Cooperative Credit:

How Community Development Credit Unions are Meeting the Need for Affordable, Short-Term Credit

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May 2007

Woodstock Institute

Acknowledgments

The Alternatives to Payday Lending Program (APPLE) was organized by the National Federation of Community Development Credit Unions. APPLE and this evaluation were funded by J. P. Morgan Chase. Additional support for Woodstock Institute's work to promote affordable financial products and to restrict predatory products is provided by the Driehaus Foundation, the Heron Foundation, and the John D. and Catherine T. MacArthur Foundation.

The author would like to thank the staff and/or board of community development credit unions that participated in this project: Audrey Cerise and Shannon Cian of AFI Federal Credit Union; Joy Cousminer and Kevin Porter of Bethex Federal Credit Union; Rita Haynes and Gloria McClendon of Faith Community United Credit Union; Meagan van Harte and Veronica Ballass of Lower East Side People's Federal Credit Union; Gregg Brown of South Side Community Federal Credit Union; and Rufino Carbajal Jr. and Melissa Reyes of West Texas Credit Union.

In addition, Alice Greenwald of the National Federation of Community Development Credit Unions and Ed Jacob of the North Side Community Federal Credit Union provided invaluable assistance.

Thanks also to Beverly Berryhill, Malcolm Bush, Tom Feltner, and Patricia Woods-Hessing for their support and advice.

About the Author

Marva is Senior Vice President of Woodstock Institute. Her program areas include: community development finance institutions (CDFI), financial services, and community reinvestment coalition-building. Marva recently completed a guide to enable community organizations to develop partnerships with credit unions, an analysis of the asset building programs of large mainstream financial institutions, and an evaluation of affordable alternatives to payday loans. Marva is also the coordinator of the CRA Coalition. Marva has presented expert testimony on community development finance issues to the U.S. Senate Banking, Housing and Urban Affairs Committee, and the Illinois General Assembly and made numerous conference presentations as well. Marva holds a Ph.D. in urban planning and public policy from Rutgers University's Bloustein School of Planning and Public Policy.

Executive Summary

Woodstock Institute conducted an 18-month evaluation of the affordable PDLs offered by credit unions participating in the National Federation of Community Development Credit Unions (National Federation) and JP Morgan Chase Alternatives to Payday Lending Program (APPLE) from January 2005-June 2006. The credit unions include: ASI FCU, Bethex FCU, Faith Community CU, Northeast Community FCU, South Side Community FCU, and West Texas CU. In addition to describing loan activity, Woodstock Institute identified the factors that account for affordable payday loan program success—financially and operationally, and also as an attractive alternative to high cost payday loans (PDLs). This evaluation shows the importance of:

- Adopting consumer protection practices that discourage over-borrowing by limiting the number of loans a borrower may receive and encouraging or requiring financial education.

- Enabling affordable PDL borrowers to accrue savings during the term of the loans so they do not need to rely on loans to pay emergency expenses.

- All of the credit unions participating in this study make affordable PDLs at 18 annual percentage rate (APR) or lower, thus documenting that it is possible to operate financially feasible products at reasonable interest rates by utilizing common sense underwriting criteria. These criteria include direct deposit of borrower's paychecks or benefit checks, automatic payment of loans, and special loan loss reserves.

- Serving as a convenient alternative to predatory payday loans by adopting expedited loan applications and processing, which allows borrowers to receive their loans proceeds in just a few minutes.

- Developing a long-term relationship with customers has real payoffs for financial institutions. The credit unions participating in this study reported that, in general, longer-term members have better repayment records than newer members.

- Several CDCUs obtain the credit reports of borrowers in an effort to identify errors and educate the member on ways to improve their credit. In addition, all the credit unions report repayment of affordable PDLs to the credit bureaus, thus helping borrowers establish credit.

The report also found that the size of the financial institution is a major factor in financial and operational sustainability. Larger institutions can lower program costs by offering direct deposit and automatic loan payments, and utilizing loan processing software to decrease staff costs. Larger institutions can also minimize the opportunity costs of new products and because these loans are a smaller portion of their loan portfolios, spread the risk across multiple loan products.

A major priority for Woodstock Institute is the support of affordable alternatives to predatory payday loans. In addition to our efforts to enact consumer protections for the PDL industry and to improve the financial management skills of current and prospective borrowers, the establishment of affordable PDLs is essential for consumers of small and large financial institutions, banks, and credit unions. Affordable PDLs also serve as competition to predatory payday lenders, which may be forced to lower their costs as the number of affordable PDLs grow. It is imperative that regulators encourage and enable credit unions, banks, and thrifts to establish affordable payday loans as an alternative to predatory payday loans.

