

# The Impact of Large Capital Infusion to Community Development Credit Unions

by Jared Raynor

Abstract: Through a process of peer comparison and analysis of historical financial trends, the impact of outside capital on the development and growth of community development credit unions is examined and small case studies of superior performers are presented. The data set includes twenty credit unions that have received CDFI core awards in the 1996 to 1999 period. The findings indicate that awardees have a higher growth rate than their peer groups in all areas of traditional indicators, including asset growth, member growth, share and deposit growth, loan growth, non-member deposit growth, and overall capitalization. It is further indicated that while the award money itself has an impact on growth, it is not the primary cause of the higher growth rates over the peer group. Rather, the award allows the organizations to expand by helping provide a stable capitalization ratio, financing new projects that increase growth, and giving the credit unions a positive reputation with investors other than the CDFI Fund.

Community development credit unions have been recognized as a significant tool for empowering local communities to develop and control their own financial institutions. Every year the National Credit Union Administration's (NCUA's) Office of Community Development Credit Unions in the United States releases a

year-end report documenting trends in this special designation of credit union, and several academic publications have explored their successes (see, for example, Isbister, 1994; Gunn & Gunn, 1991). The development credit unions have consistently shown strong growth in assets, shares, loans, and members.

Much of the research, however, has focused on either the financial performance of low-income credit unions (LICUs) compared to mainstream credit unions or on the impact of the credit unions within local communities. Little has been done to examine the impact on the development of the LICUs themselves from the infusion of outside capital in the form of grants, loans, or nonmember deposits. This article attempts to begin the analysis of how this type of capital affects credit union performance by comparing a set of LICUs that received large amounts of funding to a peer group that did not receive the funding.

In 1996 the Treasury Department of the United States began making investments in development organizations in the form of grants, loans, and deposits through a new initiative called the Community Development Financial Institutions Fund (CDFI). Through a lengthy application process, development organizations throughout the country compete for funding in order to expand their finance-led development activities in low-income areas. There are three funding classifications: core awardees, intermediary awardees, and technical assistance awardees. As part of their awards, core and intermediary recipients can receive several types of funding, while technical assistance awards are for reimbursement of technical assistance expenditures.

This paper analyzes one type of award recipient, community development credit unions (CDCUs), in order to understand what impact the fund money has on CDCUs. After

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a brief description of the methodology, the institutional performance of the award recipients will be analyzed and compared against a peer group. Analysis is performed using traditional indicators, including asset growth, lending growth, delinquency analysis, membership growth, leverage (ability to attract additional outside capital), and net worth and capitalization. Finally, the highest performing credit unions are discussed in four mini-case studies.

### Methodology

From 1996 to 1999, twenty-two CDCUs were recognized as CDFI core award recipients (see Table 1 for a list of CDCUs analyzed for this study). As of December 31, 2000, they had been awarded \$10,180,000 in capital grants, \$1,450,000 in loans (including secondary capital and nonmember deposits), and \$803,500 in technical assistance, for a total of \$12,433,500. Of the twenty-two awardees, two had not yet received money from the fund and three had received awards in two different years.<sup>1</sup>

The impact of the awards has been significant. Those receiving money (including the two 1999 recipients), collectively made 188,632 new loans totaling \$255,661,904 since receiving the award. They added 17,225 new members, creating 31,427 new shares totaling \$18,924,292 in savings. They also averaged \$1,248,556 per CDCU in nonmember deposits. All of this represents new money infused into and retained in low-income communities.

CDCU performance was examined by looking at their financial performance since receiving the award. Peer groups have been used for comparative purposes based on the asset size of the CDCU at the time of the award. The peer group was established from the spring 2001 low-income designated CDCU list and was further categorized based on total asset size in the year the award was given. For example, a credit union (CU) receiving an award in 1996 would be compared with

**Table 1. CDCUs Receiving CDFI Awards**

Credit Union	Year of Award
Appalachian Development FCU	1998
Vermont Development CU	1997
Neighborhood Trust FCU	1998
Bethex FCU	1996
Northeast Community FCU	1998
Unified Singers FCU	1997
Tri-County CU	1997
Quitman/Tri-County FCU	1996
Homesteaders FCU	1999
Near Eastside Community FCU	1999
Alternatives FCU	1997
Central Appalachian Peoples FCU	1997
School Workers FCU	1996
St. Luke CU	1997
Santa Cruz Community CU	1996
Faith Community United CU	1996
New Community FCU	1998
Union Settlement FCU	1997
First American CU	1996
College Heights CU	1997

other low-income designated credit unions with a similar asset size in 1996 (see Table 2 for asset size categories).

Individual CU data was obtained from the Peer-to-Peer program, a program that compiles financial information for all credit unions and is sold by Callahan's. Trend analysis was calculated for three, five, and ten year periods, where data was available. Additionally, trends were calculated based on the year of the CDFI Core Award in order to examine the impact of the award verses general growth patterns. The trend was based on five years before and including the year of the award and another trend for the period of time from year-end the

year the award was given to year-end 2000. For example, if a CU obtained an award in the first year, 1996, the first trend would consist of the years 1991–1996 and the second would be for the years 1996–2000. The year of the award was included in the “before” trend due to the lag in closing and actually receiving the funds.

