

Surviving the Recession: How Microlenders are Coping with Changing Demand, Risk and Funding

The recession and financial crisis have created dramatically different market conditions for microlending organizations. These conditions – a weaker economy, a highly stressed private financial sector, donors and investors with weaker endowments or corporate profits – have affected microlenders in varying ways. They affect existing borrowers, whose businesses may face declining sales. They have altered the profile of potential borrowers: lenders may see businesses that were formerly able to access financing from banks that have tightened their lending, as well as new entrepreneurs looking to supplement or replace wage income. And, they affect microlenders’ budgets, as many donors and investors have fewer resources.

As is always the case with change, these new conditions create both opportunities and challenges for microlenders. Opportunities lie in the potential to expand core lending activities by serving new types of customers, and in growing loan capital with increased Federal funding that seeks to combat the recession. But, these opportunities are tempered by challenges, as existing borrowers are stressed, and non-Federal donors and investors have fewer resources.

Data available through FIELD’s periodic field-wide survey, its annual MicroTest data collection program, and the Opportunity Finance Network’s quarterly Market Conditions Survey illustrates the complex forces that microlenders must navigate. This Trendlines fact sheet, the first in FIELD’s series of publications highlighting data from MicroTest and other key sources of data on the U.S. microenterprise industry, presents data in key areas of loan demand, portfolio quality, and funding and capital availability.

Box 1: Data Sources

Over its history, FIELD has conducted periodic surveys of the microenterprise industry, aimed at documenting the scope and breadth of the U.S. microenterprise development community. FIELD has recently published findings from a survey that collected data on program activities in fiscal year 2008; the most recent prior survey documented activities in fiscal year 2002. MicroTest is FIELD’s performance measurement system for microenterprise organizations. Member programs can report annually on a set of common measures of key areas of performance, including: scale, target groups, credit program effectiveness, training program effectiveness, costs and sustainability. This fact sheet examines data from MicroTest on measures that relate to demand, risk and funding for the years 2005 to 2008 – the years just preceding the recession, and reflecting the first year of the downturn. Both the MicroTest and field-wide survey data presented in the fact sheet are longitudinal data, meaning that the findings are for a set of programs that reported data in each of the years examined in the analysis. *(Continued on next page)*

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The Opportunity Finance Network (OFN) launched its Market Conditions Survey in mid-2008, as the impact of the recession was becoming clear. The survey collects information demand, risk, and capital availability on a quarterly basis from Community Development Financial Institutions (CDFIs) of all types. Beginning in the fourth quarter of 2008, OFN began to segment its findings for CDFIs whose primary area of financing activity was microenterprise lending. This fact sheet includes data from OFN's Market Conditions Survey from quarter four of 2008 through quarter one of 2010.

The institutions responding to the survey varied from quarter to quarter; as a result, the OFN survey findings are "snapshot" data. In addition, FIELD surveyed registrants for one of its recent Webinars regarding their experiences with changing demand and lending activity. This simple survey asked respondents to compare their experiences in 2009 to that in 2008.

Trends in Demand

FIELD's field-wide survey collects data on three measures that can help create a picture of loan demand:

- the number of loans disbursed in a year;
- the volume of loans disbursed in a year; and
- the dollar value of loans outstanding at year end.

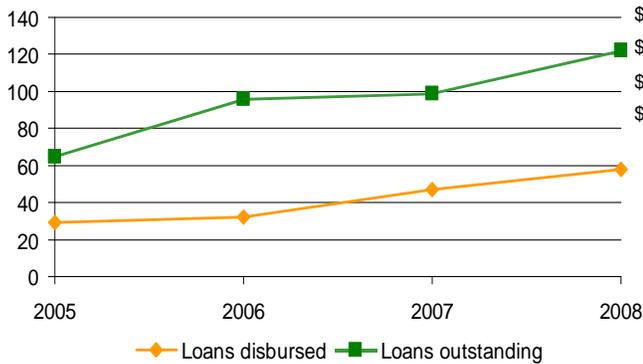
The annual MicroTest performance data process collects these three measures, along with a fourth: the number of loans outstanding at year end.