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Introduction

Woodstock Institute conducted an 18-month evaluation of the affordable PDLs offered by credit unions participating in the National Federation of Community Development Credit Unions (National Federation) and JP Morgan Chase Alternatives to Payday Lending Program (APPLE) from January 2005-June 2006. The credit unions include ASI FCU, Bethex FCU, Faith Community CU, Northeast Community FCU, South Side Community FCU, and West Texas CU. In addition to describing loan activity, Woodstock Institute identified the factors that account for affordable payday loan program success—financially and operationally and also as an attractive alternative to high cost payday loans.

The payday loan industry, which enables consumers to borrow small amounts for a term of two weeks or more, charges interest rates of over 500 annual percentage rate (APR) in some states. Virtually unheard of in the early 1990s, there are currently over 22,000 payday loan stores with a loan volume of $40 billion nationwide.[1] Consumer and community advocates have responded to these high cost predatory products by making proposals for stronger consumer protections and the establishment of financial education to inform people of the risks of PDLs and similar products. In addition, advocates are also working with financial institutions and others to develop and promote affordable PDL alternatives. These alternatives were first pioneered by the community development credit union (CDCU) industry.

The purpose of APPLE is to establish sustainable CDCU PDL products that protect and appeal to consumers. APPLE has funded CDCUs with new and expanded affordable PDLs. The proliferation of affordable PDLs is crucial. First, they offer much lower interest rates than predatory PDLs, and can save consumers thousands of dollars in fees, prevent financial distress, and bankruptcies. Second, the documentation of affordable PDLs offered by some CDCUs has led to an increase in mainstream credit unions and a few banks offering these products. Third, as the number of affordable PDLs increases, they serve as competition to predatory PDL lenders, which may be forced to lower their costs. Last, it serves as a reminder to policymakers and bank regulators that short term credit can be made at an affordable rate to consumers.

Woodstock Institute provided each credit union participating in the APPLE program with an electronic questionnaire (Appendix A) that allowed them to input information on each product as well as to record loan activity. Questionnaires were collected in six month intervals during the 18 month evaluation. Several follow-up phone calls were necessary to clarify answers, fill in incomplete data fields, or to make revisions. In fall 2006, all of the credit unions participated in a conference call to discuss factors they believed were important to protecting consumers, enhancing the viability of the affordable PDLs and promoting consumer convenience.

There are four sections to this report. The first section describes basic information on the six credit unions, including assets, net worth, loans, and membership. A description of each loan product, such as product terms, underwriting criteria, and product administration, comprises the second section. The third section provides data on the loan activity and other factors of each affordable PDL alternative from January 2005 to June 2006. This section contains the number of loans made, credit scores of the

[1] Stephens Inc., Industry Report: Payday Loan Industry. (2004).

borrowers, purpose of the loans, and loan delinquencies. There is also analysis of data on the cost and revenue of each affordable PDL alternative. The last section of this report explores best practices. This report also shows that the CDCUs participating in APPLE have instituted practices that serve to protect consumers, increase the product's financial and operational sustainability, and enhance the loan's appeal to consumers as a convenient and cheaper alternative to predatory PDLs.

Part I
Descriptions of the Participating Credit Unions

Most of the CDCUs participating in the affordable PDL program are fairly small, with assets ranging between $2 and $11 million (see Figure 1). The largest credit unions are ASI FCU, with over $285 million in assets and West Texas CU with assets of approximately $53 million. Most of the credit unions were chartered from 1961 to 1986. The exception is South Side Community FCU, which was chartered in 2003. With the exception of ASI FCU, the net worth ratios of all the credit unions are between 7.1 percent and 18.0 percent, which is above the 7 percent statutory defined minimum of a well capitalized credit union. ASI FCU, which is located in Louisiana is facing several financial challenges (see following section) as a result of hurricanes Katrina and Rita in the Fall of 2005, including a net worth of 5.5 percent in June 2006. The loan delinquencies of the credit unions range from a low of 0.3 percent of loans (Northeast Community FCU) to 9.3 percent (South Side Community FCU).

Figure 1
Credit Union Descriptions
June 2006

	ASI	Bethex	Faith Community	Northeast Community	South Side Community	West Texas
Location	Harahan, LA	Bronx, NY	Cleveland, OH	San Francisco, CA	Chicago, IL	El Paso, TX
Year Chartered	1961	1970	1957	1981	2003	1964
Low-Income Designation	Yes	Yes	N/A	Yes	Yes	Yes
Assets	$285,526,691	$11,001,156	$10,224,536	$9,128,010	$2,288,827	$53,916,443
Shares	$267,163,848	$10,061,242	$ 8,374,102	$7,535,355	$2,011,151	$47,071,083
Net Worth Ratio	5.5%	7.1%	18.0%	12.9%	11.7%	9.8%
Loans	173,349,336	4,838,376	6,307,874	3,700,230	356,585	46,248,737
Loan to Share Ratio	64.9%	48.1%	75.3%	49.1%	17.7%	98.3%
Percent Delinquent Loans	1.1%	2.2%	2.5%	0.3%	9.3%	0.9%
Number of Members	72,528	9,150	5,256	1,337	1,367	17,280
Full Time Equivalent Staff	204	16	6	7	2	42
Ratio of Members to One Staff Person	355	572	930	183	684	408

Loan delinquencies: two months or more

Most of the credit unions have low-income designations. The low-income designation is made by the National Credit Union Administration (NCUA) for credit unions based on one of two criteria. At least 50 percent of their members earn 80 percent or less of the area median income.[2] A credit union that serves a geographic area where a majority of residents are lower-income is presumed to be serving predominantly low-income members. Faith Community United CU does not have a federal low-income designation because it is a state chartered credit union with private insurance.