Peer averages were also calculated by the Peer-to-Peer program. In order to control for the size of the credit unions, most calculations were done using the growth percentages and not the absolute numbers. Averages for peer group comparisons were calculated by aggregating all the data points for credit unions with data available and dividing by that number of credit unions.

### Analysis

An analysis of the data indicates that the infusion of capital into CDCUs not only provides additional funds for low income communities, but it has a significant impact on the growth potential of the institution.

#### *Asset Growth*

Assets for the twenty awardees grew at a very rapid pace, averaging 20.32% growth per year with a median of 16.40% since receiving the award. The average growth rate before receiving the award was 11.70% per year. The awardee growth rate outpaced the average peer growth rate by 12.85% per year since receiving the award, versus only outpacing them by 5.77% before the award.

**Table 2. Asset Size Categories**

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\$0–1 million
\$1–5 million
\$5–10 million
\$10–20 million
\$20–75 million

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**Figure 1. Average Asset Growth**

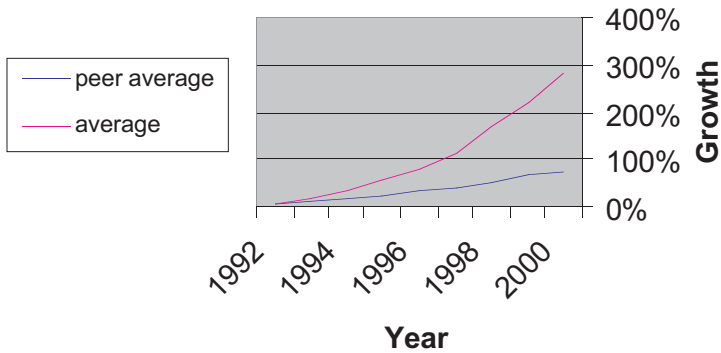


Figure 1 shows the average growth for the awardees and the corresponding peer group average, using 1991 as the base year. The CDFI core award credit unions outpaced the other credit unions by a considerable amount. The slope of the regression line for the peer group is 0.086, while the slope for the CUs is 0.342.

Based on the selection criteria for CDFI awardees, it is expected that those chosen for the award would outperform their peer groups. Indeed, looking at the 1992–1996 period, the peer slope was 0.06 and the awardee slope was 0.18. While the asset growth could be attributed to the selection process itself having a bias toward outstanding performers, there is evidence that the CDFI award has positive effects. If one looks at Figure 1 carefully, there is a noticeable change in the slope for the awardees in 1997, where it becomes steeper. Between 1997 and 2000, the slope of the regression line jumps from 0.18 to 0.58, a significant increase given that the peer slope increased only slightly.

All but three of the credit unions outpaced their peer groups, and only one credit union, College Heights, had negative growth (see Table 3). Appalachian Development and

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Neighborhood Trust are start-up credit unions, beginning operations in 1996 and 1997, respectively. Consequently, the comparison rates to a peer group are slightly misleading. However, even if a comparison group of credit unions that started up between 1996 and 1997 is compiled (17 credit unions produce a peer average of 13.41% asset growth per year), both CUs still outperform their peers. College Heights, the poorest performer, can attribute most of its decline to the loss of its one nonmember depositor, leaving it with zero nonmember

**Table 3. Credit Union Average Asset Growth Rates**

	Growth rate before award	Growth rate after award	Peer growth rate before	Peer growth rate after
Appalachian Development FCU	NA	60.3%	3.1%	10.0%
Vermont Development CU	27.9%	39.7%	5.0%	7.7%
Neighborhood Trust FCU	NA	37.6%	5.3%	6.2%
Bethex FCU	14.5%	32.6%	5.4%	7.5%
Northeast Community FCU	5.8%	30.1%	5.3%	6.2%
Unified Singers FCU	5.2%	27.5%	2.5%	10.8%
Tri-County CU	34.4%	21.6%	6.2%	7.9%
Quitman/Tri-County FCU	13.5%	18.8%	5.4%	7.5%
Homesteaders FCU	19.8%	17.7%	5.9%	5.5%
Near Eastside Community FCU	9.5%	17.2%	5.9%	5.5%
Alternatives FCU	6.6%	15.6%	7.3%	7.4%
Central Appalachian Peoples FCU	16.0%	15.5%	6.2%	7.9%
School Workers FCU	10.3%	14.0%	6.2%	8.1%
St. Luke CU	7.2%	13.7%	6.2%	7.9%
Santa Cruz Community CU	5.5%	12.7%	8.4%	7.3%
Faith Community United CU	8.2%	12.0%	5.4%	7.5%
New Community FCU	3.9%	10.3%	6.3%	5.7%
Union Settlement FCU	7.0%	6.7%	6.2%	7.9%
First American CU	7.1%	5.1%	8.4%	7.3%
College Heights CU	8.3%	-2.4%	5.0%	7.7%

