratio below 8 percent (50 were below 9 percent). In addition, the currently proposed Notice of Proposed Rules for Basel III will increase the requirements for core common capital and eliminate the use of hybrid securities such as trust preferred securities, which was a valuable source of capital for these banks.

All this is coming at a time when regulators are imposing aggressive write-downs that further reduce profitability and weaken balance sheets.

Regulations

The uncertainty around new regulations (such as the Wall Street Reform and Consumer Protection Act) and their implementation at the ground level has increased the risks and costs of operations. For small banks, the fixed costs related to compliance and processing can be difficult to manage, not to mention the risks associated with unclear regulations. This is especially true for "high-touch" institutions like CDFI Banks whose success requires constant interaction with the community. This is coming at a time when revenue streams are pressured both on the non- and net-interest income sides.

Concentration Risk

CDFI Banks (and community banks in general) have concentration risk, both geographically and by product type. CDFI Banks are relatively small, and as such tend to be concentrated in small geographic areas, primarily neighborhoods within individual cities. When those neighborhoods are heavily affected by an economic downturn, as many LMI neighborhoods are, the customer and collateral base of the CDFI Banks is broadly impacted. CDFI Banks need to diversify their financial products and services that meet the comprehensive needs of the local communities.

CDFI Banks have been a source of tremendous innovation as they manage the above cost and revenue pressures and risks. They need to continue working with consistent ingenuity, careful planning, and superb execution of the strategies that will help to sustain their efforts despite the obstacles.

In this interesting and challenging environment, it's important that the sector continues to define and perhaps to refine its goals, both for the very long term and in the shorter term. The next section articulates an aspirational goal for the CDFI Banking Sector for 2025 and strategic goals for the next five years.

CDFI Banking Sector's Aspirational and Strategic Goals through 2025

While CDFI Banks are leaders in providing much-needed access to financial services in underserved communities, the overall sector remains relatively tiny relative to the size of the U.S. economy and also relative to the scope of the needs, as indicated by the number of underserved families and communities. The CDFI Banking Sector has to grow to a substantially larger size in order to be meaningful to public and private shareholders, and only through substantial growth will the sector become visible enough to generate the scale of investment and support its social impact demands.

Therefore, the key aspirational goal is to leverage the efforts of CDFI Banks and their many partners to grow the CDFI Banking Sector from its current asset base of approximately $27 billion to at least $100 billion by 2025.

In doing so, the CDFI Banking Sector will be better equipped to garner support and to weather future financial shocks. Scale may be achieved by increasing the number of certified CDFI Banks from the current number of 85 to, say, 200. Given that the number of banks in the high-performing Quadrant 1 (NCIF Social Performance Metrics) is 483, this number seems reasonable and achievable.

This substantial increase in scale seems critical to attracting more significant amounts of capital and support from stakeholders. It is unclear as to how this growth will happen, how the number of certified banks will increase, or where the asset growth will come from—hence this remains aspirational. In this scenario, the highly successful institutions will grow, while others that fail to achieve scale and critical mass may be absorbed into larger banks.

The key benefit of this scale will be, of course, that more small businesses will receive job-creating financing, more families will be able to escape poverty, and the amount of wealth created in LMI communities will be substantially increased.

Strategic Goal 1: The CDFI Banking Sector generates superior Financial and Social Returns and is recognized as a Double Bottom-line Financial Services Leader

The CDFI Banking Sector has to continue to improve its financial performance and generate reasonable financial returns for its investors. This implies that individual banks need to grow in size, increase net interest and non-interest income, and reduce costs, so that returns on assets and equity are comparable to market returns.

In addition, the industry needs to find ways to pay dividends to investors, provide liquidity in stock holdings, and generate the desired financial returns.

The CDFI Banking Sector generates superior social and economic development impact in low- and moderate-income communities. Historically this has been measured anecdotally and in an ad hoc manner. Many industry leaders recognize the need to standardize the methods of measurement, and to convert it into an index of social return that can help investors meet their total return hurdles. Through these efforts, CDFI Banks will become recognized as leaders generating high impact and reasonable financial return for stakeholders.

What is the 'Investment Product?'

CDFI Banks need to create an Investment Product that provides Investors with:

- Financial return associated with receipt of dividends and appreciation of invested capital
- Social Return in a measurable manner
- Exit Strategy within a reasonable time frame to meet investor hurdles

The Total Return Equation

Investors and the CDFI Banking Industry need to agree on a mechanism to value and incorporate social return to meet and exceed total return hurdles as per below:

Total Return = **Financial Return** + **Social Return**

Strategic Goal 2: Promote Social and Community Development Impact Measurement and Certification and enhance the Brand

Investors are drawn to the CDFI Banking Sector because it represents the most important local financial institutions providing development financial services—credit and noncredit—to underserved markets in LMI communities. The sector creates unparalleled impact in LMI communities by providing responsibly priced services, promoting small businesses, and creating jobs. It can therefore be a positive and counter-cyclical force in the economic development of the communities it serves.

To make this widely known and provide evidence of the impact, the industry needs to collaborate, standardizing impact measurement and creating standards to differentiate CDFI Banks from other community banks. A common taxonomy and data repository need to be created so that individual banks can be benchmarked against the rest of the industry. The short-term result will be a more robust way to "Tell the Story" of the industry—one that incorporates both privately reported and publicly available information, and that expresses impact using both data and anecdotes. This presentation could provide a human side to the impact numbers. In the medium-term, this initiative will likely result in the creation of an independent certification (similar to the "Designated CDBI" certification created by NCIF) that will signal to investors the double bottom-line mission of banks, resulting in increased investment and support.

