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POLICY BRIEF: Advancing Economic Opportunity in New York City — The Role of Credit Unions, Community Banks and CDFIs

BACKGROUND

Economic insecurity and income volatility impact far too many City residents. Credit unions, community banks and Community Development Financial Institutions (CDFIs) exist throughout the City and play an important role in addressing these problems. This Policy Brief presents information on the role of these community financial institutions and recommendations for how New York City can advance economic opportunity in this important area.

INCOME VOLATILITY & HIGH-COST CREDIT

According to Pew Charitable Trusts (Pew), i**ncome volatility** is defined as **short-term fluctuations in income** that deviate by 25 percent or more from a household's yearly base rate.[i] Such income fluctuations make it difficult for families to plan, pay regular expenses, save, or pay down debt.

Income volatility is a problem that disproportionately affects households with hourly and monthly wage-earners, those with multiple part-time jobs, and those with variable expenses, making it hard for these households to plan their budgets in the short-term or to maintain their current standard of living in the long-term.

In addition to income volatility, these often economically insecure consumers face challenges such as low wages and no savings, which can lead to low or bad credit. This may disqualify them from loans and financial services in traditional banks.

These households often resort to **high-cost small credit** options (e.g., payday loans, auto title loans, subprime installments, pawn shops, rent-to-own, overdrafts) as a stopgap measure. Pew estimates that affected households nationwide pay in excess of **$40 billion dollars in fees and interest payments** annually for these services.

According to an FDIC survey, seven percent of households are completely unbanked[ii] and another 20 percent use alternative financial services in addition to traditional bank accounts.

In New York City, high-cost small credit options frequently take the form of overdraft and rent-to-own fees:

- Low-income people pay the bulk of overdraft fees with eight percent of consumers paying 74 percent of all overdraft fees (i.e., fees imposed when consumers overdraw their bank account). These eight percent of consumers pay an average of $380 annually in overdraft fees (an average of $75/transaction).
- Nationally, five billion dollars is spent annually on rent-to-own loans (rent-to-own or "rental-purchase" involves leasing big ticket consumer items in exchange for a weekly or monthly payment, with the option of purchasing the items at some point).

NEW YORK CITY FINANCIAL INSECURITY

The Federal Reserve Bank of New York's Regional Household Debt and Credit Snapshot, documents borrowing and indebtedness trends across the country. It includes data about mortgages, student loans, credit cards, auto loans, home equity lines of credit (HELOC), and delinquencies.

The Snapshot for New York City **reveals extensive neighborhood variation when it comes to credit-worthiness** and access to credit by traditional financial institutions—with a much lower percentage of residents from the **Bronx** and from **central Brooklyn** able to borrow than residents from elsewhere in the City (or in the rest of the country). (See Table on page 5)

The US Financial Diaries project tracked 235 low- and moderate-income households over the course of a year to collect highly detailed data on how families manage their finances on a day-to-day basis.[iii] The project's sample was nationwide, with 75 families coming from the New York City area. The **main findings** include:

- **Wages are stagnant**, especially outside of urban areas.
- **Incomes tend to be volatile**, with many middle class families earning incomes below their annual mean for as many as five months out of the year, and with some of these families experiencing periods of poverty that are hidden because it averages into their annual incomes.
- **Liquidity "emergencies"** are frequent enough in the lives of some of these families that they **opt for jobs with lower pay and longer commute times** as a tradeoff for greater income stability.
- Many of these families **do have bank accounts and are financially literate**.
- **Traditional concepts of a stable financial path have become obsolete**, as have assumptions of a straight though precarious tightrope to be traversed. Rather, household finances for many of these households have turned into a long rocky road, with steep valleys and ups-and-downs.

AVAILABLE FINANCIAL & BANKING ASSISTANCE

Credit unions, community banks, and Community Development Financial Institutions (CDFIs) exist throughout the City to provide banking services and financial products to individuals and small businesses, particularly lower- and middle-income people in lower-income neighborhoods. They have been helping struggling lower-income residents and small businesses in gentrifying areas of the City.

Because many lower-income clients are holding down multiple jobs, working erratic hours, and are struggling economically, community financial groups cater services and financial advice to their needs, importantly providing an alternative to predatory lenders. These customers want reasonable-rate credit to make up for income fluctuations.

These institutions also partner with community-based organizations or nonprofits to offer products that incorporate incentives for saving into their lending products, alternative credit scoring programs that look at ability to repay versus credit scores, and credit-building loans. These products allow lower-income people with low or bad credit to access loans and financial products that would otherwise be difficult to access by community members.