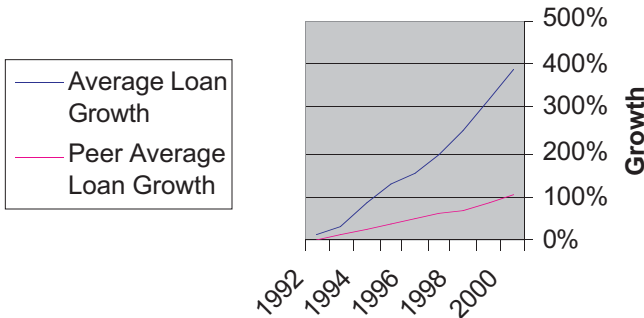
deposits in 2000, down from \$620,000 in 1999, though there were other indicators of negative performance.

It appears that the CDFI award designation has a positive effect on the asset growth of CDCUs. Though the award accounts for a significant boost to assets in general, it does not alone account for the high rate of growth. Other factors include a focus or desire to increase assets at a rapid pace, an increased ability to attract nonmember deposits, increasing the amount of member shares through both increasing the average dollar amount of shares per member and increasing the number of members.

### *Lending Growth*

The awardees were able to translate much of the acquired capital into loans, as evidenced by increasing loan growth (see Figure 2). They increased the number of loans made by an average of 3.39% per year more than their peer groups, and total loans made (in dollars) grew 10.22% per year faster than the peer groups. This was also an increase from the preaward growth period, where the awardees were increasing the number of loans 2.65% faster and the amount of loans 4.91% faster than their peers. Actual average loan growth for award recipients was 18.70% per year in dollars and 9.48% per year in number of loans. The loan growth in dollars was only slightly

**Figure 2. Average Loan Growth (in Dollars)**



slower than the 20.32% average asset growth over the same period.<sup>2</sup>

The two top performing credit unions were Northeast Community and Near Eastside Community, both with average annual loan growth over 42%. The other three top performers were Vermont Development (39%), Appalachian Development (36%), and Neighborhood Trust (33%).

The evidence indicates that the CDFI Award has a positive impact on a credit union's ability to expand its loan portfolio. Major determinants of loan growth potential include a history of expanding loans and a desire to expand the loan portfolio. The growth in loan size most likely represents a trend toward loans for larger development projects like home ownership, small business, and possibly vehicle loans, rather than just increasing the amount of personal consumer loans for the CDCUs. It will be years before hard evidence will be able to prove it, but it is anticipated that these types of loans will have a larger, wealth-creating component in the low-income areas where they are being provided, due to the equity inherent in homes and businesses.

### *Delinquency Analysis*

As a result of the loan growth, it was expected that delinquency would probably also grow—and it did. Unfortunately, loan delinquency (dollar amount) grew at an annual rate of 15.99% faster than at their peer institutions and the number of delinquent loans was growing 14.54% faster than in the peer group. The CUs had an average annual delinquency growth rate (in dollars) of 17.47%, after receiving the award, while the peer group averaged negative 2.81% delinquency growth. Asset growth over the same period (20.32% per year) outpaced the delinquency rate. While having the asset growth outpace delinquency growth is desirable, the high delinquency growth rate raises some concern.

While this section will focus on possible reasons for the discrepancy between the peer group and the CUs, it is important to note that the actual delinquency rate is not that bad.

The CUs had an average 4.36% delinquent loan/total loan ratio (DL/TL) in 2000, slightly higher than their peers at 2.73% and an improvement over the 1996 DL/TL CU average of 5.23%. The median 2000 DL/TL ratio for the CUs was 3.63%, only one percent point higher than the peer median of 2.57%.<sup>3</sup>

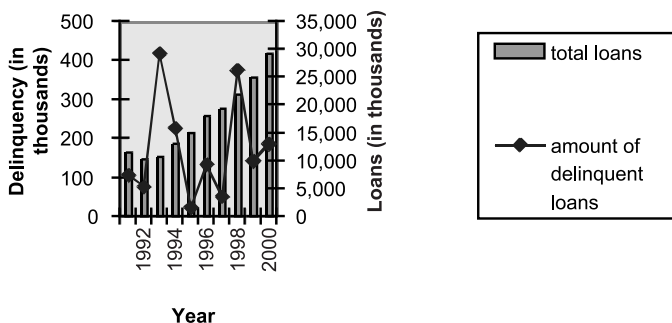
The median delinquency growth rate (in dollars) was 8.82%, indicating that a few CUs had very high delinquency growth. These CUs were identified as Homesteaders, Unified Singers, and School Workers, all three of which had irregularities causing the delinquency.<sup>4</sup>

If these three are removed in order to examine delinquency growth rates, the actual delinquency growth per year (in dollars) changes from 17.47% to a negative 0.82%. This shows, at least on the surface, that most awardees are able to manage delinquency rates. A careful analysis of DL/TL ratio and return on average assets (ROAA) provides a broader view of the actual productivity of assets (it should be noted at the outset that the 1999 NCUA low-income credit union report gives the average ROAA as 0.8% for LICUs and 0.9% for all federally insured credit unions) (NCUA, 2000). The DL/TL indicates how stable a loan portfolio is, while the ROAA shows the overall productivity of the loan portfolio (though it can be influenced by the loans to shares ratio and the amount of income from nonoperating sources, like grants).