The social and community development impact has been unparalleled over the last ten years, and historical risk profiles have been comparable to the industry.[4] Measuring this impact, sharing this information widely, and creating a widely recognized brand will increase support from all stakeholders.

Strategic Goal 3: Promote High-Performance Collaboration within the CDFI Banking Sector

Given the recession and the need to raise capital and enhance operating efficiencies, there is a strong desire throughout the industry to increase collaboration across many functional areas, including product development, revenue enhancement, technology adoption, and cost reduction. Collaboration may also enhance efforts to raise capital in a manner that will meet the investment hurdles of investors and create operating efficiencies through shared services. Finally, collaboration will also be fostered to promote social-impact measurement, as noted above.

Strategic Goal 4: Promote Synergies with the Mainstream and Socially Responsible Investors

The CDFI Banking Sector provides financial products and services to customers who are not being served by anyone apart from alternative financial services providers (check cashers and payday lenders) who often provide "irresponsible" products. A complementary and synergistic strategy with larger banks may help bring more financial and technical resources. Larger banks may not be able to take the credit risk of low- and moderate-income customers or be able to provide them services in a cost-efficient manner. This synergy is likely to be more important as some of the larger banks reduce their branch presence in many parts of the country. Similarly, CDFI Banks may need to create platforms for socially responsible investors to route deposits, debt, equity, and grants to banks that meet their programmatic criteria or geographic focus areas.

Strategic Goal 5: Use Technology to Increase Business Reach and Efficiency

CDFI Banks must invest in and develop technology tools that can assist in generating business, increasing revenue, and cutting operational costs. For all industries, a successful future has meant embracing and innovating using new technology, and this is especially true in the case of banking. Technological advancements in payment products, mobile banking, and prepaid cards, as well as the possibility of using "cloud technology," to reduce data processing needs, are changing the way banking will be done in the future. These tools need to be adopted individually and collectively across the CDFI Banking Sector.

Strategic Goal 6: Create an Investment Bank Focused on the CDFI Banking Sector

This is a period of evolution and change across the financial services industry, and CDFI Banks are in the throes of these transitions. The transitions will involve mergers and acquisitions, capital raising, issues relating to the bond guarantee program, and risk management—all areas in which advisory services may be needed. The services of an Investment Bank that understands the nuances of the CDFI Banking Sector may help the industry achieve scale.

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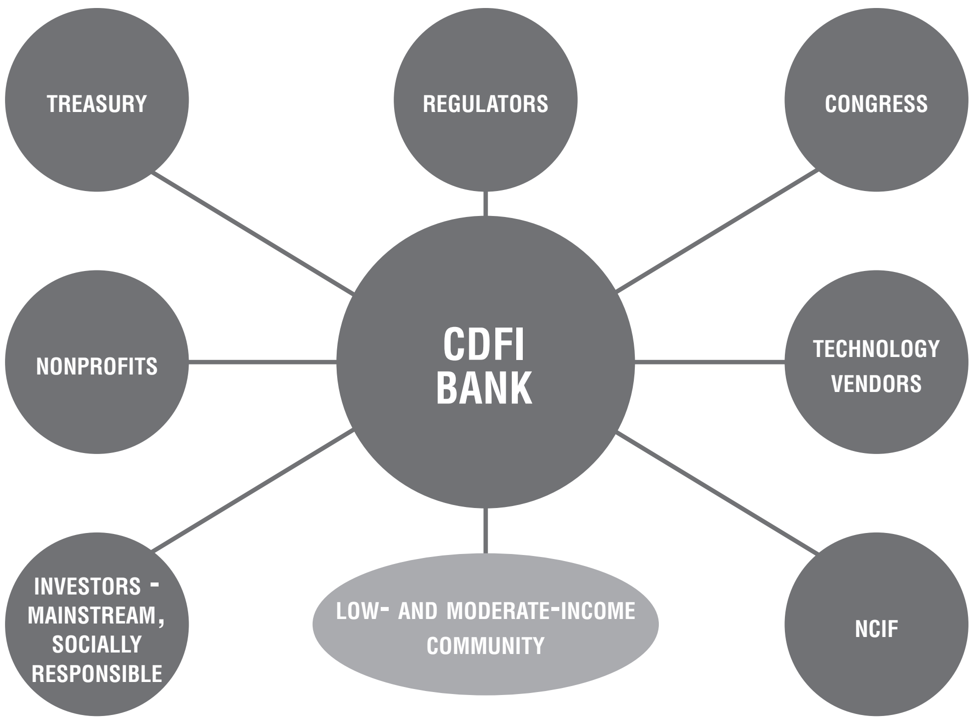
4 See "Community Development Banking Institutions," 2011.

A Probable Future – A Networked and Collaborative CDFI Banking Sector

Currently, each CDFI Bank tends to operate within its own silo, working diligently to be profitable, fulfill its mission, and remain safe and sound. But in an environment of changing business conditions it is critical for the sector to collaborate in finding effective responses and solutions to these challenges.

The CDFI Bank ecosystem consists of many participants that share the common end goal of providing responsibly priced financial services to the underserved. These include the Treasury, regulators, Capitol Hill, nonprofits, investors, and technology vendors. CDFI Banks are working with them to raise capital and deposits, garner support, use technology for stable systems, and book loans.