ASI Federal Credit Union

ASI FCU is the largest and oldest credit union participating in this program with over $285 million in assets. The credit union was chartered in 1961.

ASI FCU is located near New Orleans, and most of its branches were damaged by hurricanes Katrina and Rita in August 2005. As a result of the hurricanes, ASI FCU offered its consumer loan borrowers, including borrowers of the PDL alternative that were current with payments, three months payment free. The credit union reports that nearly all of the PDL borrowers have since been able to resume payments and some have even paid off their loans.

Although ASI FCU has reopened most of their branches, its assets, membership, and other key ratios have weakened as a result of the hurricanes. ASI FCU’s net worth ratio decreased from 8.5 percent in June 2005 to 5.5 percent by June 2006. Its loan to share ratio increased from December 2005, when it was 56.8 percent to 64.9 percent in June 2006. However, the credit union’s loan to share ratio is below its pre-hurricane level of approximately 75 percent. ASI FCU’s membership decreased by over 9 percent from December 2005 to June 2006.

Bethex Federal Credit Union

Bethex FCU, which was formed in 1970, is located in the Bronx, NY. The credit union has over $11 million in assets, a 27.4 percent increase from June 2005. Bethex FCU’s net worth ratio of 7.1 percent, a decrease of 2.5 percent from 2005. Bethex FCU’s loan to share ratio is 48.1 percent and its loan delinquency rate is 2.2 percent. There are 16 staff members and a membership of 9,150, giving the Bethex FCU a member-to-staff ratio of 572:1.

Faith Community United Credit Union

Founded in 1952, Faith Community United CU is located in Cleveland, Ohio. Originally a church-based credit union, Faith Community United CU primarily serves Cleveland’s lower-income African American residents, although its field of membership (FOM) is residents or business owners who worship in Cuyahoga County, Ohio. The credit union has over $10 million in assets and a net worth ratio of 18 percent. Faith Community United CU’s loan delinquencies are 2.5 percent and it has four staff members serving 5,256 members. Its member-to-staff ratio is the highest of all the credit unions, at 1,314 to 1.

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[2]NCUA Rules and Regulations Section 701.34.

Northeast Community Federal Credit Union

Located in San Francisco, Northeast Community FCU offices are in the Chinatown and Tenderloin communities. The credit union was formed in 1981, has $9.1 million in assets and a net worth ratio of 12.9 percent. Its loan to share ratio is almost 50 percent and 0.3 percent of its loans are delinquent. There are over 1,300 members of Northeast Community FCU and seven employees. Northeast Community FCU's member-to-staff ratio is 183:1.

Northeast Community FCU is a member of the San Francisco Bridge APPLE Consortium. The other partners include Mission Area FCU and Patelco CU. The goal of the Consortium is to provide outreach to low-income, underserved communities and to develop an affordable PDL alternative.

South Side Community Federal Credit Union

Established in 2003, South Side Community FCU is the smallest and newest credit union participating in the affordable PDL program. Located on the Southside of Chicago, the credit union has nearly $2.3 million in assets and a net worth ratio of almost 12 percent. The loan to share ratio of South Side Community FCU is only 17.7 percent and it has a very high loan delinquency rate of 9.3 percent. Credit union membership has increased by over 29 percent from June 2005 to 1,367. South Side Community FCU employs two full time staff and has a staff to member ratio of 684 to 1.

West Texas CU

Located in El Paso, Texas, West Texas CU was formed in 1964. It is the second largest of the participating credit unions with over $53 million in assets and a net worth ratio of almost 10 percent. West Texas CU has the highest loan to share ratio of the credit unions at over 98 percent and less than 1 percent of its loans are delinquent. There are over 17,000 members of West Texas CU and it employs 42. The credit union has a member-to-staff ratio of 408 to 1.

Part II
Description of Payday Loan Alternative Products

Of the six grantees, four established new affordable PDL products, including ASI FCU, Faith Community United CU, Northeast Community FCU, and West Texas CU (see Figure 2). West Texas CU offers two affordable PDLs: a debt consolidation loan to pay off existing PDLs and in June 2005 it began an affordable PDL. Bethex expanded its affordable PDL product and South Side Community FCU made revisions to an existing loan product.