Half of the CUs followed a similar pattern of delinquency. Assuming the money was received in the year after the award was granted, one to two years later there is a jump in the amount of delinquent loans.

This is usually followed by a sharp decline the following year, as seen in Figure 3. It is assumed that the increase in loan delinquencies (in actual dollars) results from an increase in lending, and the sharp decline results from charging off those loans. This may indicate some sort of pattern of poor loans being made and then being charged off. The DL/TL ratio often reflected this pattern. However, the ROAA was not highly correlated with the DL/TL ratio. For most of the CUs, the

Figure 3. Santa Cruz Loan Analysis



ROAA jumped slightly in the year after the award date, a manifestation of the actual award money flowing through the income statement.

There is no one pattern that characterizes the CDFI awardees as per loan delinquency. Each CU must be looked at individually, considering its objectives and historical performance. This would entail an entire paper by itself. However, more than half the CUs in the study exhibit some characteristics of loan portfolio problems, though overall the DL/TL ratio (4.36% average in 2000) is not terrible and the ROAA (1.53% average in 2000) is better than even mainstream credit unions. The portfolio problems are usually evidenced by an increase in delinquencies two to three years after the award date, with a corresponding drop the following year, due to charge offs.

While some CUs had decreasing ROAA, many exhibited increasing returns, indicating higher yield products. It is not clear how much of the delinquency problem results from a need for additional and better training regarding the new products. Delinquency rates within these CUs is an area where future research is needed.

### *Membership Growth*

In addition to assets and loans, membership also grew at a very rapid rate. The CUs outpaced their peer groups by an average 9.03% annual membership growth. This represents a significant climb from the preaward growth of 3.16% faster than the peer group. The actual average membership growth for the CUs since receiving the award was 12.66% per year. The overall large increase in membership may represent the recognition given to the credit unions through their CDFI core award designation. For individual CU data, see Table 4.

As Figure 4 shows, the CDFI awardees attracted members at a much faster rate than their peer groups. The sharp upward bend in the member line in 1997 is evidence that the award had a positive effect on membership growth. Having a sufficient potential member group is also an important factor in allowing a credit union to increase its membership. Additionally, a focus on obtaining new members is important to actually gaining new members (i.e., the CDFI designation is not enough in and of itself).

### *Leverage: Attracting Outside Capital*

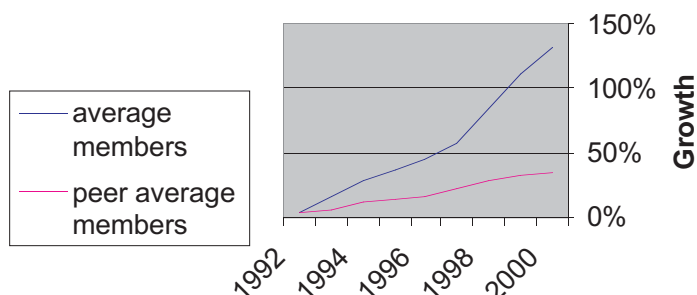
The credit unions in the data set were able to leverage their CDFI awards by obtaining additional nonmember deposits. The awardees were increasing their nonmember deposits at an average annual rate of 21.35%, much faster than the 12.30% growth rate of their peers. But even more important than the growth rate is the absolute size of the nonmember deposits, with the awardees averaging \$1,248,556 per CDCU.

At the end of 2000, these credit unions collectively had \$29,096,898 in nonmember deposits, much more than their peers, whose average composite was \$4,290,633.<sup>5</sup> The CDFI award requires that members match funds committed to them from the fund 1:1. This can be done by using their retained earnings as the 1:1 match. If the award is matched from retained earnings, the credit unions must increase their shares 4:1 over a 24-month period. Given that only three credit

**Table 4. Individual Credit Union Membership Growth**

Credit Union	Year of first award	Member ship in 2000	Member ship year of Award
Appalachian Development	1998	1,257	627
Vermont Development CU	1997	6,994	2,920
Neighborhood Trust FCU	1998	3,257	1,491
Bethex FCU	1996	7,750	1,786
Northeast Community FCU	1998	1,100	832
Unified Singers FCU	1997	673	560
Tri-County CU	1997	3,650	3,410
Quitman/Tri-County FCU	1996	1,996	1,067
Homesteaders FCU	1999	871	821
Near Eastside Community FCU	1999	2,592	2,468
Alternatives FCU	1997	5,839	7,004
Central Appalachian Peoples FCU	1997	1,334	1,368
School Workers FCU	1996	1,880	1,906
St.Luke CU	1997	2,316	1,624
Santa Cruz Community CU	1996	7,497	6,227
Faith Community United CU	1996	3,778	2,797
New Community FCU	1998	4,428	4,218
Union Settlement FCU	1997	4,030	4,550
First American CU	1996	18,946	15,454
College Heights CU	1997	2,442	2,234

