

Comprehensive Ratings for CDFIs: The Return on Investment (ROI) of the CDFI Assessment and Ratings System (CARS™)

February 6, 2013

Organized by the Federal Reserve Bank of Richmond

Comprehensive Ratings for CDFIs: The ROI of CARS™

A Webinar Series for Community Development Financial Institutions (CDFIs)

Hosted by the Federal Reserve Bank of Richmond

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Welcome

Thank you to everyone for joining this session.

Jen Giovannitti

Regional Community Development Manager,
Federal Reserve Bank of Richmond



Legal Notices and Disclaimer

The information, analyses, and conclusions set forth are those of the presenters and do not necessarily indicate concurrence by the Board of Governors of the Federal Reserve System, the Federal Reserve Banks, or members of their staffs.



For today:

- This call is being recorded.
- An archived recording of this session will be available at http://www.richmondfed.org/conferences_and_events/community_development/2013/cars_webinar_20130206.cfm.
- Please direct your email questions to jen.giovannitti@rich.frb.org or click the Q&A button at the top of the Live Meeting toolbar. These questions may be part of the recorded archive for this session.

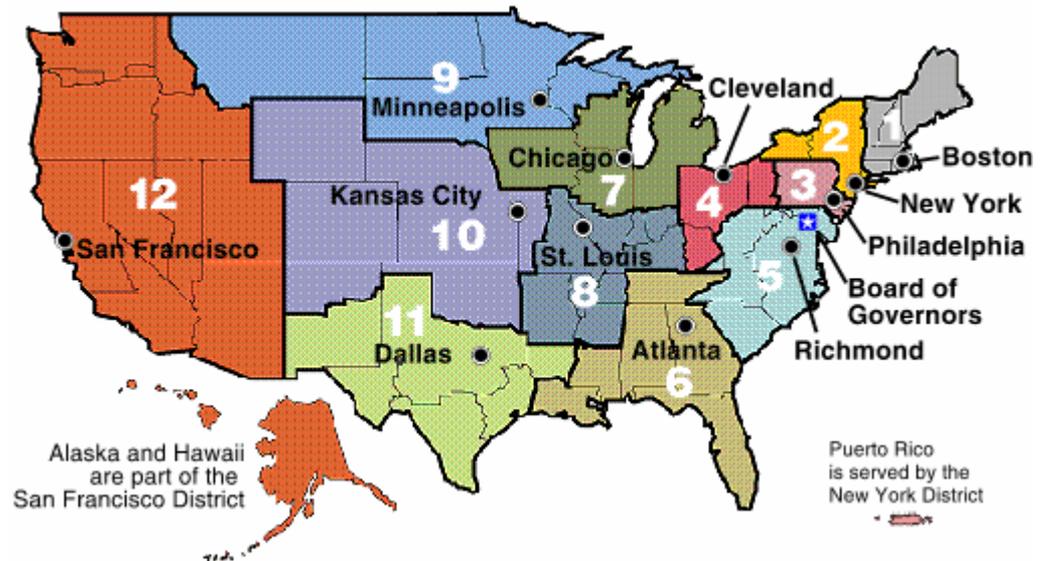


Community Development at the Federal Reserve Banks

In 1981, the Federal Reserve System established the Community Affairs program in each of the 12 Federal Reserve Banks.

The mission of the Community Development Department at the Federal Reserve Bank of Richmond is to support the economic growth objectives of the Federal Reserve Act by working with public and private partners to resolve credit and development issues in low-and moderate-income communities.

At the Richmond Bank, our department is called Community Development (CD).



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Introduction to the Topic

Why we chose CARS™ ratings for this webinar:

- Participant feedback indicated an interest in learning more about rating systems for CDFIs

The agenda for today's webinar:

- Basic background on CARS™ ratings and what you can expect from a third party assessment
- Information from CDFIs who have gone through the process and can share their perspective
- Thoughts from a foundation about whether having a CARS™ rating matters to them in making investment decisions



Today's Presenters

- **Tess Colby**, *Director of Ratings*, CARS™ Rating System
- **Clint Gwin**, *President*, Pathway Lending
- **Mary Mathews**, *President and CEO*, Entrepreneur Fund
- **Cecilia Walker**, *Director of Domestic Risk Management*, Calvert Foundation



What is a CARS™ Rating?