Credit unions, community banks and CDFIs also provide small business loans to micro-entrepreneurs and community businesses, companies that are often overlooked by the big banks.

The Office of Financial Empowerment (OFE) of the New York City Department of Consumer Affairs works to support New Yorkers and communities with low incomes in building wealth and improving financial capabilities. OFE runs Financial Empowerment Centers which offer free financial counseling, tax advice, and guidance on how to open bank accounts. OFE also works on the development of neighborhood-level financial empowerment models.

The National Credit Union Administration's payday alternative loan (PAL) program is a way for consumers to get access to cash without the outrageous fees and interest rates of high-cost credit products. According to Pew, the PAL program is underutilized, with fewer than 200,000 of these loans made in 2015 (less than one percent of payday loan market volume). Pew sees a need for the **Consumer Financial Protection Bureau (CFPB) to make it more feasible for banks to make payday alternative loans.** Proposed reforms are currently under consideration by CFPB.

Community Credit, Inclusion 2015 Q4

INDICATORS		US	Bronx	Queens	Kings	Staten Island	Manhattan
Credit Economy	Included	89.2	67.3	79.4	72.5	87.6	81.1
	Not Included	10.8	32.7	20.6	27.5	12.4	18.9
Convenient Credit	Revolving Credit	69.7	71.7	80.7	78.8	80.0	82.8
	Utilization	37.9	28.6	45.6	42.2	43.1	51.2
Credit Quality	On-Time Payers	77.7	68.1	79.1	76.4	78.1	83.5
	Prime	49.0	31.5	52.4	47.5	54.6	61.2
	Subprime	33.0	47.5	27.5	32.2	28.0	21.5

Credit Economy: Percent of adult (18+) census population with a credit file and a credit score.
Convenient Credit: Percent of the credit economy with a credit card or a home equity line of credit.
Credit Quality: Percent of the credit economy with a payment history that is current on all credit obligations for each of the past four quarters.

Source: www.nyfed.org/communitycredit & New York Fed Credit Panel / Equifax

RECOMMENDATIONS

Traditional banking practices often do not translate well in lower-income neighborhoods where there are diverse customers and needs. Economically insecure consumers face multiple challenges such as income volatility, low wages, and no savings which can lead to low or bad credit. This may often disqualify them from loans and financial services in traditional banks.

This is where credit unions and community banks play an important role—matching these clients with specific products that could most benefit them—which often requires specialized local knowledge and a "holistic relationship." An example is developing partnerships with community based nonprofits that can provide consumers with specialized educational counselling and immigration advice.

New York City can do more to support credit unions and community banks so that they can grow and provide more services to lower-income families and communities. Some opportunities include:

- Explore options for New York City and its agencies to deposit funds with these institutions which would allow them to provide more loans and services.
- Make a responsible small dollar loan program available to certain city workers, providing a reasonable loan option and increasing the number of depositors at these banks.
- Increase the number of referrals from the NYC Office of Financial Empowerment (OFE) to the institutions that are offering reasonable-rate loans and innovative products.
- Urge OFE to hold an annual meeting with credit unions, community banks, and CDFI banks to strengthen ties.
- Examine whether the state law regulating the rent-to-own industry needs to be improved to protect consumers.

NEED HELP?
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Recommendations for State funding and State legislative items include:

- Fund the NYS Community Development Financial Institutions (CDFIs) Fund.[iv] This would allow for more loans and financial services to be provided by CDFIs.

- Oppose the bill (S.6985-B/A.9634-B) allowing check cashers to become small business and commercial lenders. The bill would give additional authorization to check cashers to partner with out-of-state banks to bring consumer, business and other kinds of loans into New York—including at extremely high interest rates that are illegal under our usury caps.

Recommendation for Federal funding:

- President Trump has proposed to eliminate federal Community Development Financial Institute (CDFI) funds in his 2018 budget. The U.S. House of Representatives has proposed a 30 percent cut to the program. Some credits unions and community banks receive CDFI funds to deliver responsible, affordable credit and banking options to help low-income, low-wealth, and other disadvantaged communities. The proposed cuts will have catastrophic impacts on these institutions, small businesses, and lower-income consumers. Congress must preserve this lifeline for these lower-income banking consumers and small businesses which are the backbone of our economy.

For questions about the content of this report, please contact the author:
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[i] http://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2017/03/how-income-volatility-interacts-with-american-families-financial-security
[ii] https://www.fdic.gov/householdsurvey/2015/2015execsumm.pdf
[iii] http://www.usfinancialdiaries.org/
[iv] https://nextcity.org/daily/entry/stalled-new-york-state-cdfi-fund