**Figure 4. Membership Growth Base Year 1991**

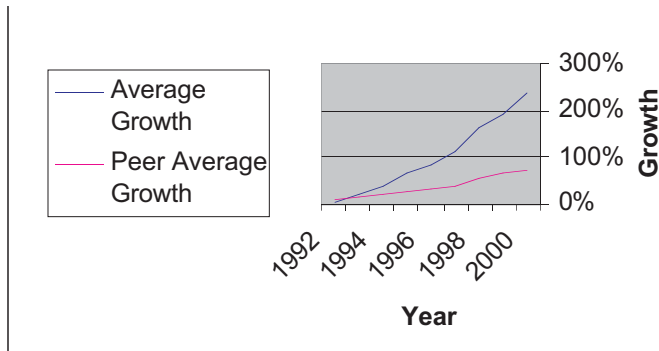


unions received nonmember deposits as part of their CDFI award, totaling \$1,450,000,<sup>6</sup> it appears the award group was able to obtain a much higher amount of outside deposits than their peers.

It is difficult to make direct comparisons regarding nonmember deposits because they fluctuate erratically. Consequently, looking at individual credit unions can be misleading, as timing influences the way the results look. It can be concluded from the absolute size difference and the average growth data, however, that the CDFI awardees are able to leverage their awards through outside nonmember deposits. Even if the award money is removed, it represents such a small percentage of the actual amount of the total that it has virtually no impact. This nonmember deposit growth corroborates the CDFI's FY1999 annual survey result that CDFI core awardees are able to generate more outside resources (CDFI, 2001).

The combination of member growth and nonmember deposit growth led to significant share and deposit growth, an average of 17.91% per year. This was 10.68% per year faster than the peer group. The growth in this area is only slightly less than the growth in assets, indicating that much of the asset

**Figure 5. Share and Deposit Growth Base Year 1991**



growth was coming from shares and deposits and not capital from grants.

This type of growth demonstrates that the awardees were in actuality growing faster than their peer groups *independently* of the award money itself. If the growth were due only to the \$10.26 million in capital grants, the analysis would have only proved the obvious—that giving an organization money leaves them with more money. However, since asset growth can be largely attributed to non-CDFI sources, it can be concluded that the award created an atmosphere in which the credit unions could grow at a rapid pace. Ultimately, this leads to long-term self-sufficiency and continued growth.

As with asset growth, there is a jump in the slope of the total shares and deposits line around 1997. Before 1996, the awardees were growing with a slope of 0.20. After the award, that doubled to 0.41, while the peer group had a slope of 0.05 before and 0.11 after 1996. This shows a strong relationship between growth and the CDFI award.

### *Net Worth and Capitalization*

The net worth of the CUs was increasing by an average 28.98% per year after receiving the award. It is intuitive that the net worth would be increasing, given that the awards consisted mainly of capital grants. As with assets, however, the type of net worth growth is indicative of more than just the award money. It has already been discussed that much of the money was transformed quickly into revenue-generating loans, which would increase net worth. Additionally, the awardees were able to leverage their awards to get grant money and secondary capital from other sources, similar to the nonmember deposits scenario. Due to a lack of available information, it was not possible to analyze what the net worth growth would look like without the award money.<sup>7</sup>

While the capital ratio analysis is constrained by the analysis of net worth, the absolute (versus the comparative) numbers are important to consider. As seen in Figure 6, the capital ratio has risen from 6% in 1992 to 14% in 2000. It appears that the

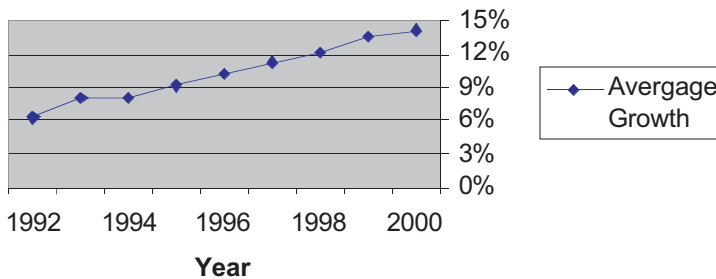
CDFI award money helped fuel the growth from the 9% range to the current levels.

By NCUA standards, 7% and above is considered well capitalized. In their year-end 2000 report, they state that low-income designated credit unions had an average net worth ratio of 11.3%, with all credit unions slightly less than that (NCUA, 2001). Given the growth rates of these credit unions, it seems the CDFI money has been critical to keeping them financially sound. Had they not received the equity grants, not only would their growth likely have been reduced, but they probably would have experienced other problems, including regulator and risk problems. Additionally, having a strengthened capital position enables the CUs to launch new loan products, increase loan size, take greater risk in lending to very low income people, and expand operations without fear of NCUA intervention.