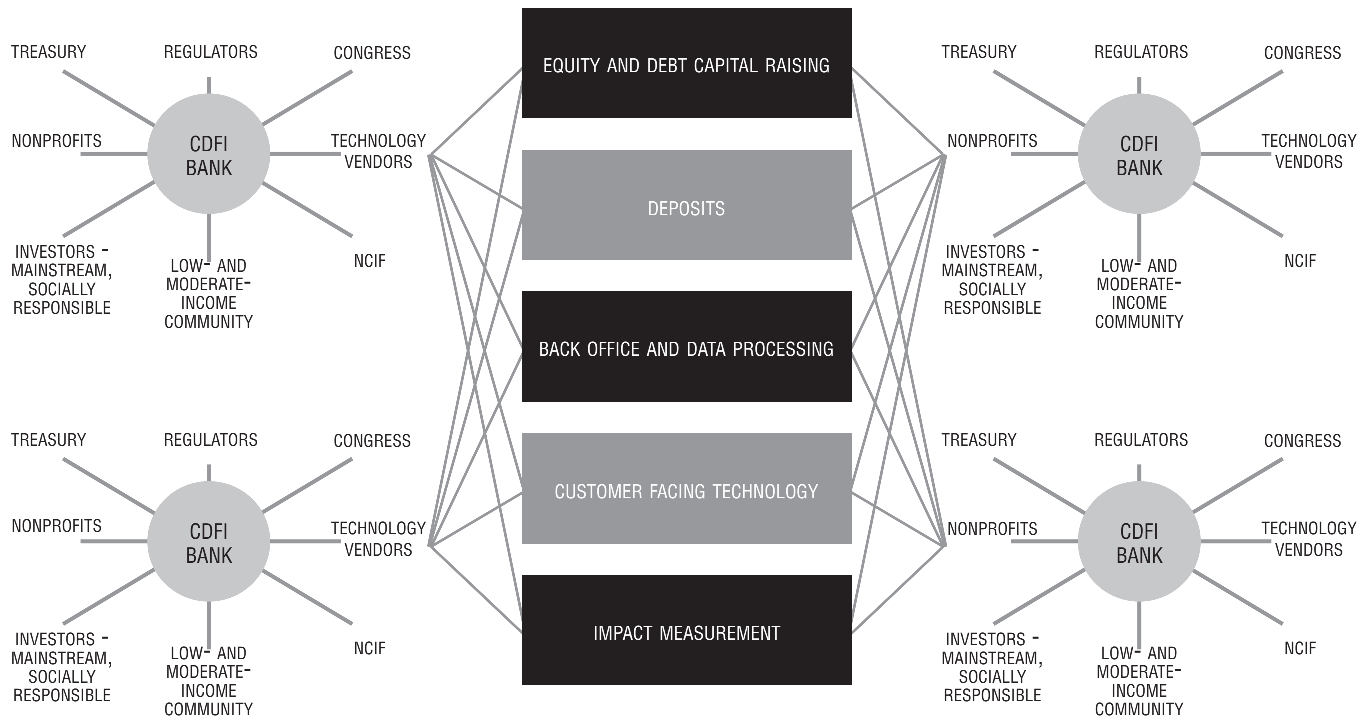
Chart 4: The CDFI Bank Ecosystem



Collaboration and effective networking can foster innovation by reducing the cost to each bank and generating better results. By working together, CDFI Banks can create economies of scale by addressing areas of common concern including capital raising, risk management, liquidity for investors, government funding, impact measurement, brand building, technology, shared services, and research.

Developing a new, collaborative business model will support individual CDFI Banks and the industry as a whole. Since CDFI Banks are rarely operating in direct competition with one another, these collaborative activities will only strengthen them and will not pose a competitive threat. Stakeholders will champion these collaboratively-operating financial institutions and make them more visible in the public eye. Collaboration provides the strength in numbers that is needed to finance industry-wide initiatives. Here are five areas where collaboration is immediately feasible.

Chart 5: Collaborative Business Models in Action



Collaboration Opportunity 1: Equity and Debt Capital Raising

CDFI Banks can collaborate to raise equity and debt capital collectively and in "size." Together, these banks will be able to raise hundreds of millions of dollars to achieve scale, provide liquidity to investors, and generate superior double bottom-line returns. Since liquidity is a key limiting factor in raising capital for CDFI Banks, perhaps we need a new approach to creating a mechanism or a platform where liquidity is available to a group of CDFI banks working together.

Ultimately, critical mass in capital raising can be achieved by creating a financial holding company similar to a "franchise model," which enables scale while retaining local control and knowledge of local communities. Some institutions may also decide to merge.

Collaboration Opportunity 2: Raising Deposits

With interest rates low and the CDFI Banking Sector flush with deposits, the focus on this part of the balance sheet is low. However, deposits and local access are the key drivers for value in banks. As interest rates rise–and they will rise, in due course–the sector can expect to see an exodus into other financial instruments.

Banks in the CDFI sector will attract deposits based on the social performance of each bank, marketing their geographic focus and social programs to attract supporters. The sector should collectively prepare for this potential movement of money by systematically creating a platform for socially responsible investors to place deposits electronically, with minimal paperwork. This online structure could be similar to the securities markets. Such a platform would be ideal for capitalizing on the current momentum behind the "Occupy" movement.