Loan Amounts: The minimum loan amount ranges from $40 at Northeast Community FCU (reduced from $50) to $500 at South Side Community FCU. ASI FCU has no minimum. The maximum loan amount ranges from a low of $300 at Northeast Community FCU to $5,000 at ASI FCU. Several of the credit unions have increased the maximum loan amount within the past year due to customer demand and the increasing loan principal of loans offered by high cost payday lenders. ASI FCU increased their maximum loan from $3,000 to $5,000 and Bethex FCU now offers its Emergency Loan for up to $1,500, an increase from the previous maximum loan of $1,000. The size of the loans is determined by need of the borrowers and market factors. Northeast Community FCU members, most of which have low- or fixed-incomes, have a very low minimum loan. Other credit unions have increased the size of their loans due to customer demand and in response to larger loans being offered by the predatory PDL industry.

Figure 2
Description of Affordable Payday Loans

	ASI	Bethex	Faith Community	Northeast Community	South Side Community	West Texas
Name of Product	Payday Lender ReBuilder Loan	Emergency Loan	Amazing Grace Line of Credit	Payday Alternative Loan		Debt Consolidation Loan and Payday Loan Alternative
New or Expanded Product as of January 2005	New	Expanded	New	New	Revised	Expanded
How Loan Differs from the Original Product		Originally, Bethex offered a “Cash-in-a-Flash” loan. This product allows qualified borrowers to access larger amounts of money	Grace Loan is a term loan. Amazing Grace, a line of credit, requires one year positive experience with Grace Loan			Expanded in June 2005 to offer a payday alternative loans in addition to a payday loan debt consolidation loan
Minimum Loan Amount	N/A	$300	$100	$40 (reduced from $50)	$500	$100
Maximum Loan Amount	Increased from $3,000 to $5,000	$1,500	$500	$300	$500	$500
Type of Loan	Installment	Installment	Line of Credit	Single Payment	Installment	Installment
Loan Term (in months)	18-months	6-months	1-month	1-month	6-months	6-months
Interest Rate	15% in urban areas, 9% in rural areas	16.5% and 12% for borrowers with good credit	17%	18%	17% or 16% with direct deposit	18%
Loan Fees	Late fees	Application fee of $25 or $35 with a cosigner	$15 one time fee to initiate line of credit and $10 monthly line of credit fee	Late fees	$20 application fee; $15 late loan fee	$10 loan application fee; late fee
Loan Fees	Late fees are charged for delinquent payments, but can be waived under special circumstances	$15 application fee, plus $10 for a credit report for each person on the application	$10 monthly line of credit fee	N/A	$15 late fee if loan is 15-days delinquent	
Loan Restrictions	Loan may only be used to pay off outstanding debts to payday lenders; ASI pays these lenders directly	N/A	No more than one advance of line credit per month	N/A	Member may receive up to two loans per year	N/A

Loan Term: Four of the affordable PDLs are installment loans with terms ranging from 6-18 months. Faith Community United CU offers a line of credit that must be paid in full in one month. Northeast Community FCU is the only lender that offers a single payment affordable PDL.

Interest Rates: The interest rates on the affordable PDLs generally range from 15-18 percent annual percentage rate (APR). South Side Community FCU offers a 1 percent discount, from 17 percent to 16 percent, if borrowers have direct deposit. Bethex FCU reduced the interest rate of their Emergency Loan product from 17 percent in June 2005 to 16.5 percent in December 2005. Further, Bethex FCU affordable PDL borrowers with good credit histories can receive a rate as low as 12 percent. ASI FCU offers its Payday Lender ReBuilder Loan for 15 percent to residents in urban areas and 9 percent in a lower-income, rural community it serves.

Loan Fees: The application fees for the affordable PDLs range from $10-35. Bethex FCU charges an additional $10 if there is a loan co-signor. Faith Community charges a $15 one-time fee to initiate the line of credit and a $10 monthly line of credit fee. Northeast Community FCU is the only lender that does not charge loan fees of any kind (with the exception of late loan fees). South Side Community FCU, which requires credit reports, includes this additional cost in its loan application fee.

Loan Restrictions: The ASI FCU product is restricted to paying off the existing payday loan balances. The credit union makes the payment directly to the lender. Further, borrowers must sign a statement pledging that they will not incur another PDL during the term of their loan with ASI FCU. Faith Community United CU allows borrowers only one advance on their affordable PDL line of credit per month and South Side Community FCU limits borrowers to two affordable PDLs per year. However, to receive the second loan from these CUs, borrowers must pay the entire balance of the first loan.

Underwriting

Figure 3 summarizes the underwriting criteria of the six products. It includes requirements for minimum membership tenure, credit scores, direct deposit and/or automatic loan payments, and other criteria.