Tess Colby
Director of Ratings
CARS™ Rating System



What Is CARS™?

- An independent ratings and information service for CDFI investors
- Provides ratings and in-depth analyses of CDFI loan funds' social impact methodology and financial performance
- <http://www.carsratingsystem.net>



Who Does CARS™ Rate?

- CDFI loan funds with a minimum of five years of lending history
- Ratings currently are available for 75 institutions:
 - Manage almost 50 percent of all on-balance sheet assets
 - Range in size from \$1 million in assets to \$1 billion
- CARS™-rated CDFIs lead the field through their commitment to transparency and rigorous performance standards



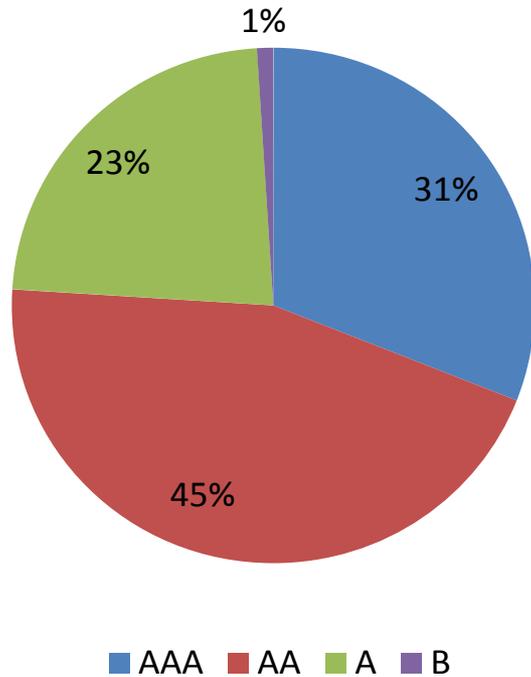
What Does CARS™ Rate?

- The impact performance rating measures how well a CDFI does what it says it's trying to do.
 - AAA (highest) to B (lowest)
 - Recognizes the role of policy change
- The financial strength and performance (FSP) rating assesses overall creditworthiness.
 - Based on a CAMEL analysis similar to the one regulators use for banks
 - 1 to 3 rating indicates “sound”
 - 4 or 5 rating indicates “vulnerability to changes in the operating environment”