Collaboration Opportunity 3: Shared Back-Office Platform

Consider three CDFI Banks with approximately $200 million each in individual assets, or $600 million in combined assets. Under current conditions, each bank manages and staffs a back-office processing function that has the capacity to manage operations for a $500 million bank. To decrease these costs, the three banks could create a shared-services platform for managing back-office operations. The result of this collaboration will be substantial savings for each of the participant institutions, savings that can be redirected to the bottom line or to investment in other revenue-generating activities. If the bank creates additional capacity, that capacity can also be "sold" to additional partner banks.

Collaboration Opportunity 4: Customer-Facing Technology

Innovations in technology continue to be very significant and have the potential to change the way banking is done. These innovations can increase the ability of CDFI Banks to increase their reach beyond their immediate service area, allowing for the use of products that generate cost efficiencies with high volumes. However, it is not easy for any one institution to understand new technology and then negotiate technology contracts. A collaborative that applies new technology to support new customer acquisition, mobile banking, payments, remote deposit capture, bill invoicing, peer lending, and other technologies as they mature would rapidly increase scale for all participating banks.

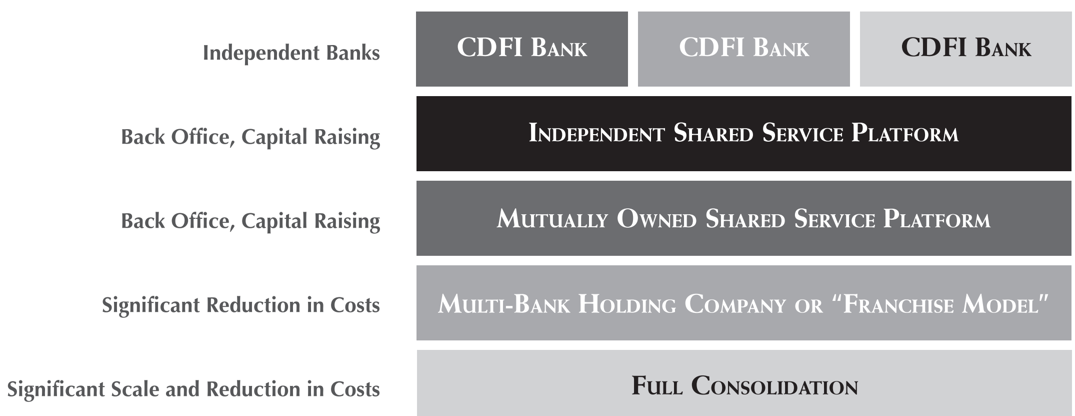
It should be noted that technology is also a potential competitive threat. Some customers are leapfrogging to mobile- and internet-based banking platforms, technologies that may reduce the demand for physical bank branches.

Collaboration Opportunity 5: Social Performance Metrics and Telling the Story

As mentioned earlier, the CDFI Banking Sector is known for the significant impact it generates. This will increase the visibility not only of the individual banks but also the entire CDFI Banking Sector. If the industry can establish an effective "brand" for itself, customers, depositors, and investors around the country will seek out CDFI Banks as trusted partners in economic and community development in the United States.

NCIF Social Performance Metrics provide a consistent standard for measuring impact and ranking institutions based on investor goals, but much more could be done with greater participation of CDFI Banks and other organizations.

The following graphic depicts a representation of how CDFI Banks could collaborate using shared-service platforms, to a franchise model, or to full consolidation, if appropriate.



These are just some examples of the successes that can be realized through collaboration. To move forward with these initiatives, CDFI Banks will need to come together around topics of importance to the sector and define and promote best practices.

NCIF hopes that stakeholders throughout the CDFI Banking Sector will be active participants in further defining this "Probable Future of CDFI Banking" through these collaborative activities, and will join in the efforts to realize the goals and the action steps that will lead toward greater scale and increased impact throughout the communities CDFI Banks serve. This will also help individual CDFI Banks sustain themselves and achieve greater success amid the challenges and uncertainties to come.

History has shown in many industries that working together is often the best way to address fundamental challenges. NCIF hopes that this working paper begins the process of promoting and facilitating collaboration to the benefit of all individual participants and the industry as a whole.

There is no certainty that these goals will be achieved, but given the value that CDFI Banks create in the communities they serve, and their importance to overall success and viability of the local businesses and families, these persistent efforts will indeed result in positive outcomes.

Appendix 1

Acknowledgments

NCIF would like to thank the following industry leaders for participating in this important planning process.