Membership Tenure: ASI FCU requires that a borrower be a member of the credit union for at least three months before they are eligible to receive a loan. Borrowers from Northeast Community FCU must be a member of the credit union for at least six months before receiving an affordable PDL. However, both credit unions will waive this requirement depending on the borrower's credit status, work history, and other factors. New members with good credit scores and low debt ratios are eligible for Northeast Community FCU PDLs. There is no minimum tenure requirement at Bethex FCU and Faith Community United CU requires that a new member's first direct deposit is made to the credit union before they are eligible for a Grace Line of Credit.

Credit Reports: South Side Community FCU uses credit reports in the underwriting decision. Borrowers with credit scores of below 550 are required by South Side Community FCU to have a $100 minimum deposit. Borrowers with scores above 550 must have a balance of at least $50. Bethex FCU uses credit reports to determine the interest rate of the loan, which ranges from 12 percent to 16.5 percent.

Role of Direct Deposit and Automatic Deduction: All of the credit unions encourage borrower participation in direct deposit of pay checks or benefit checks and/or automatic account deductions of loan payments. South Side Community FCU borrowers receive a 1 percent rate reduction on their affordable PDL if borrowers have direct deposit or automatic deductions. Faith Community United CU's Grace Line was originally made to members with direct deposit. It now makes loans to members without direct deposit if they can present pay stubs for three previous months. Bethex FCU, Northeast Community FCU, and ASI FCU require that borrowers participate in direct deposit and/or automatic deduction of loan payments.

Figure 3
Underwriting Criteria of Affordable Payday Loans

	ASI	Bethex	Faith Community	Northeast Community	South Side Community	West Texas
Is There a Minimum Membership Tenure?	3-months	None	First direct deposit must be made	6-months – depending on credit rating or work history	None	Draft (checking) account for at least 3-months
Are Credit Reports Required?	Yes	Yes	No	No	Yes	No
Are Credit Reports Part of the Credit Decision?	No	Used to determine interest rate			Borrowers with credit scores below 550 are required to maintain a $100 account balance or must attend 3 financial education classes. Those with scores above 550 must maintain $50	
Is Direct Deposit or Automatic Deduction Encouraged for Borrowers?	Direct deposit required	Direct deposit and automatic deduction required	Direct deposit and automatic deduction	Direct deposit and automatic deduction	Direct deposit and automatic deduction	Direct deposit and automatic deduction
Do Borrowers with direct Deposit or Automatic Deduction Receive an Incentive?	Required as condition of loan	Required as condition of loan	No – others have to document 3-months of income	No	Receive a 1% rate reduction	No
What are the Other Underwriting Requirements (Other than Proof of Income, Verification of Identity, and Address)?	(1) Cannot have filed bankruptcy within the past year; (2) Cannot be participating with a consumer credit counseling service; (3) Statement that member will not borrow from payday lenders during term of loan; (4) Member must attend two 3-hour financial management classes presented by ASI FCU staff; (5) $25 must be deposited into savings account per month	15% of the loan amount must be kept on deposit with the credit union	Must show proof of income for three months if not on direct deposit or automatic deduction		(1) Member must be employed with same company for the last six months; (2) Must earn income of at least $1,000 per month	(1) Recent bank statement; (2) Post-dated check for loan payment; (3) Document full-time employment

Other Underwriting Requirements: Bethex FCU and South Side Community FCU require additional security for affordable PDLs. Bethex FCU borrowers must pledge 15 percent of the loan amount. South Side Community FCU requires that borrowers with low credit scores have a balance of at least $100 in a credit union account, which is frozen during the term of the loan.

Three of the credit unions have instituted measures to secure affordable PDLs and encourage savings by borrowers. ASI FCU requires that borrowers deposit $15 a month into a holding account and Faith Community United CU requires borrowers to save at least $10 per month. These funds, as well as the 15 percent pledge required by Bethex FCU, are available to the member once the affordable PDL has been fully paid.

Other underwriting requirements include employment documentation, wage assignments, or histories of bankruptcies. Borrowers of South Side Community FCU must be employed by the same company for a minimum of six months or have incomes of at least $1,000 per month. In addition, borrowers must sign a wage assignment as a condition of the loan. ASI FCU will not make loans to borrowers who have filed bankruptcy within the past year.

Product Administration

Collection Procedures: All of the credit unions participating in this program institute prompt intervention if there are late payments. The manager of ASI FCU calls borrowers when they miss a payment to see if there is a problem. After ten days, a notice is sent to the borrower and ASI FCU's collection department begins making contact after 30 days of delinquency. Bethex FCU's collection procedures are the same for other loan products. The credit union has an internal collection staff person who follows up with phone calls and letters in response to late payments. Faith Community United CU sends reminders and makes phone calls to borrowers with late payments, but intervenes sooner with this product than other credit union loans. Northeast Community FCU engages in internal collections and does not send the PDL borrower's account to outside collection agencies.

Product Marketing: Most of the credit unions rely on word of mouth and teller referrals to market this product. Others utilize credit union newsletters and statement mailings, brochures, flyers, and posters. South Side Community FCU has also presented information on the loan product on radio and cable television shows.

