

## Nonprofit Notes

# The Future of Your CDFI Depends on Tackling Three Emerging Issues: Funding, Impact and Innovation

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The mission of Community Development Financial Institutions (CDFIs) is to support underserved communities that do not have access to funding on their own. It is vital for CDFIs to increase capital to continue serving low-income communities and fulfill their missions.

While the mission of a CDFI remains unchanged, its sources of funding, methods of measuring community impact and use of new technologies to innovate have now all shifted — forcing CDFI leaders to evolve and adapt to ensure longevity.

As a CDFI leader, being aware of and developing a plan to tackle these emerging issues will help the future of your organization. Knowing what you can do to access more capital, report measurable impact, work with technology and address the needs of your communities to expand funding in the upcoming years is crucial to your mission.

Following our three recommendations below will help:

### 1. Funding: Attract New Capital and Optimize Your Portfolio

Without consistent and reliable funding, it will be difficult for your CDFI to achieve its goals. Understanding the environment surrounding funding is, therefore, more important than ever. While there was previously strong investment by funders in CDFI organizations in response to COVID-pandemic recovery efforts, this funding has proven temporary. As pandemic-related awards continue to close out, the funds are likely to go with them.

While the problem for the future is not exactly less capital, it is a change in funding itself. If you have relied on a single government award as a funding source in the past, you may consider pivoting to obtain debt capital from a variety of lending institutions and a broader mix of investors. Our professionals can assist you in evaluating the more complex debt covenants and higher capital costs that may come with these funding options.

- **Find New Funding Opportunities:** Programs from government sources have also played a role in the evolved funding challenges. With changes in legislation and budget cuts, certain government agencies that once offered CDFI awards no longer have the budget to do so. However, this has been offset by a big push to help revitalize rural America. More government agencies are now offering awards and programs for CDFIs to help rural America — which may present new funding options for your CDFI.
- **Leverage Loans to Release Balance Sheet Capital:** Lastly, there has been a large increase in the volume of loans sold by CDFIs to secondary markets. This gives a CDFI the flexibility to free up balance sheet capital to offer more loans and financial support to the communities they serve. It is also a way for your CDFI to increase cash flow without obtaining additional funding sources.

## 2. Demonstrate Value: Measure Community Impact and Funder Expectations

Funders look for measurable impacts to give them a reason to help and get involved with a CDFI. As banks, investment funds, corporations, private foundations and even government agencies become more selective, you must work toward diversifying metrics and clearly demonstrating community outcomes. The ability to show where capital is going and who it is impacting can help retain and attract funders. Steps that can be taken by your CDFI include:

- **Improve Data Quality:** With today's rapidly evolving technology, it is key for your CDFI to continue to evaluate how it measures community impact and whether there are new processes/systems that could increase effectiveness, such as impact-specific customer relationship management (CRM) tools. These systems will allow your CDFI to shift from basic databases to more specialized platforms to automate the collection of social and environmental outcomes.
- **Survey Your Borrowers:** Another area where your CDFI can rapidly and effectively demonstrate community impact is by using automated borrower surveys. Mobile-friendly surveys can provide your CDFI with the ability to gather rapid, untampered feedback directly from end beneficiaries, such as microloan recipients. CDFIs that leverage these tools are able to obtain metrics related to business growth, jobs creation, housing stability, neighborhood development and financial inclusion to truly understand the impact of their investments on the communities they serve.

Future access to funding will depend on your ability to demonstrate measurable community outcome along with financial performance.

## 3. Innovate: Use New Technologies (AI, Alternative Data) and Adopt Inclusive Financing

As expectations grow, technology can assist in meeting these new expanding financial needs in underserved communities. Most CDFIs will continue to follow a traditional route as outlined above, but the expansion of AI can assist rather than take over. Key benefits are efficiency, early identification of issues and identifying underserved communities. These ideas can open a world of opportunities for your CDFI.

- **Strengthen Your Underwriting Process:** Implementation of AI can provide efficiency in the underwriting process, monthly reporting (internal and external), and regular day-to-day operations. Using AI, CDFIs will be able to analyze larger quantities of data for an underserved community and assist those borrowers with financial needs, which your CDFI might not have recognized previously. AI can also streamline the underwriting process for messy commercial and small business data.
- **Evaluate Thin and Nontraditional Credit Files:** AI may help loan officers evaluate applicants with thin credit files or nontraditional financial documentation. Traditional credit metrics may not fully reflect an applicant's financial circumstances. When implemented with appropriate governance and fair-lending safeguards, specialized platforms can help loan officers consider a broader range of relevant information and identify applications that may warrant further review.
- **Supplement Financial Data:** For small business and entrepreneurial lending, CDFIs may face difficulties obtaining the financial sheets required during the lending application process. Documents may be handwritten, incomplete or messy. AI can help your loan officers gather and analyze these types of documents.

Overall, AI can assist in handling the heavy lifting of the underwriting process by analyzing incomplete or messy documents, flagging potential irregularities or fraud patterns and calculating risk tiers. Once the heavy lifting is done, your staff can complete the overall analysis with the information provided. Loan officers will have everything they need in order to generate the standardized credit memos for applicants.

As technology continues to grow and emerge, the balance between equitable lending and innovation is more important than ever.

## We Can Help You Move Forward

It's critical for your CDFI to modernize its tools and strategies to secure funding, prove your impact and ensure the future of local lending. Each of these connected components plays a key role in the development of your community funding. In order to secure funding and attract a variety of investors, your CDFI must demonstrate innovative ideas and expand along with the growing environment. [Our professionals](#) can help you do that.

## Contact Us

For questions about advancing your CDFI to greater efficiency and impact, please contact your PKF O'Connor Davies client service team or:

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