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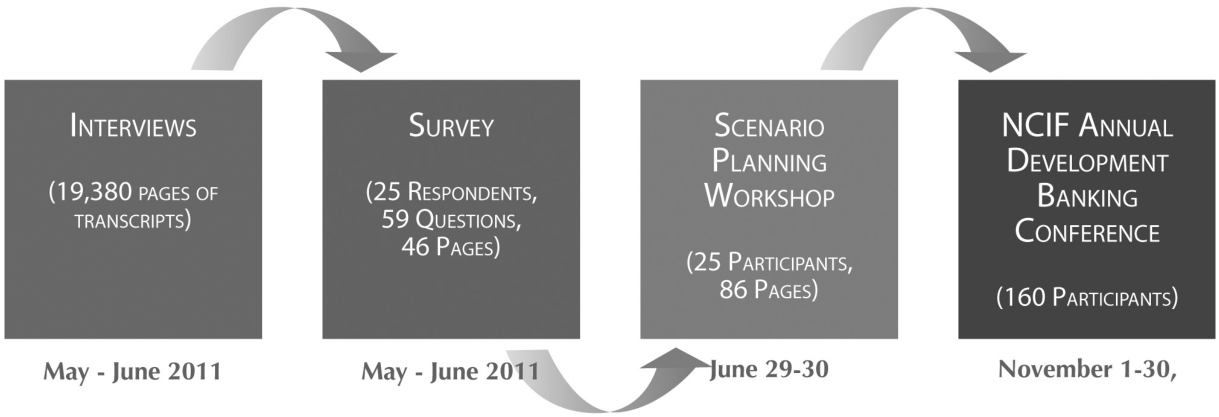
Bill Placke	President/CEO, New Haven Bank
Bob McGill	CEO, Neighborhood National Bank
Bob Schall	President, Self Help Ventures
Carlton Jenkins	Partner, Yucaipa Funds and NCIF Trustee
Chuck Van Loan	Former Chair, Independent Bancorp and NCIF Trustee
Dan Letendre	CDFI Lending and Investing Executive, Bank of America
David McGrady	Vice Chairman, City First Bank of DC/Chairman, NCIF
David Reiling	CEO, Sunrise Banks
Debbie Wright	Chairman and CEO, Carver FSB
Deborah Cole	CEO, Citizens Savings Bank and Trust
Dorothy J. Bridges	Senior Vice President, Federal Reserve Bank of Minneapolis
B. Doyle Mitchell	CEO, Industrial Bank of DC
Ellen Seidman	Chairman, Center for Financial Services Innovation
Evelyn F. Smalls	President and CEO, United Bank of Philadelphia
Floyd Weekes	COO, Citizens Savings Bank and Trust
George Surgeon	President and CEO, ShoreBank Corporation
Ignacio Urrabazo Jr.	CEO, Commerce Bank
James E. Young	President & CEO, Citizens Trust Bank
James Maloney	President, Mitchell Bank
Jeff Lacey	President/Chief Banking Officer, Merchants & Farmers
Jeannine Jacokes	Policy Advisor, CDBA
Joe Ferrari	National Community Investment Fund
Joe Neri	CEO, IFF
Joe Schmidt	National Community Investment Fund
John Berdes	CEO, Craft3
Kim Saunders	CEO, Mechanics and Farmers Bank
Louis E. Prezeau	Retired CEO, City National Bank of New Jersey
Luther Ragin Jr.	CEO, The GIIN; Former Vice President, The FB Heron Foundation
Mark Pinsky	CEO, Opportunity Finance Network
Mary Houghton	Founder, ShoreBank Corporation
Mary Tingerthal	Commissioner, Minnesota Housing Finance Authority and NCIF Trustee
Matthew Roth	President & CEO (proposed), Generations Community Bank
Pedro Bryant	CEO, Metro Bank
Peter Hurst	CEO, The Community's Bank
Phil Baldwin	Former President and CEO, Southern Bancorp
Preston Pinkett III	CEO, City National Bank of New Jersey
Ron Grzywinski	Former, Founder, ShoreBank Corporation
Scott Budde	Managing Director, Social & Community Investing, TIAA CREF
Steve Lydenberg	Chief Investment Officer, Domini Social Investments
Trinita Logue	President, IFF
Vince Siciliano	CEO, New Resource Bank
Wes Maher	National Community Investment Fund
Yman Vien	President & CEO, American Metro Bank

Appendix 2

The NCIF Strategic Planning Process

The NCIF planning process engaged a wide cross section of industry leaders from within the CDFI Bank Sector, other forms of CDFIs, and investors, to develop a broad understanding of the issues faced by CDFI Banks.



In 2011, NCIF completed 19 telephone interviews with leaders from across the industry and conducted a detailed survey to capture feedback from 25 additional respondents. We then held a two-day scenario planning workshop, engaging 25 leaders from across the CDFI industry in a collaborative effort to explore the future of the industry, and identify the most productive strategies for NCIF going forward. The information collected was then discussed at the NCIF Annual Development Banking Conference. The contents of this working paper are drawn largely from these activities.

Feedback on this work will continue to guide us as we work toward "The Probable Future of CDFI Banking." Our hope is to come out of the recession stronger and in a better position to serve LMI communities around the country.

Appendix 3

Themes Explored and Quotations from Participants

In our discussions, we explored many topics of interest to CDFI Bank leaders. Below we have included comments that we received on a few particularly interesting themes. Following these comments, we present some of the findings from our survey.

1. **What is the state of the economy and expectations for the future?**

   "The effect of the financial crisis is going to be extraordinarily harmful to low-income markets, and the large banks will continue to shy away from them. And the not-for-profits don't have the capacity to fill the gap. That translates into a huge shortage of capital in low-income markets, so once it's revived and profitable, the community development banking industry ought to evolve to serve this need."

2. **What should the business strategy of CDFI Banks be given the challenges we are facing? Are there alternative business models that need to be considered?**

   "Now is a time for CDFI Banks to be thinking about their role in the future of the greater financial services industry. . . We need to think beyond a siloed approach, to see what we need to do collaboratively."

3. **How do we continually improve governance, management and human capital at CDFI Banks?**

   "I find increasingly in talking to the people at the large banks that they're very skilled, knowledgeable, capable, talented people, but their knowledge is a mile deep and an inch wide. If you're trying to find a generalist who's had experience across the board, that just doesn't exist anymore. Therefore, it seems to me that management succession for Community Development Banks is going to be a real struggle. As an industry we will need to be paying attention to this issue, and perhaps it is time to consider a broader educational program to develop a new generation of leaders."