### Case Analysis of Best Performances

Given the performance of the credit unions in the data set, it was desirable to begin analyzing what characteristics contributed to their growth. To do so, a simple rating system was set up to find the top performers from the awardees. The credit unions were ranked according to growth over the peer group in the growth categories discussed in this report. The top five

Figure 6. Average Capital Ratio



performers were given points, starting with five points for the top performer and one point for the fifth. All others received zero points for that category. The totals were then simply aggregated (see Table 5 for the ratings breakdown).

The top four performers, in order of highest to lowest, were: Vermont Development, Northeast Community, Neighborhood Trust, and Appalachian Development. A simple set of questions based on specific CDFI goals and financial statements was compiled for each CU. Additionally, due to availability and geographic diversity, Bethex and Quitman/Tri-County were also included in the case study.<sup>8</sup> Northeast Community and Neighborhood Trust did not respond to the questions and so are not included.

The surveys were very preliminary and not comprehensive. The results, which will be briefly described below, were intended to provide an overview to this research as well as provide a basis for future research. As a further disclaimer, ranking in the top portion of this research is not necessarily an indicator of CU success, though the top performers (or the CDCU) have all shown remarkable growth and innovation.

### *Vermont Development Federal Credit Union*

Vermont, though not the number one performer in any one category, consistently outperformed in all areas of growth. According to sources at the credit union, a recent project by the University of Vermont found that VDFCU helps people in three areas: (1) a direct financial impact; (2) giving people a long-term picture of their own financial life (i.e., plans to get a better job, etc.); and (3) confidence, voting, and involvement in the community.

As already mentioned, VDFCU had significant asset growth. Since the CU receives no support from the state of Vermont, most of its funding has come from social investors and federal funds. In recent years, many of the social investors have made deposits as members (versus nonmember deposits). The CU continues to increase membership from its low-income target market, but these shares represent a very small

**Table 5. Ratings System to Determine Top Performers**

	Asset growth	Loan growth numbers	Loan growth amount	Member growth	Total share/deposit growth	Non-member deposits	Delinquent loans number	Delinquent loans amount	Net worth	Capital ration	Total
Vermont Development CU	4	4	3	2	3			2	4	4	26
Northeast Community FCU	1	3	5		2	2	5	5			23
Neighborhood Trust FCU	3		1	5	4		3	3	3	2	21
Appalachian Development FCU	5		4	3	5	3		2	2		22
Near Eastside Community FCU			2					5	5	5	12
Bethex FCU	2	1		4	1			1			9
College Heights CU		5				4					9
Central Appalachian Peoples FCU							1	1		3	5
Union Settlement FCU						5					5
Alternatives FCU		2				1				1	4
St. Luke CU								4			4
Tri-County CU							4				4
Quitman/Tri-County FCU				1			2				3
New Community FCU							3				3
Faith Community United CU (NA)											0
First American CU											0
Homesteaders FCU											0
Santa Cruz Community CU											0
School Workers FCU											0
Unified Singers FCU											0

Rating/Point comparison

Rating	1	2	3	4	5	6 and up
Points	5	4	3	2	1	0

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amount of the total. VDFCU attributes much of its member and loan growth to successful partnerships with other organizations. On the other hand, its loans are made almost exclusively to low-income individuals. Through an innovative loan program, with the slogan “we don’t say no, we say when,” it prepares individuals to receive loans rather than just denying them outright. This “tracker” loan is educational and also helps perspective borrowers “overcome a psychological milestone.” Consequently, the CU is quite successful in lending out its assets, with total loans to total assets at 88% in 2000.

VDFCU has also hired a “pipeline counselor” who helps people who aren’t ready, but want to own a home. VDFCU has been successful in increasing the amount of loans while simultaneously decreasing delinquencies and attributes this to having high credit standards and preparing its borrowers. The CU is very proactive about helping borrowers not to take more than they can afford (for example, encouraging a cheaper car). VDFCU also services all of its own loans, which, in the words of the management, “allows us to hear or see when there is a problem and we can react quickly.”

VDFCU’s major obstacle to growth is acquiring sufficient capital to increase lending. For example, management cites the \$100,000 insurance cap on deposits as a deterrent to many would-be depositors who already support and believe in the credit union. Consequently, VDFCU doesn’t think that it can keep up the growth of nonmember deposits (one of the two areas where it was not in the top five for growth).

The capital ratio, 19% in 2000, is an important aspect of their growth. It causes less hassle from the regulators as it expands and tries new programs. VDFCU has also been remarkably self-sufficient in the last couple of years (as evidenced by earned revenue to expenses), which is attributable to its size. As it grew it needed grant money to help with all of its new programs and expansions. Now, while grants are still important to the organization, it is able to self-fund or partially self-fund some of its new projects.

VDFCU has also been successful at retaining employees and attracting new, high-quality employees. While management says some of that is due to layoffs in the banking world, they also note the size and success of the CU as major draws for good employees. The CU also has significant training for its tellers, whom it uses as a tool to promote savings, and new products (like CDs) and to keep good relations with its customers.