In both cases, longitudinal data show that the period leading to the recession was a time of overall growth in lending activity in the microenterprise field. The largest body of data is from the field-wide survey. Among 57 lenders who reported data in both 2002 and 2008, the median number of loans disbursed increased from 25 to 32. Fifty-nine lenders reported the value of loans disbursed in both years; the median for this group increased from \$221,048 to \$349,900. Total outstanding loans at year-end also increased among this group, with the median value among 53 reporting lenders growing from \$448,800 to \$533,565.¹

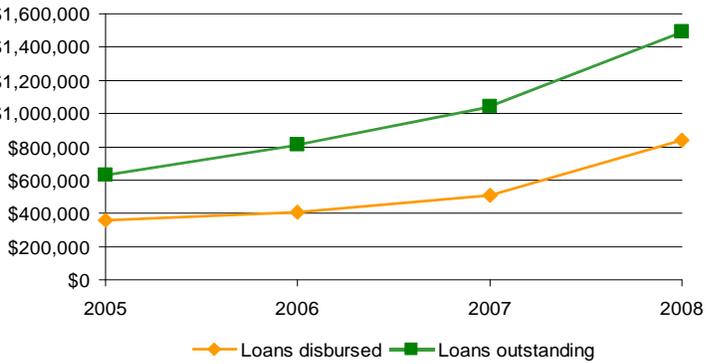
Longitudinal data for 15 lenders that reported to MicroTest each year between 2005 and 2008 show that demand for this group of lenders – as experienced by growth in their lending activity – grew steadily. In fact, median data on each of these four measures at least doubled over the period (see Figures 1 and 2).

¹ In aggregate, the number of loans disbursed increased by 21 percent (n=57), the dollar value of loans disbursed increased by 68 percent (n=59) and outstanding loans increased by 45 percent (n = 53).

**Figure 1: Median Number of Loans
Longitudinal Data from MicroTest
2005-2008
N=15**



**Figure 2: Median Volume of Loans
Longitudinal Data from MicroTest
2005-2008
N=15**



Notably, the lending activity of this group of MicroTest “longitudinal” lenders is significantly larger on a median basis than the larger number of lenders for which FIELD has longitudinal data from the field-wide survey. In fact, as Table 1 indicates, in 2008 both the median number of loans and the median dollar volume of loans made by the 15 lenders in the MicroTest longitudinal group were almost five times as great as those for the field-wide survey group. Furthermore, at year-end the median dollar volume of outstanding loans for the MicroTest longitudinal group was more than five times that of the field-wide survey group. Despite the differences in scale among these two groups, however, the trend is consistent: that in the years leading up to, and through the first months of the recession, the microenterprise field was experiencing gradual growth in demand, as measured by increasing lending activity.

Table 1: Microlending Activity in 2008

Lending Activity in 2008 (median values)	# of loans disbursed	\$ volume of loans disbursed	\$ value of outstanding loans
MicroTest longitudinal group (n-15)	58	\$841,764	\$1,493,793
Field-wide survey respondents (number of programs reporting)	12	\$178,471	\$284,736
	122	119	154

The OFN Market Conditions Survey provides data on a small set of microlenders starting just about when FIELD’s MicroTest and field-wide survey data leave off – in the fourth quarter of 2008. These data show that, for these lenders, the demand for microloans has grown substantially since the beginning of the recession. The OFN study asks responding lenders to indicate whether the number of applications and originations has increased over the previous quarter, and asks whether they anticipate that demand will increase in the next quarter. As Table 2 indicates, in four of the five quarters between Q4

2008 and Q1 2010, a strong majority of responding lenders indicated that they experienced an increase in loan applications. In each quarter, at least half of lenders – and in most cases substantially more – also indicated they expected the demand for financing to increase in the coming quarter.