4. **What does the industry need to do to reduce costs and increase scale? How can it better adopt new technology?**

   "There's tremendous amount of strength in CDFI Banks that can be leveraged with the appropriate technology innovation and capital, to do some fantastic things."

   From that perspective, there's no end to the opportunities for a CDFI Bank. However, CDFI Banks must be 'on the right side of the microchip' and active in developing and applying new technology if they hope to attract customers, particularly younger customers who have grown up to expect a more technologically advanced user experience."

5. **What are the opportunities for the future, and how does the sector position itself to take advantage of these opportunities?**

   "There are two opportunities banks can look at. One, of course, is to look at small business and not just commercial real estate, but actually lending to small businesses, which typically brings in nice deposits and good pricing. As far as the consumer goes, I have always sort of thrown in the towel and figured that the big banks are going to handle that. But I am rethinking that for two reasons.

   One is, I think, there are still some communities that are relatively under banked. But what has to be sold is the idea that a community bank is more valuable to the community than a big national bank. I don't think that idea has been sold.

   Two, it's a different world in my opinion going forward. Not so much on the loan side, although it is true that as mainstream banks retrench on their lending side, CDFI Banks could become more relevant on lending. They still are less relevant on the cutting edge, so the speak, or perhaps the bleeding edge of a lending side relative to CDFI loan funds. But on the depository side, they will become more and more relevant, and more and more important every year that goes by."

6. **How should CDFI Banks measure and report on social performance & impact?**

   "NCIF Social Performance Metrics is a great tool. Particularly when it first came out, I thought it was really wonderful from an advocacy perspective in that it demonstrated a real concrete way a community development bank was different from a traditional bank. While the industry realizes that collecting social impact data is really important, banks often don't like to do it."

   "The CDFI Banking Industry needs to use quantitative criteria and metrics tools to measure and communicate the impact that they are generating. When asked, several banks will say that they already do the work (that is being done by the NCIF Social Performance Metrics) but in reality they are not really measuring it in a quantitative and standardized manner. The industry needs to standardize this reporting so that they are able to garner better support from the stakeholders."

7. **What role should NCIF take to guide the sector forward?**

   "I would love to increase NCIF's bandwidth so that we have the ability to make sure that the banks can stay ahead of the curve in terms of what's new in the industry. Do we need to rethink the strategy? Should we have a for-profit arm that is faster and not bound by the nonprofit regulatory stuff that impedes our ability to be a real player?"

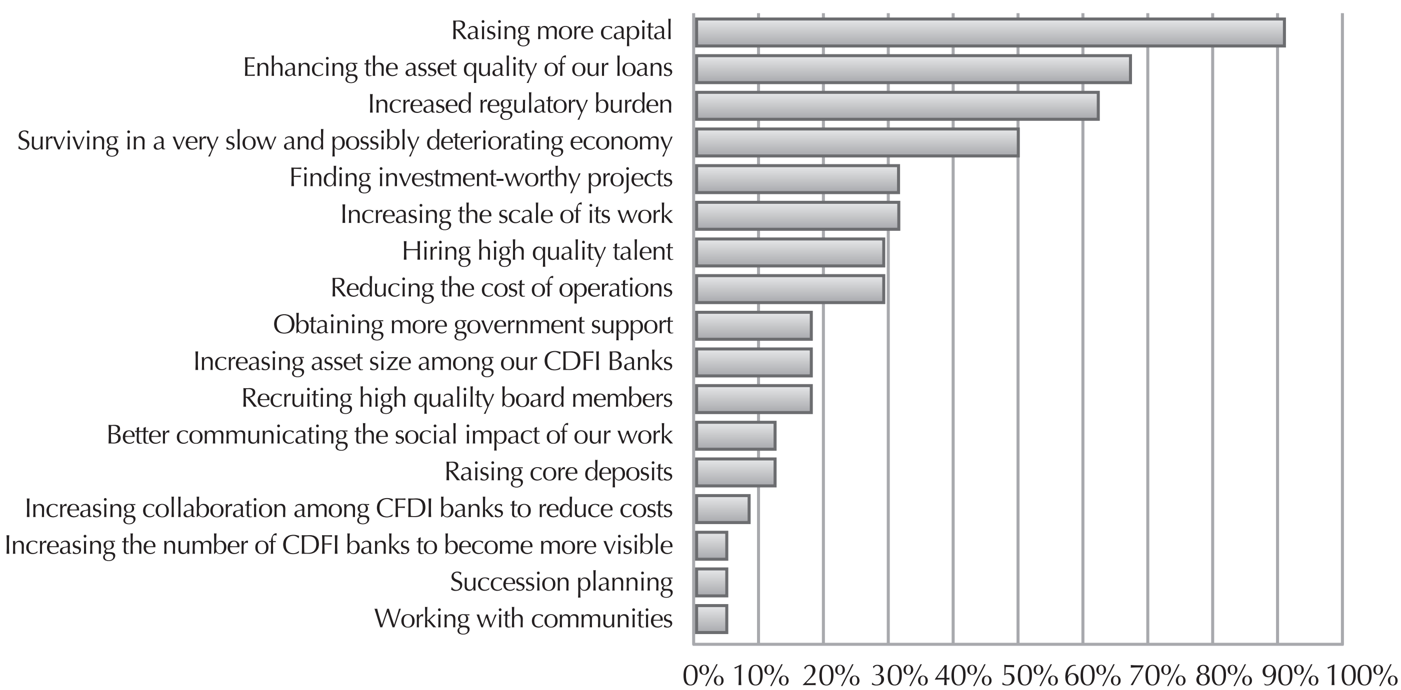
Appendix 4

Survey Results

CDFI Bank leaders are concerned about increasing regulation, raising capital, and protecting themselves from downside risk by enhancing the quality of their portfolios. They value peer collaboration, and seek opportunities to enhance their technology platforms and to their operations. The chart below details a ranking of the most critical issues facing the CDFI Banking Sector as indicated by the planning participants.