Use of Technology: None of the credit unions reported using new software programs or other technology to accept applications, underwrite, close, or service loans. All the credit unions use in-house loan processing software.

Use of Financial Literacy Classes and Savings Incentives: All of the participating credit unions offer financial education classes and counseling to credit union members. ASI FCU requires that all borrowers attend a financial management class after their loan has closed. South Side Community FCU requires borrowers with scores below 550 to attend three financial literacy classes after their first loan has closed.

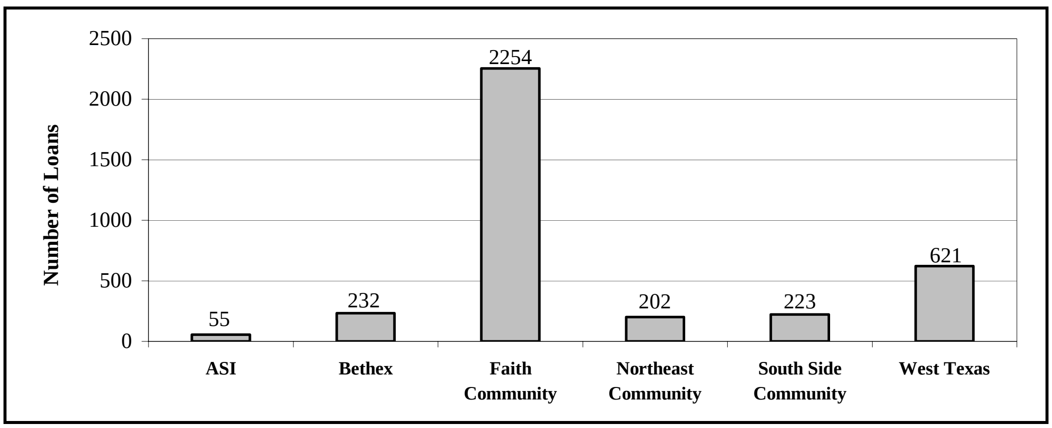
Partnerships: South Side Community FCU has leveraged the availability of its affordable PDL to market the credit union to employers. One employer provides a loan loss reserve to employees and two other employers market the program to their staff. West Texas CU has partnered with a local affordable housing agency to market their affordable PDL product.

Part III
Payday Loan Alternative Product Activity
January 2005 to June 2006

Number of Loans and Borrowers: Figure 4 depicts the number of loans made by the credit unions in NatFed/JPMC Alternatives to Payday Lending Program between January 2005 and June 2006. Most of the credit unions closed between 202 and 621 loans each with the exception of ASI FCU and Faith Community United CU. Due to the hurricane, ASI FCU only closed 55 loans. Faith Community United CU, which offers a PDL line of credit, advanced 2,254 lines of credit between January 2005 and June 2006.

Other than Faith Community United CU's line of credit product and West Texas CU, there were few repeat borrowers. Bethex FCU and South Side Community FCU had two and 14 repeat borrowers, respectively. West Texas CU had 82 repeat borrowers out of 202 total borrowers.

Figure 4
Number of Loans
January 2005 to June 2006



Total Amount of Loans: Total dollar volume of loans closed ranged from $102,716 at ASI FCU to $328,746 for West Texas CU (Figure 5). Faith Community United CU's line of credit product made over $790,000 in affordable PDLs. The average loan per borrower varied from $1,868 at ASI FCU (whose loans are used to pay off existing PDLs) to $352 for Faith Community United CU.

Figure 5
Total Loan Volume and Average Loan Amounts

	ASI	Bethex	Faith Community	Northeast Community	South Side Community	West Texas
Total Amount of Loans	$102,716	$192,824	$793,804	$104,345	$104,500	$328,746
Number of Loans	55	232	2,254	202	223	621
Average Loans	$1,868	$824 (831)	$352	$517	$500 (468)	$468 (529)

Membership Tenure of Borrowers: Most of the affordable PDL borrowers were fairly medium to long-term members of the credit unions. As shown by Figure 6, 60 to 96 percent of the affordable PDL borrowers from ASI FCU, Bethex, Faith Community United CU, Lower East Side Peoples CU, and West Texas CU were members for at least six months. At Northeast Community FCU, 64 percent of alternative PDL borrowers were members less than one month. Nineteen percent of South Side Community FCU affordable PDL borrowers were members less than one month and 21 percent were members for 1-5 months. At West Texas CU, which initially did not have a minimum tenure requirement for affordable PDLs, 7 percent of borrowers were members for less than one month. The credit union changed this policy in June 2005, requiring all borrowers to have a checking account with West Texas CU for at least three months.