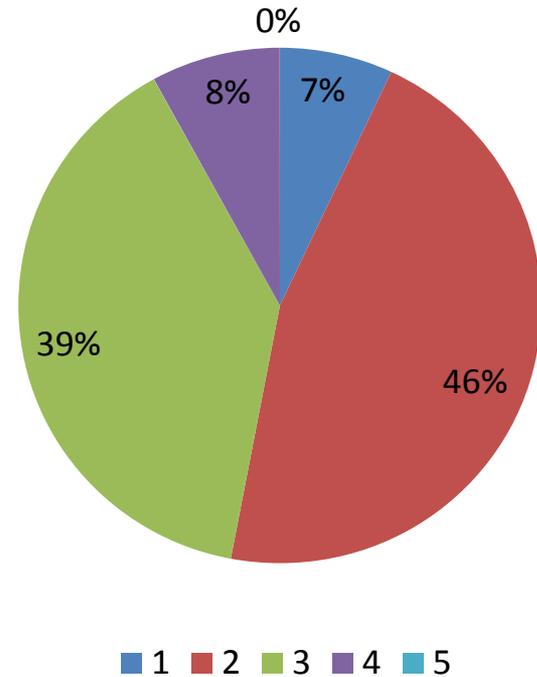


Current Ratings Distribution

Distribution of current impact performance ratings at December 31, 2012



Distribution of current FSP ratings at December 31, 2012



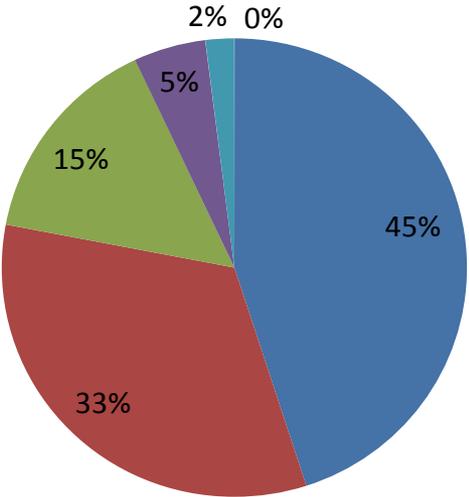
The Ratings Process

- We look at five years of audited operating history through the most recent quarter-end.
- We do NOT use benchmarks:
 - How does the individual CDFI's business model introduce risk?
 - How does that CDFI protect unsecured, general obligation lenders from that risk?
- There is a lengthy document request.
- Two analysts spend two days on-site interviewing management, reviewing loan files, etc.



CARS™ Subscribers

Entities that use CARS™



- Financial institutions
- Foundations
- Socially responsible investment/Religious
- Government
- Other
- Insurance-related

- Financial institutions and foundations are the primary users.
- Federal and state agencies have begun to use CARS™.
- Several CDFIs are now subscribers.

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Which CDFIs Are Rated?

RATED CDFIs

(Ratings & analyses currently available)

[ACCION Texas-Louisiana](#)
[Baltimore Community Lending](#)
[Boston Community Capital](#)
[Business Carolina Inc.](#)
[Century Housing Corporation](#)
[Chicago Community Loan Fund](#)
[Citizen Potawatomi CDC](#)
[Clearinghouse CDFI](#)
[Coastal Enterprises, Inc.](#)
[Community Economic Development Assistance Corporation](#)
[Community First Fund](#)
[Community Housing Capital](#)
[Community Reinvestment Fund](#)



- Rated CDFIs on CARSRTM Inc. Website:
 - <http://www.carsratingssystem.net/ratings/ratedCDFIs.asp>

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What's Next?

- Increase the number of rated CDFIs.
- Automated data collection platform:
 - Participating CDFIs will be able to easily upload quarterly financial reports and other funder-requested documents.
 - A Web-based query system will mine the data, providing access to analytic tools that facilitate trend analysis and peer comparisons.



For More Information

- CARS™ Inc. Web Site
<http://www.carsratingsystem.net/>
- CARS™ On The Road
[http://www.carsratingsystem.net/pdfs/CARS OntheRoad Edition6.pdf](http://www.carsratingsystem.net/pdfs/CARS%20OntheRoad%20Edition6.pdf)
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The CDFI Perspective: What Is the ROI of CARSTM?

Clint Gwin

President
Pathway Lending



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Pathway Lending

- Reasons for getting a CARS™ rating:
 - Provide board of directors an independent analysis of organization
 - Provide management team with objective data on performance:
 - Identify strengths and weaknesses
 - Identify policy and procedure improvement
 - Increase organization's credibility in the market place
 - Provide lenders with another source of due diligence



Pathway Lending (continued)

- Results from getting a CARS™ rating:
 - Board of directors realized we were doing pretty well, which provided management team with additional credibility.
 - Management team was able to identify strengths and weaknesses in operations and to make changes to improve operational performance.
 - Can now tell others both in our industry and outside our industry that we subjected ourselves to additional reviews to gain additional credibility.
 - Some lenders have used the CARS™ reports to initiate underwriting.



Pathway Lending (continued)

- Things expected from a CARS™ rating that we did not get:
 - Board of directors expected more specific recommendations for areas of improvement and how to improve (i.e., what others in the industry are doing in areas of weakness that we could implement).
 - Expected we would have access to peer data to see how we compared to other similar organizations (coming in 2013).
 - Expected that CARS™ could take the place of providing potential lenders with full due diligence packages.
 - Expected CARS™ would increase funding more quickly than it has.