### *Appalachian Development Federal Credit Union*

Appalachian Development started operations in 1996. It grew quickly, even when compared to the start-up group of the same period. As part of an initiative to attract outside resources, it has a nonmember investment program that is very successful at attracting deposits. Additionally, management notes that since becoming a CDFI core awardee, financial institutions call *them* wanting to invest in the credit union. Unfortunately, it has not been able to capitalize on all of the offers due to NCUA nonmember deposit constraints and a concern for its capitalization (the nonmember deposits would increase assets but not net worth, causing a lower capital ratio).

Appalachian's membership growth is attributable to constant outreach and "very powerful" word of mouth in the area. It has also had success increasing its loans, which is remarkable given that many of its members need loans between \$70 and \$500. As part of the solution to its delinquency problem, it recently had the fortune of adding an attorney to its board, who is volunteering her services.

As a start-up, Appalachian Development is interested in its long-term sustainability. Its plans to increase self-sufficiency include increasing its membership (economies of scale) and building solid, long-lasting relationships. One of the most innovative things Appalachian Development does to solidify relationships and build community is to host periodic events for the members. In the summer of 2001, it had four family swim nights. These events single it out as a thoughtful asset to the community. Another innovative program is the

Drive-to-Work program. Given the rural community the CU serves, cars are an important aspect of job security and growth. This program gives members the chance to improve their quality of life by providing reliable transportation.

### *Bethex Federal Credit Union*

Bethex has been able to leverage its CDFI money with remarkable success. Much of its success has come from expanding its membership, which it does through outreach programs and acquisitions of other credit unions. It has taken control of several credit unions in the last couple of years that were in financial trouble and attributes its ability to do this to its high capital ratio (17.70% in 2000), which is largely attributable to the CDFI grant. As a consequence, the CU has doubled in size in the last five years. One of the techniques for outreach includes a school banking program. It is very resource intense, but Bethex goes into the schools and helps young people start and maintain accounts. It pays off through the new members it brings into the CU, including parents of the children. In management's words, "it makes saving a family affair."

Perhaps the most innovative program in the country is the recent partnership that Bethex has formed with local check cashers, long considered the enemy to low-income individuals and CDCUs. Bethex hopes to use the check cashers to offer more convenient services to its members and break down the antagonistic relationship between the two. Additionally, while many CDFIs cite lending to microenterprise as a way to create jobs in the community, Bethex goes a step further, employing welfare-to-work individuals directly in the credit union. One of the welfare-to-work recipients is the new manager for one of Bethex's newly opened branches.

On the lending side, Bethex notes a lack of demand as a reason why it is only 45% loaned out. However, it has been able to increase its loan growth by "refinancing," for example, a \$1,000 loan for \$5,000 and by expanding its microenterprise loans. According to management, while only 10% of the microenterprises succeed, even when the failures can usually be

counted successes because people gain confidence and skills by running their own business. Bethex management has learned that “we have to know their business and what they need better than they do,” in order to be successful with business loans. Overall, there is an air of “can-do” at Bethex. Employees and management think innovative and big, and when an idea works, they are pleased; when it doesn’t, they consider it time to try the next new idea.

### *Quitman/Tri-County Federal Credit Union*

Quitman has a historical reputation of success for rural credit unions. Its growth is best characterized by two recently opened branches and plans for a third. It intended to use the CDFI money to expand its lending for home improvement and residential construction. According to management, just recently it built the first new housing unit in Quitman County, Mississippi, in the last fifteen years. One of Quitman’s keys to success is its close relationship with a local community development nonprofit organization. The two organizations have a symbiotic relationship that allows for both organizations to maximize the good to the community. Quitman has worked hard to be a self-sufficient organization and has self-sufficiency as a constant goal. Management says there is “a bias towards action”—the board and staff are very good about quickly evaluating and implementing new programs. This has allowed Quitman to capitalize on many opportunities that would have been lost at other credit unions.

## **Key Findings**

There were several themes that emerged from the successful credit unions. Though not exhaustive, these characteristics seem to be important to the growth trends of these institutions.

1. *Growth orientation.* All of the organizations have explicit aggressive growth goals. They do not get bogged down in a plethora of specific goals, though they do plan for their

growth. Part of the growth orientation is a desire to be a self-sufficient organization.

2. *Partnerships*. The credit unions have established and carefully manage partnerships with other agencies in the community. Some of them work directly with nonprofit organizations. As a sidenote, they also indicate that when a partnership goes wrong, it kills a project.

3. *Innovative*. These credit unions have an orientation for trying new things. They are not afraid of charting new territory and their entire staffs are encouraged to be a part of the innovation.

4. *Strong networks*. Their networks consist of more than just partnerships—there are many specific personal relationships between personnel at the credit unions and people at other organizations or in the community. The credit unions know their NCUA regulators very well and what the regulators want.

5. *Good employees*. The management and staff at the credit unions are energetic and innovative. The credit unions pay more for their staff (at least anecdotally) in order to attract and keep them. They put time and resources into training and promoting from within.

