

banks and CDFIs

Putting on the brakes

While the CDFI sector has been happily speeding ahead, expected cuts to the government's Phoenix Fund next year could put a halt to its progress. David Adams looks at the implications of this and finds out what charities relying on community development finance institutions can expect

Once again, it seems that government intervention may lead to the voluntary sector moving two steps forward then one step back. The community development finance sector, in part a creation of government policy over the last five years, maintained a healthy rate of growth in

2004, according to *Inside Out*, a report published in April by the Community Development Finance Association (CDFA). But its future may not be so bright. The report outlines the organisation's ongoing concern about cuts expected next year to the DTI's Phoenix Fund, the largest contributor to the running costs of community development finance institutions (CDFIs) in 2004, and a major source of the capital used by them to offer lending to small business, social enterprise and voluntary sector start-ups.

The value of loans and investments provided by CDFIs increased by 40 per cent in 2004 to almost £150 million, split among more than 6,500 loans. Funds now available for loans from CDFIs have reached about £400 million, up from £220 million in 2003. "Almost half of the CDFIs have only been operating for two years or less, so if that progress is maintained we'll see more CDFIs providing more services," says the report's author, Sarah McGeehan, deputy chief executive of the CDFA.

The figures may add up to a small share of the funds moving through the voluntary sector as a whole, but the financial assistance and consultancy services offered by CDFIs is often crucial to small organisations struggling to survive the first phase of their existence, when help from a conventional financial provider is usually out of the question. This is particularly the case for non-profit organisations like charities, but also for social enterprises, which received more than half of all loans offered by CDFIs in 2004.

"These are income generating organisations but they may not be profit maximising, and that's something that's still very hard for the bank to understand," says McGeehan. "Sometimes the

guarantees that the mainstream finance providers want are too exacting – not many trustees want to put their own houses on the line for their organisations." By contrast, the services that CDFIs provide are tailored to the needs of these organisations, such as loans that bridge the gap before a grant arrives, and additional business support services, like mentoring or consultancy.

With the role of the Phoenix Fund diminishing, the government wants regional development agencies (RDAs) and the devolved assemblies in Wales, Scotland, and Northern Ireland to take greater responsibility for supporting the CDFI sector. "We are concerned about the move from a national funding body to regional funders," says McGeehan. "There's some real progress being made in some regions, but others are still a bit behind."

Banks have offered crucial support to the CDFIs, and this may now be under threat. "Our current and future credit decisions are difficult when it comes to CDFIs because of the uncertainty regarding the Phoenix Fund," says Craig Campbell, head of community banking at the Bank of Scotland. "That is making risk assessment extremely difficult, so we have actually taken a step back in terms of working with CDFIs."

Campbell says the Bank of Scotland anticipates some consolidation within the CDFI sector during the next few years, with organisations merging or disappearing. This may leave CDFIs that look more attractive to banks, but that might not be very good news to their client organisations. At present, many CDFIs specialise in a single niche market, offering expertise that might not be so easy to access through a larger organisation.

Nor can there be much hope of the



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banks themselves filling the gaps left by a shrinking CDFI sector. "For the banks, most charities are all like the local scout group and they will give us free banking provided we don't carry out more than ten transactions a month," says Chris Harris, director of finance and resources at Action for Blind People and chair of the Charity Panel at CIPFA (the Chartered Institute of Public Finance and Accountancy). "True, most do now have a dedicated charities unit but they're dealing with the big charities who they treat just like big businesses."

A number of the high street banks, particularly, perhaps, the Co-operative, would vehemently disagree with this view, but the fact remains that most banks almost always have to assess charities in the same way as they would any small business. That may mean that for some charities looking to borrow small amounts of capital money cheaply, the specialist banks dedicated to the not-for-profit sector, like Charity Bank, CAF Bank and Unity Trust are more likely to be able and willing to help. "Many charities come to us for advice and finance having been turned away at the first approach by the high street bank," says Nigel Price, relationship manager at Unity Trust Bank. "Frontline high street bank managers are incredibly busy these days and charities still don't feature high up on their priority list." The major disadvantage of working with a specialist banks is the lack of branch infrastructure. A number of the smaller providers do now work with mainstream banks to provide access to their services through high street branch networks, but this is not always free of charge.

But the specialist banks do still need to act like banks, so charities may have to turn instead to agencies like the government's Futurebuilders scheme, which provides risk capital that covers risks a bank will not underwrite. It may also be able to help in instances where a bank is prepared to lend, but not quite to the extent required. "We've been involved in a number of investments where co-financing is involved," says Richard Gutch, chief executive of Futurebuilders England. "In those cases there may be a bank involved, but they only invest 70 per cent of the total amount needed and we come in with the remaining 30 per cent." (Similarly, Venturesome, part of the Charities Aid Foundation, offers loans that can be repaid through royalty or quasi-equity arrangements, and in some circumstances written off as if they were grants).

But charities using these services should never lose sight of their true circumstances, warns Harris, particularly if they are working on government contracts, where the sensibilities of the commercial and the third sectors now seem most likely to clash. "The government is very keen on charities providing public services, but charities will only step up to the mark if they think they're going to get proper funding, and anyone who is going to lend them money will only want to do so if they're going to get that money back," he says. "My fundamental objection to the model the government is proposing is that in effect they're saying

if only not-for-profits acted like the commercial sector then everything would be alright. That's not how the sector works. Very few organisations in this sector are solely contract-driven. If the government is expecting the charity sector to be like business and make returns on capital then that is a mistake. The sector can only work if there are donations. The vast majority of charities work on that basis, especially smaller charities."

For Harris, the worries surrounding the future of the CDFI sector highlight deeper problems connected to helping small organisations get started. "The major

difficulty most small bodies face is that they don't know where to go or who to go to to get the resources they need," he says. "Although there are lots of funders, most are over-subscribed and don't have the resources to look for the smaller start-ups. Local networks should be a much better point of information for those organisations, where they can find out what is available and from where."

Harris believes the ChangeUp programme could play a role in tackling this problem.

Malcolm Hayday, chief executive of Charity Bank, thinks it's important to maintain a sense of perspective on the present, but also the potential future value of the CDFIs to the charity sector. "The CDFIs are worth a tiny amount alongside the money in the sector as a whole, but it has the capacity to grow significantly," he says. "You could say that at the moment the CDFIs are only making a marginal contribution, but it's a growing contribution."

He remains confident that the sector has a future. "It is a developing market, and it is fragile, but it is here for the long term and I'm not worried that CDFIs are going to fall over in huge numbers."

The charities who need support from the CDFI sector, and the causes and communities they serve, will just have to hope he is right. "The banks will never ever move so far into this market as to replace the CDFIs," says McGeehan.

"So if the CDFIs fail to grow then those services will just not be available."