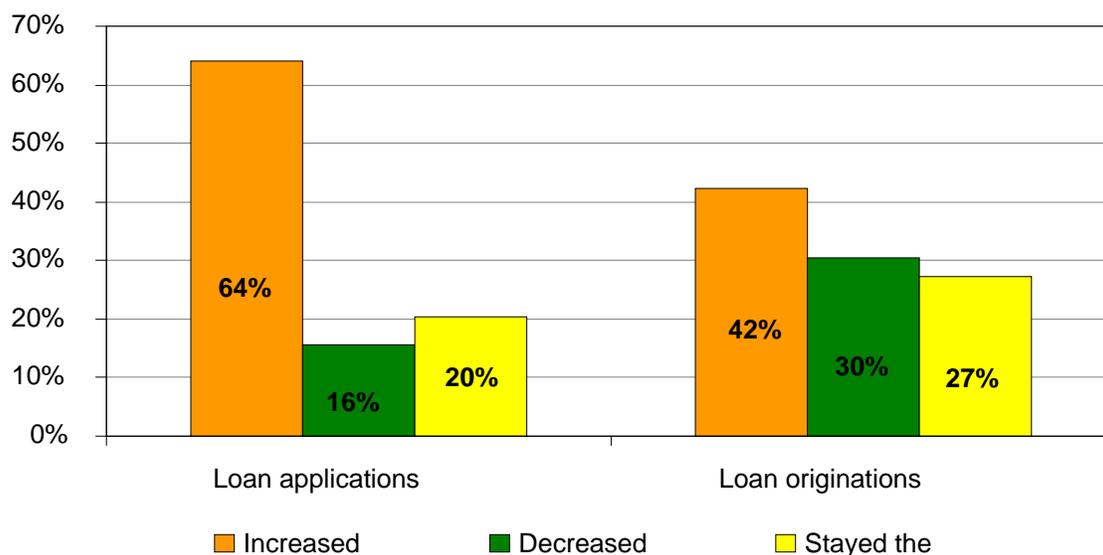
Table 2: Applications, Originations, and Expected Demand Quarter 4 2008 through Quarter 1 2010						
Increasing:	Q4 2008 (n=22)	Q1 2009 (n=11)	Q2 2009 (n=20)	Q3 2009 (n=13)	Q4 2009 (n=16)	Q1 2010 (n=18)
Applications	77%	73%	80%	69%	44%	61%
Originations	67% (n=21)	42% (n=12)	50%	62%	31%	50%
Expected Demand for Financing	78%	85%	71%	77%	50% (n=14)	62% (n=13)

Source: OFN, *CDFI Market Conditions Report, First Quarter 2010 (June 2010)*

Although the OFN survey results find that applications are up, new originations have not kept pace. In each of the five quarters for which data are available, the percentage of organizations reporting increases in originations has lagged that reporting increases in applications – in some quarters by a significant amount. Other data from the survey shed light on the reasons why loans are not growing as rapidly as applications. In some cases, microlenders lack the capacity to process the growing number of applications. In others, lenders are being forced by growing risk in their existing portfolio – as discussed below – to divert staff resources from underwriting to collections.

A survey conducted by FIELD, of registrants for a Webinar on the topic of this fact sheet, similarly found that increases in applications to microlenders outpaced increases in originations. Figure 3 below presents the results from survey questions that asked respondents to compare their numbers of applications received and loans originated in 2009 to 2008.

Figure 3: Microlenders' Experiences with Changing Demand, 2009 Relative to 2008
N=128 applications; 125 originations



Trends in Risk

Growing risk in microloan portfolios is a second critical dynamic faced by microlenders in the current economy. Data from both MicroTest and the OFN Market Conditions Survey shows that portfolio risk has grown, although this trend may be moderating as lenders have tightened practices and procedures.

MicroTest collects data on three measures of portfolio quality: portfolio at risk, restructured loan rate, and loan loss rate.² The first two measures identify the level of risk in the portfolio due, respectively, to loans that are past due on their payments, and loans that have been restructured due to past repayment problems.³ The loan loss rate examines the percent of loans written off over the course of the year.⁴

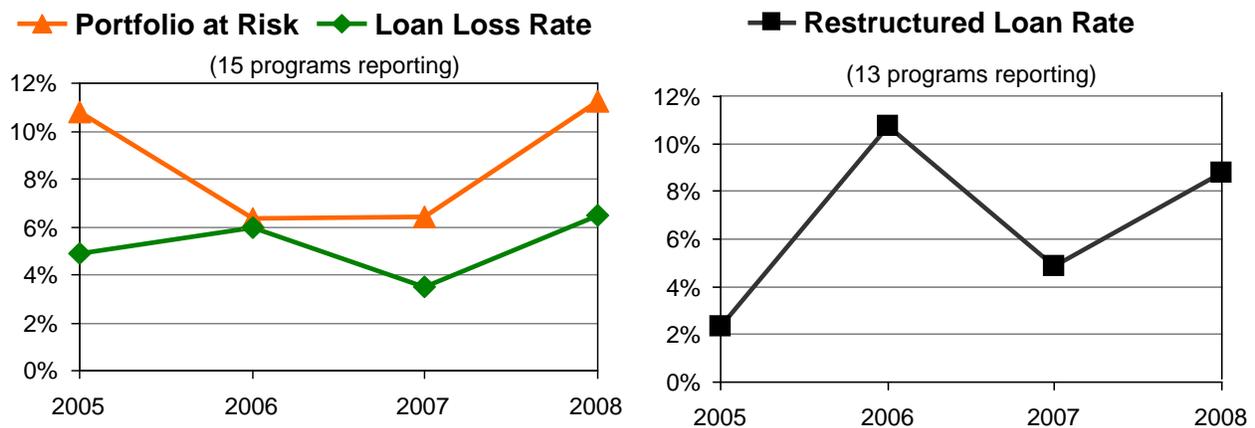
² Because of the time required to obtain consistent data across institutions on measures of delinquency and loan loss, FIELD's field-wide survey does not attempt to collect data on these measures.