The CDFI Perspective: What Is the ROI of CARSTM?

Mary Mathews

President and CEO
Entrepreneur Fund



Entrepreneur Fund

- We are a small, rural Minnesota CDFI; a small business lender.
- Reasons for getting CARS™ rating:
 - In 2010, I was the Opportunity Finance Network Board Chair. All other board members' CDFIs were rated.
 - It was the worst time in our history for a financial performance review, yet we went ahead knowing CARS™ would provide a thorough review of our systems, management, and processes.
 - We hoped it would help raise capital.



Entrepreneur Fund (continued)

- What happened?
 - Thorough review of loan fund and systems, with a road map for changes
 - Reality check on our financial condition
 - Financial performance rating (4) expected
 - AA Impact rating and Policy “+” affirming
 - Raised money, improved systems and loan processes
 - Second annual review: improving performance
 - Re-rating scheduled for November 2013



Entrepreneur Fund (continued)

- Benefits of CARS™ rating:
 - We have three applications for Equity Equivalent Investments (EQ2s) pending with banks that are CARS™ subscribers.
 - From investors, we hear that the rating process is more important than the final rating.
 - As loan funds get larger, investors will ask for greater transparency to build and maintain confidence.
 - We are building a body of industry experience and data.



Do Third Party Assessments Matter to Investors?

Cecilia Walker

Director of Domestic Risk Management
Calvert Foundation



Calvert Foundation: Who We Are

- We are a non-profit and certified CDFI (not an endowed foundation).
- Through our community investment note, we enable investors to invest in improving underserved communities around the world.
- The capital raised through our notes goes to providing CDFIs and other social enterprises with affordable, flexible financing.
- We invest in CDFIs.
- We are a full CARS™ subscriber.
- We use CARS™ to supplement our due diligence process.
- We have undergone third party assessments for potential investors.

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Third Party Assessments

- Provide an independent assessment of an organization's financial condition and programmatic focus
- Capture non-financial capabilities and proficiencies
- Address social impact and mission attainment
- May include action plan to achieve best practices
- Provide transparency into an organization's performance



Do Third Party Assessments Matter to Investors?

- Yes, they do because:
 - Socially responsible investors are looking for confidence in the CDFI industry
 - Third party assessments dispel the myth of high risk and expose the safety/soundness in the industry
 - Third party assessments apply “conventional” standards to the review of CDFIs
 - Third party assessments result in an unbiased look at processes, systems, technology, staffing, strategy, governance, and financial condition



Do Third Party Assessments Matter to Investors? (continued)

- Yes, because third party assessments have the potential to generate:
 - Investor confidence in the organization and the industry
 - A realistic view of organizational strengths and weaknesses
 - Critical assessment of an organization's capital structure
 - A deep dive into an organization's portfolio strategy and loan fund performance
 - An action plan for continued organizational improvement
 - Thoughtful review of management strength and plan for succession



Investor Expectations

- Supplemental to existing due diligence
- Deeper review of financial strength
- Explanation of unique strategies or goals
- Thorough assessment of mission objectives, strategic initiatives
- Expert knowledge of the assessor provides additional comfort to the investor



Calvert Foundation Experience

- Calvert Foundation has used third party assessments.
- Calvert Foundation has undergone third party assessments.
- It has been an invaluable experience that provides useful information for future growth and development.
- It provided an additional, supplemental tool to aid in making an informed investment decision.
- We expect to continue to utilize third party assessments in the due diligence process as appropriate.
- We anticipate future third party assessments will be conducted by potential investors and industry stakeholders.



Do you have questions?

E-mail us at:

jen.giovannitti@rich.frb.org



Wrap-up/Closing

Thank you to today's presenters and to all participants for joining this session.

Next steps:

- All session materials are available on our web site and in the next few days including a recording of this session.
- If you have topical suggestions for future sessions, or any questions about this program, please feel free to contact us at jen.giovannitti@rich.frb.org
- Information about future sessions will be posted on our website along with archived materials from past sessions:
http://www.richmondfed.org/conferences_and_events/community_development/