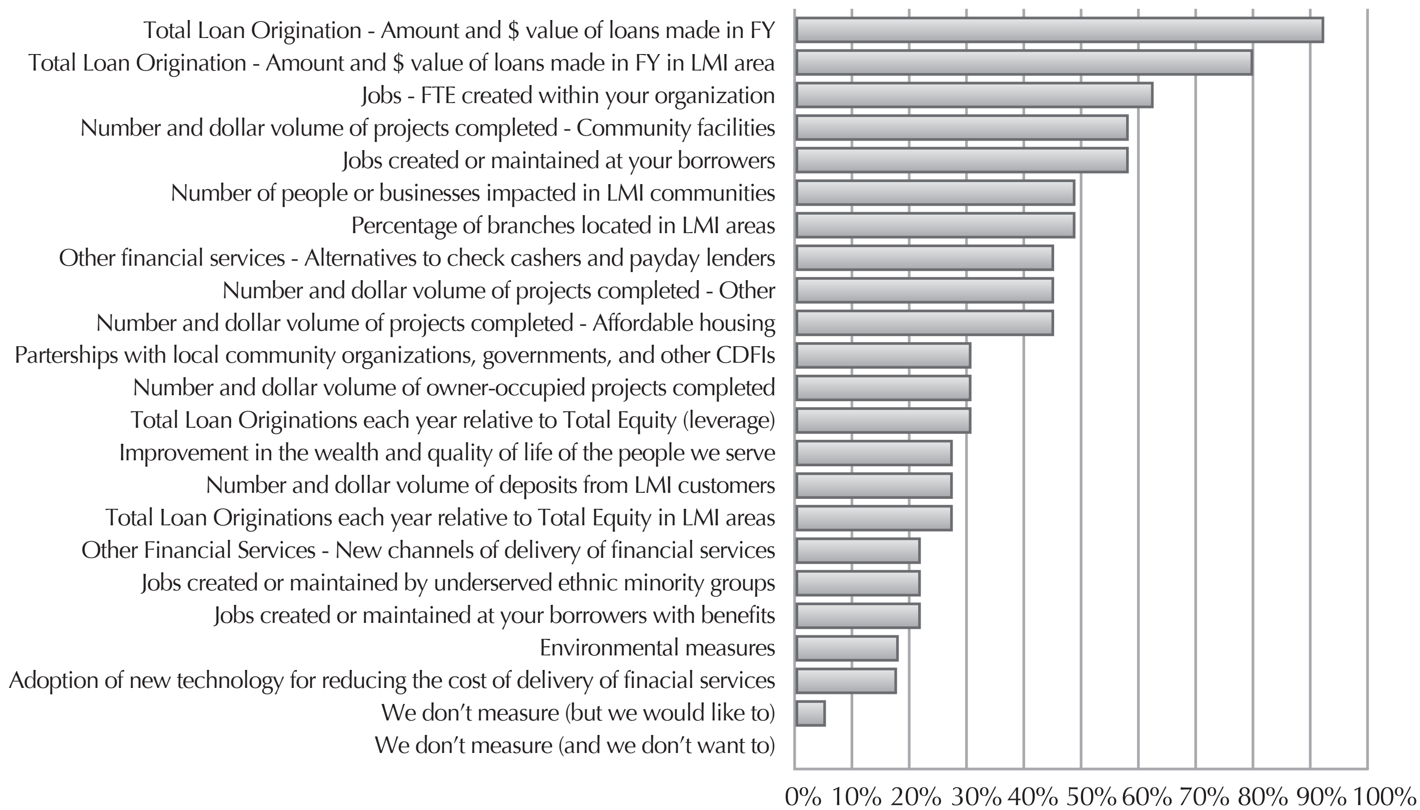
In addition, we also present graphs that show how respondents believe we should measure social and community development impact, the best ways to collaborate among CDFI Banks, and areas of interest for collaboration. These findings had considerable influence on defining the aspirational and strategic goals we have presented above, and were validated in our interviews and the scenario planning workshop as well.