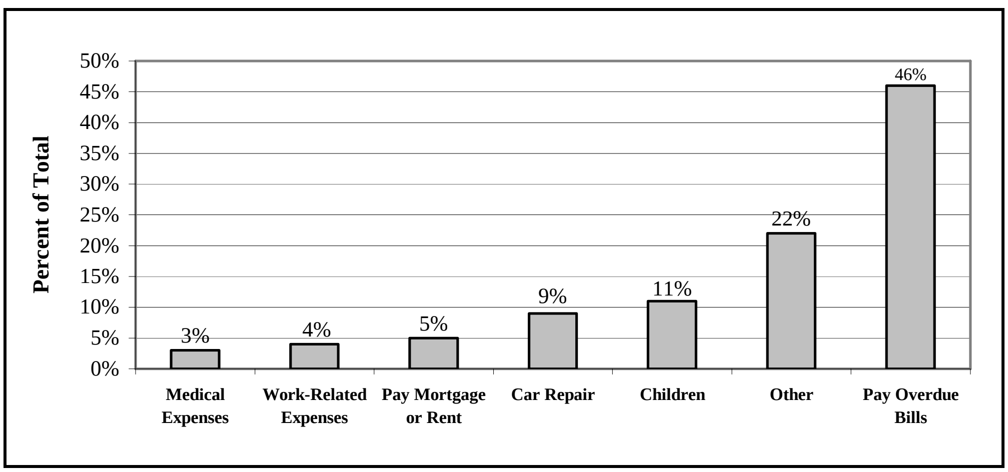
Figure 6
Membership Tenure of Borrowers

	ASI	Bethex	Faith Community	Northeast Community	South Side Community	West Texas	Total
Less Than One Month	0%	14%	0%	55%	19%	4%	9%
1-5 Months	4%	12%	7%	9%	21%	17%	10%
Over 6 Months	96%	74%	92%	36%	60%	80%	81%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

Purpose of Loans

Almost half of the proceeds from affordable PDLs were used to pay overdue bills including ASI FCU loans which are exclusively used to pay off existing PDLs (Figure 7). Also notable were loans made to pay car repairs and expenses associated with children, such as tuition, schools supplies, and clothing. Other reasons for loans include medical expenses, work related expenses, and to pay mortgage or rent. The other category of 22 percent includes loans for travel, income taxes, parking tickets, special occasions, purchasing furniture, paying moving expenses, family emergencies, and groceries.

Figure 7
Purpose of Loans



Credit Scores of Borrowers: Figure 8 provides data on the credit scores of PDL borrowers, which were reported on 74 percent of borrowers. Most of the credit scores reported show that loans are going to borrowers with marginal to poor credit scores. Thirty-two percent of the loans are to borrowers with credit scores of 499 or less and 38 percent are to borrowers with credit scores between 500-599. Only 1 percent of the borrowers had credit scores of 700 or above. In addition, 16 percent of the borrowers had no credit rating prior to obtaining an affordable PDL.

Figure 8
Credit Scores of Borrowers

	Bethex	Faith Community	Northeast Community	South Side Community	West Texas	Total
No Score	27%	18%	50%	0%	37%	16%
400 – 499	15%	43%	45%	53%	8%	32%
500 – 599	42%	27%	5%	40%	39%	38%
600 – 699	16%	11%	0%	7%	17%	14%
700 – 799	0%	0%	0%	1%	0%	1%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

The credit scores vary by credit union. Over one-half of borrowers from South Side Community FCU had scores below 499. Further, the majority of borrowers from Bethex and West Texas CU had scores over 500.

Borrower Bankruptcy: As reflected by Figure 9, the credit unions in this project are making some loans to at-risk borrowers. A small portion of affordable PDL borrowers have experience with bankruptcy. ASI FCU, Bethex FCU, Faith Community United CU, and South Side Community FCU made loans to members that had filed for bankruptcy at some time in the past, although these borrowers are not currently in bankruptcy. Note that ASI FCI will not make affordable PDLs to borrowers that have declared bankruptcy within a year of applying for a loan.

Figure 9
Number of Bankruptcy Filings

	ASI	Bethex	Faith Community	Northeast Community	South Side Community	West Texas
Number of Borrowers Who Have Ever Declared Bankruptcy	16	11	75	0	32	0

Loan Delinquencies: Northeast Community FCU, which requires that their affordable PDL be paid off each month, reported that they experienced no loan delinquencies. Others report fairly low loan delinquencies, ranging from one-tenth of one percent at Faith Community United CU to 1.8 percent at South Side Community FCU. However, ASI FCU delinquencies are much higher at over 40 percent. ASI FCU has undergone tremendous changes over the last year due to hurricane damage, membership relocation, and other issues. Therefore, their delinquency rate is not typical for CDCU affordable PDL products. Although it has the highest number of affordable PDL borrowers that have ever declared bankruptcy (32 borrowers of 223 loans), South Side Community FCU has experienced a modest delinquency rate of 1.8 percent.