6. *Importance of the CDFI award*. The equity money, especially, appears to be critical to all the high growth organizations in order to maintain an adequate capital ratio. They also indicate that the designation has had positive marketing effects for the organization. While the marketing effects are unique to CDFI, the necessity of the equity money could be applied to any large grant making organization (and some would argue so could the marketing effects).

7. *Problems with member savings*. Almost as an aside, it is important to note that the largest problem area mentioned is getting their members to save larger amounts of money. This is an area that merits further research.

## Conclusion

What impact does a CDFI core award designation or the infusion of outside equity have on a credit union? The evidence provided here indicates that it allows the credit union to grow at a rate significantly faster than it normally would. The CDFI designation does two important things. First, it is essentially a stamp of confidence and advertising that allows the CU to solicit and obtain additional resources, specifically through nonmember deposits and member growth. Second, it provides a shot of capital that allows the CU to pursue projects that it otherwise would not be able to do.

Many CUs are constrained by capital limitations. Many development credit unions have expanded to their capacity of financial resources, though not of ideas, needs, or clients. The CDFI award provides a significant resource to overcome a hurdle blocking growth, which will allow them to more fully serve their communities.

Additional research needs to examine whether the infusion of capital has the same impact on other types of microcredit institutions. Research also needs to examine the organizational implications of rapid growth due to capital grants and what quality and service implications exist due to the growth.

The analysis presented here indicates that the infusion of outside capital has a positive snowball effect on CDCUs. Credit Unions get capital, leverage that capital through outside resources, expand their products and services, and generate more income. Their constituency gains wealth both through loans to increase their asset base (in the form of a car, a small business, etc.) and through returns on their deposits, not to mention the avoidance of costly fees and services through unfriendly low-income lenders like pawnshops and predatory lenders. As they gain wealth, the resources of the credit unions increase and their income generating potential goes up. Over the long-term, this means self-sufficiency, growth, and hope for low-income communities.

# The Impact of Large Capital Infusion

## Notes

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1. Chowan CU, Inc., and Borinquen FCU had not received money and are not included in the analysis. Multiple-award recipients are: Alternatives FCU in 1997 and 1999, Bethex FCU in 1996 and 1998, and School Workers FCU in 1996 and 1999.

2. The asset to loan growth spread of the after award period (1.62%) was inverted from the before period. Loans were growing faster than assets by 2.25% in the before period. The transposition is easily accounted for by the diversity of uses for which the CDFI award was acquired. Not all of the credit unions had the goal of increasing loans or loan products. Also, many of the credit unions were not overly loaned out to begin with and so the award money could not quickly be turned into loans.

3. NCUA reports a 1.81% delinquency as a percent of total loans for low-income credit unions at year-end 1999. All federally insured CUs do only slightly better, with a 0.75% ratio. Given the aggressive nature of the CDFI core awardees, the delinquency rate is not that poor. See NCUA, 2000, p. 16.

4. Homesteaders (delinquency growth of 149%) has an odd pattern of charging off a large amount of loans every other year, which has the effect of decreasing the amount of delinquent loans. In 1999 they charged off a large amount and consequently had a low amount of delinquent loans, which jumped back up in 2000. This indicates a pattern of bad loans; however, the growth change in absolute terms of DL/TL was only 1.9 percentage points: from 1.76% in 1999 to 3.7% in 2000. Unified Singers (107%) had a huge increase from 1999 to 2000 due to the death of a client of which they were not aware. The insurance payments are still being arranged, but it is now in the process of being paid off fully. Gross loans charged off have remained zero for the entire period (with total loans outstanding at 1.1M). The one bad loan raised the DL/TL ratio to 2.41%. School Worker's (62%) total delinquency has been rising steadily, but not as drastically as its 62% would indicate. It appears that in 1996 a number of the delinquent loans were charged off, giving a lower 1996 delinquent loan amount. However, in 1997, the number jumped back to a level similar to the 1995 amount. The lower starting amount had the impact of producing an inflated growth rate.

However, even in 2000, the DL/TL was only 1.38%, more than 1% less than the peer average.

5. The composite average was calculated by taking the corresponding average nonmember deposit amount for each credit union's peer group and aggregating it.

6. The three CUs receiving nonmember deposits were Central Appalachia, \$100,000 received in 1998; Alternatives, \$850,000 received in 2000; and Appalachian Development, \$500,000 received in 1999. Appalachian Development's award represented 35% of their \$1.4 million nonmember deposits, whereas Alternatives' award represented 20% of their \$4.1 million and Central App's award represented 3% of their \$3.3 million. Even if the award money is removed, the growth is still much higher for the awardee group than for their peers.

7. For the majority of the credit unions it was not possible to obtain the dates when the money was actually dispersed. Many had multiple disbursements of the award over a 1–2 year period.

8. Bethex was the number six top performing CU in the group, whereas Quitman fell in the bottom half. However, Quitman has long been recognized as a good example of rural LICU development and is the subject of a current Winthrop Rockefeller research project.

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