³ Portfolio at risk is defined as: outstanding balance of all loans with payments >30 days past due/total outstanding portfolio. Restructured loan rate is defined as: outstanding balance of all loans that have been restructured due to past payment problems/total outstanding portfolio.

⁴ Loan loss rate is defined as total charge-offs net of recoveries/average outstanding portfolio.

In 2008, MicroTest data for the longitudinal group of 15 programs show elevated levels of risk. As Figure 4 indicates, median portfolio at risk was 11.2 percent and the loan loss rate was 6.5 percent – the highest levels of each over the four-year period. The restructured loan rate at year-end was 8.8 percent, the second-highest level over the period.

Figure 4: Portfolio Quality, 2005-2008 (longitudinal)



Median data from MicroTest

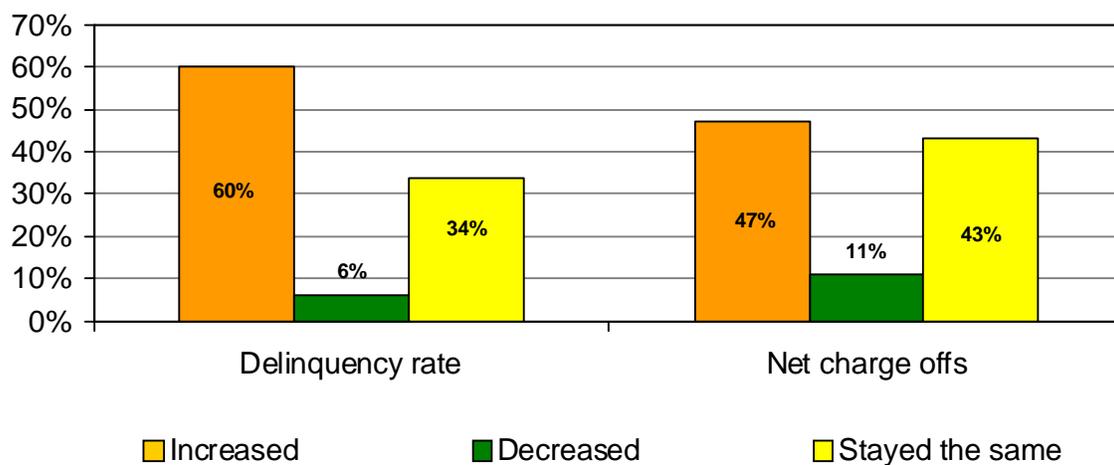
OFN’s Market Conditions Survey also provides evidence that microlenders are struggling with portfolio quality. Average portfolio at risk for 12 lenders responding to the survey in Q4 2009 was 13.2 percent, while the loan loss rate was 3.5 percent. And as Table 3 indicates, over the period of the recession, high percentages of microlenders have reported increasing levels of delinquency, workouts and loan extensions, and that they have been increasing their loan loss reserve ratios.

Table 3: Portfolio Quality Quarter 4 2008 – Quarter 1 2010						
Increased:	Q4 2008 (n=22)	Q1 2009 (n=12)	Q2 2009 (n=20)	Q3 2009 (n=13)	Q4 2009 (n=16)	Q1 2010 (n=18)
Delinquency	50%	50%	45%	62%	44%	33%
Workouts	68%	58%	45%	62%	69%	44%
Loan Extensions	73%	58%	65%	46%	31%	33%
Loan loss reserve ratio	41%	67%	40%	46%	33% (n=15)	35% (n=17)

Source: OFN, CDFI Market Conditions Report, First Quarter 2010 (June 2010)

Once again, data obtained from FIELD Webinar registrants also show evidence of growing portfolio quality challenges in 2009. As Figure 6 illustrates, a significant majority of lenders noted that their portfolio quality in 2009 deteriorated relative to 2008.