Most Critical Issues – Next 5 Years

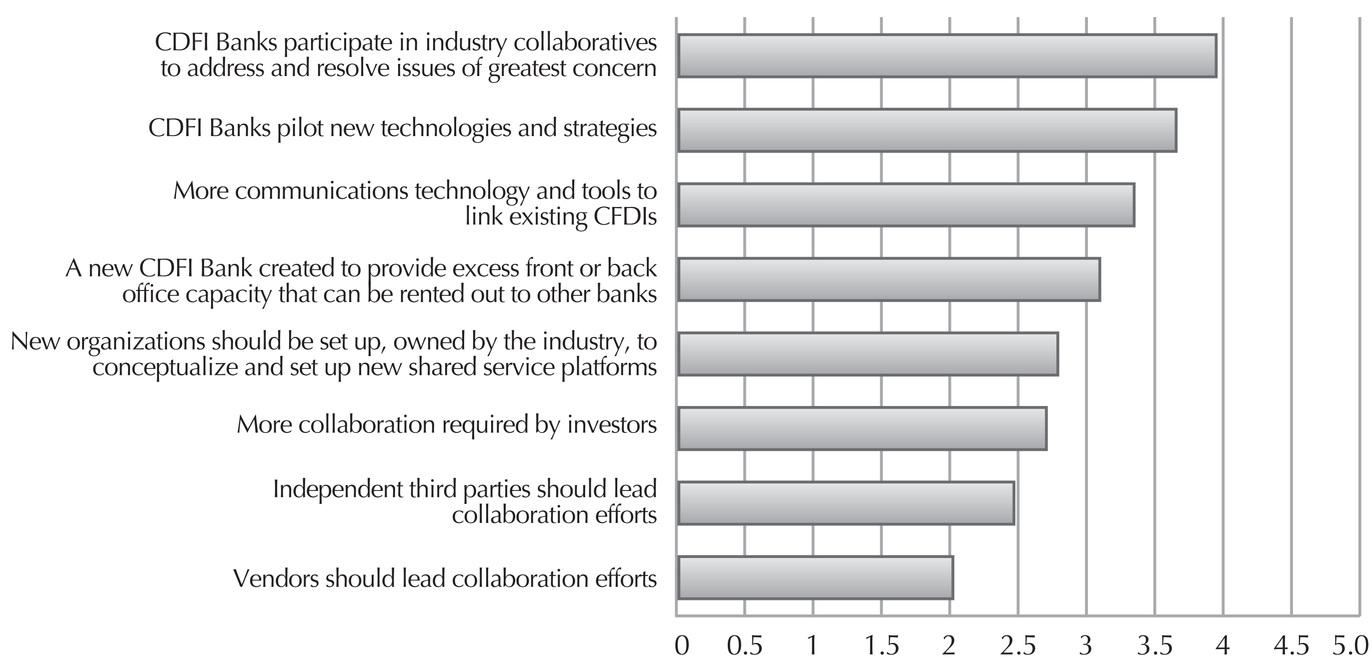


Survey Results (continued)

Measuring Social and Community Development Impact

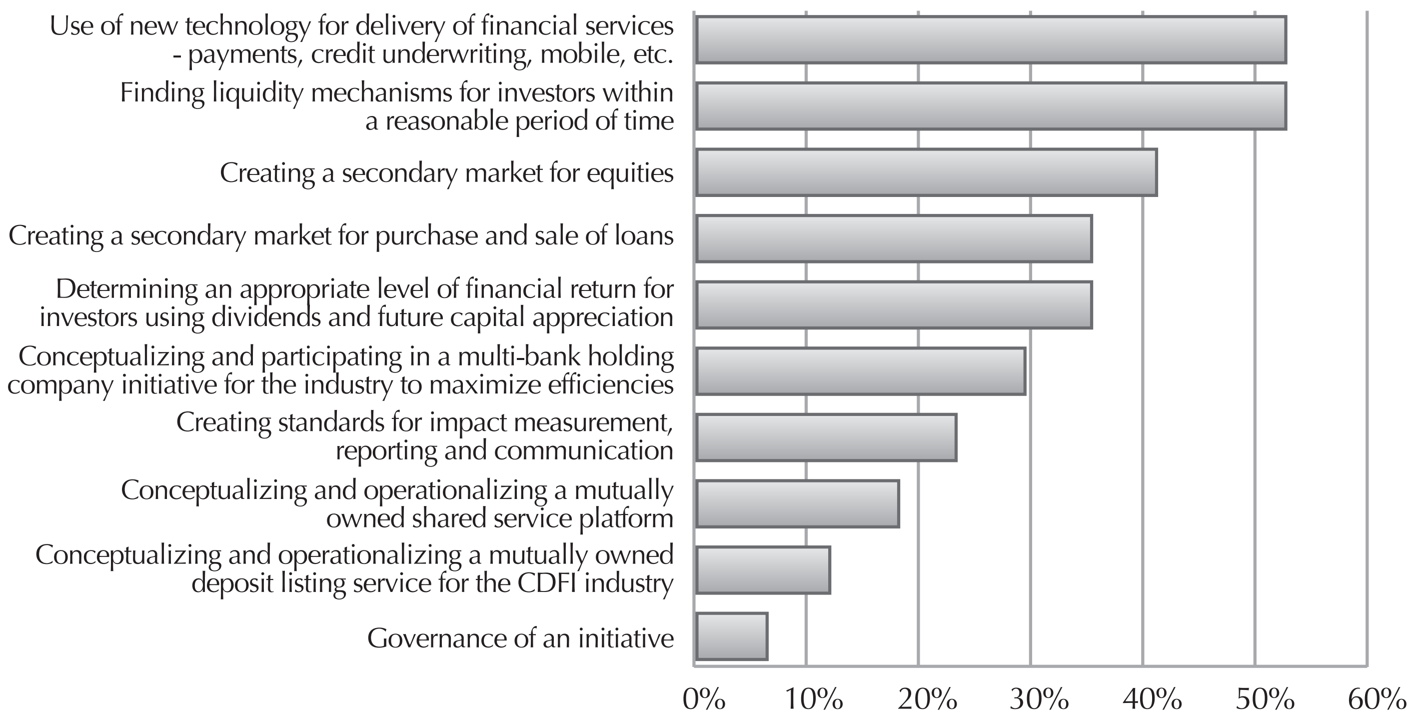


Best Ways to Collaborate Among CDFI Bank Industry



Survey Results (continued)

Industry Collaboration Interest Areas



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