Figure 6: Microlenders' Experiences with Portfolio Quality in 2009, Compared to 2008
 N=126 (delinquency rate), 129 (net charge-offs)



Trends in Funding

The availability of funding for both capital and operations is critical to a lender's ability to grow. Prior to the recession, the longitudinal groups of lenders from both the field-wide survey and MicroTest experienced growth in both their microloan capital and their operating budgets.

Among 43 lenders who reported data on their total microloan capital through the field-wide survey in both 2002 and 2008, the median increased from \$598,400 to \$1 million. Aggregate microloan capital increased by 85 percent. Thirty-nine of the lenders submitted data that allowed for the calculation of the percent of their capital deployed in loans to microenterprises. In 2002, the programs had a median deployment rate of 63 percent. In 2008, the median deployment rate for this group of lenders had increased to 71 percent. Median operating budgets of microlenders also increased between 2002 and 2008, with the median budget among 54 reporting lenders growing from \$411,449 in 2002 to \$556,078 in 2008 (all figures in 2008 dollars).

The 15 MicroTest lenders that reported data from 2005 through 2008 showed even more rapid rates of growth. The median dollar value of the capital pools of these microlenders doubled between 2005 and 2008 to just under \$1.6 million. Their ability to deploy their

loan capital also grew over the period, as the median percentage of their total loan capital deployed as loans grew from 55 percent to over 71 percent. Median operating revenues for their microenterprise activities also grew fairly steadily over the period to \$729,000. These trends in funding and deployment reflect the abovementioned fact that the portfolios of these lenders grew rapidly during these years.

Figure 7: Median Microloan Capital, 2005-2008
Longitudinal data from MicroTest
N=12

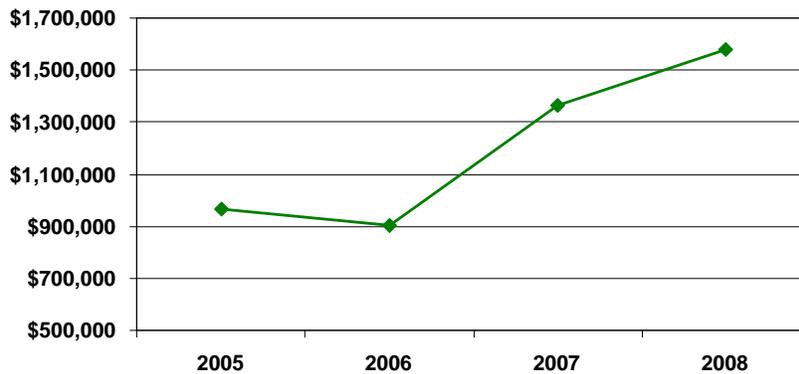


Figure 8: Median Microloan Capital Deployment, 2005-2008
Longitudinal data from MicroTest
N=12

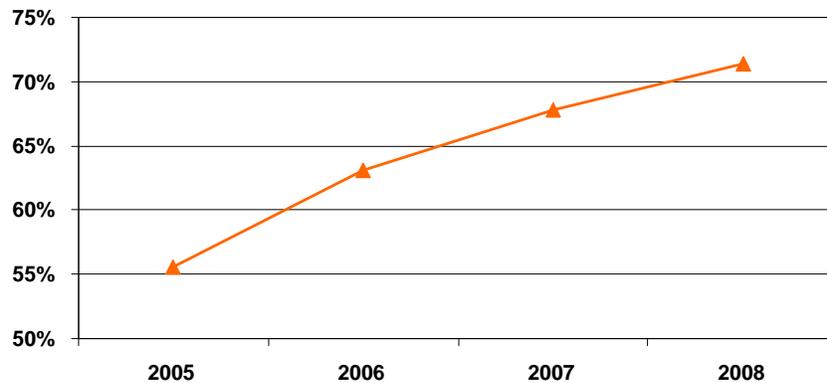
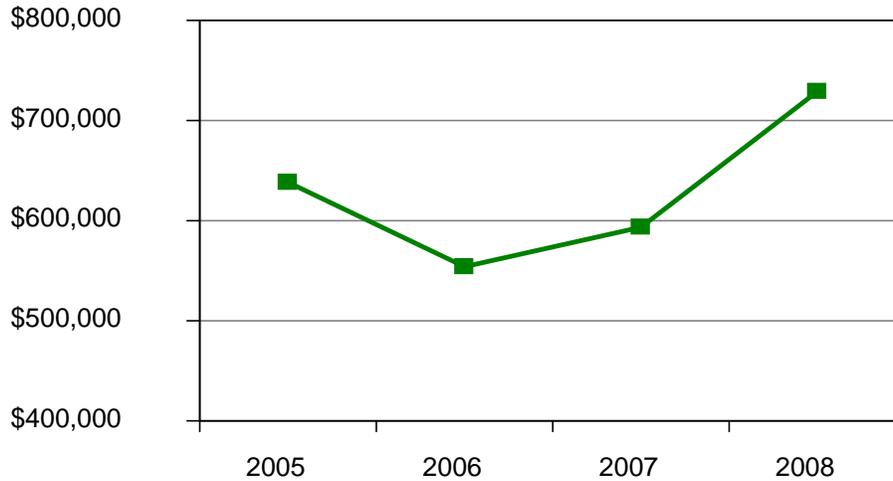


Figure 9: Median Microenterprise Program Revenue, 2005–2008
 Longitudinal data from MicroTest
 N=12



Although the years leading up to 2008 showed positive trends of growth in funding and capitalization, the OFN Market Conditions Survey indicates that the recession and financial crisis have placed financial constraints on microlenders. As Table 4 below indicates, in each quarter between the fourth quarter of 2008 and the fourth quarter of 2009, between 38 and 50 percent of microlenders reported that they faced debt and/or equity constraints. Somewhat smaller percentages – but typically one-quarter or more – of responding lenders reported having difficulty in accessing capital or in capital liquidity. Data from the first quarter of 2010 suggest that fewer microlenders are facing such constraints at present.

Table 4: Capital Access, Liquidity and Capital Constraints for Microlenders						
Quarter 4 2008 through Quarter 1 2010						
	Q4 2008	Q1 2009	Q2 2009	Q3 2009	Q4 2009	Q1 2010
Decreased:						
Ability to access capital	32% (n=19)	13% (n=8)	27% (n=15)	25% (n=8)	30% (n=10)	7% (n=15)
Capital liquidity	45% (n=22)	25% (n=12)	55% (n=20)	23% (n=13)	25% (n=16)	24% (n=17)
Increased:						
Debt and/or equity constraint	41% (n=22)	50% (n=12)	45% (n=20)	38% (n=13)	50% (n=16)	17% (n=18)

Source: OFN, *CDFI Market Conditions Report, First Quarter 2010 (June 2010)*

Conclusion

The data that are available illustrate the challenges that current market conditions are presenting to U.S. microlenders. Loan applications increased, yet many lenders have found it hard to fully meet the increased demand. This may be partly due to the fact that, although microlenders generally experienced growth in the years prior to the recession, most remained fairly small when measured in terms of their lending activity, available loan capital and operating revenues. The small scale of many lenders likely inhibited their ability to take on large numbers of new loans.

The decline in portfolio quality that accompanied the recession also affected the ability of lenders to respond to increasing demand. Levels of delinquency, loan loss, restructurings, workouts, and term extensions all increased over the period between 2008 and 2009, although that trend may be beginning to moderate. The need for lenders to focus staff on portfolio monitoring and collections, rather than originations, also affected their ability to respond to growing demand.

Finally, the increase in demand came at a time when most funding sources – including foundations, corporations and state government – were retrenching due to falling endowments and revenues. In the early stages of the recession, this likely affected the ability of lenders to secure new capital. More recently, increased levels of Federal funding – in particular through the U.S. Small Business Administration Microloan Program and the CDFI Fund – appear to have eased the capital constraints facing at least some lenders. However, the question remains as to whether microlenders will be able to secure the operational dollars that are necessary to build the capacity to deploy more loan capital.

For More Information

For more information regarding market conditions and their effect on microlending, see the following resources:

- Trends in Demand, Risk and Funding: Market Conditions for Microlending, FIELD Webinar, March 2010.
- Managing Your Microlending in a Challenging Environment, FIELD Webinar, March 2010.
- *CDFI Market Conditions Report, First Quarter 2010 (June 2010)*, <http://www.opportunityfinance.net/store/product.asp?pID=176>
- Field-Wide Survey Data Highlights FY2009 Data, <http://fieldus.org/Publications/HighlightsFY2008.pdf>
- MicroTest FY2008 Program Performance Data Overview, <http://fieldus.org/MicroTest/FY08PerformanceOverview.pdf>