Figure 10
Delinquency Rates of Affordable Payday Loans

	ASI	Bethex	Faith Community	Northeast Community	South Side Community	West Texas
Delinquency Rate	40.3%	1.6%	0.1%	0.0%	1.8%	1.2%

Loan Charge-Offs: Policies regarding when to charge-off delinquent loans or loans in default are generally established by each credit union. However, charge-offs are non-performing loans that have not been paid for several months. Loan charge-off data was collected by the National Federation from each credit union participating in this project for January-December of 2005. The charge offs ranged from $0 per $1,000 in loan volume at Bethex FCU to $29.11 at South Side Community FCU (Figure 11).

Figure 11
Charge-Offs per $1,000 in Loan Volume
2005

	ASI	Bethex	Faith Community	Northeast Community	South Side Community	West Texas
Charge-offs per $1,000	5.52	$ -	11.28	2.88	29.11	12.75

Cost and Income of Affordable Payday Loans

A major area of interest of this evaluation is to determine the cost and income of making affordable PDLs. Therefore, respondents were asked to estimate the average cost of making each PDL for the entire year, including staff time and other expenses, and to report loan program revenue. There is significant variation in the reported numbers. Further, most of the affordable PDL products are fairly new and cost efficiencies may develop over time.

Revenue of Affordable Payday Loans: Figure 12 documents estimates of revenue and expenses of affordable PDLs from January 2005 to June 2006 (does not include grant income from the NatFed/JPMC grant program). Total revenue ranges from $8,395 at ASI FCU to $7,151 at Northeast Community FCU. Revenue per loan also varies widely.

Most of the credit unions generate the majority of their revenue from interest. However, Faith Community United CU earned almost 70 percent of revenue from loan application fees and 27 percent of the revenue at Bethex FCU was made through loan application fees. Late loan fees and other fees were relatively small sources of revenue except at South Side Community FCU which earned over 25 percent of its revenue from late loan fees.

The total revenue per loan and per $1,000 in loans varies significantly. Per $1,000 in loans, West Texas CU generates an average of $35.86 and Bethex FCU earns $116.12 and there is a standard deviation of over $32. The standard deviation of revenue per loan is over $53 and ranges from a low of $16.77 at West Texas CU to $152.65 at ASI FCU.

Figure 12
Total Revenue of Affordable Payday Loans

	ASI	Bethex	Faith Community	Northeast Community	South Side Community	West Texas	Mean	Standard Deviation
Total Revenue	$ 8,395.81	$ 22,391.51	$ 30,059.10	$ 7,151.00	$ 10,148.46	$ 11,788.06	N/A	N/A
Total Loan Volume	$ 102,716.36	$ 192.823.50	$793,803.90	$ 104,344.57	$ 104,500.00	$ 328,746.47	N/A	N/A
Revenue Per $1,000 Loan Volume	$ 81.74	$ 116.12	$ 37.87	$68.53	$ 97.11	$ 35.86	$ 72.87	$ 32.10
Total Number of Loans	55	234	1,826	202	209	703	N/A	N/A
Revenue Per Loan	$ 152.65	$ 95.69	$ 16.46	$35.40	$ 48.56	$ 16.77	$ 60.92	$ 53.58

Financial Sustainability of Affordable PDLs

Figure 13 documents total revenue, total cost (variable costs, such as training, and marketing were excluded, see Appendix B for more information) and net income per loan. The costs per loan were estimated by multiplying staff costs by average number of minutes to (1) take loan applications; (2) review loan applications; (3) close loans; and (4) service loans. The total cost estimates range $3.15 per loan at Faith Community United CU (which offers a line of credit and therefore new applications are not needed for advances) to $25.08 at ASI FCU. The average cost is $12.93 per loan and there is a total standard deviation of $7.29.

Figure 13
Cost of Affordable PDLs

	ASI	Bethex	Faith Community	Northeast Community	South Side Community	West Texas	Mean	Standard Deviation
Total Cost Per Loan	$ 25.08	$ 16.00	$ 3.15	$ 12.50	$ 10.85	$ 10.00	$ 12.93	$ 7.29
Number of Loans	55	232	2,254	202	223	621	594	832.96
Total Cost	$ 1,379.13	$ 3,712.00	$ 7,100.10	$ 2,525.00	$ 2,419.55	$ 6,210.00	$ 3,890.96	$ 2,282.49
Total Loan Volume	$ 102,716.36	$192,823.50	$793,803.90	$104,344.57	$104,500.00	$328,746.47	$271,155.80	$270,771.36
Cost Per $1,000 in Loan Volume	$ 13.43	$ 19.25	$ 8.94	$ 24.20	$ 23.15	$ 18.89	$ 17.98	$ 5.84

Identifying the cost of affordable PDLs per $1,000 in loan revenue enables a comparison of products by loan size. Faith Community CU has the lowest cost per $1,000 in loan revenue due to its line of credit procedures. Although ASI FCU has the highest costs per loan ($25.06), its costs per $1000 in loan volume ($13.43) are the second lowest because the credit union makes larger loans than the other credit unions. In addition, when controlling for loan size, the standard deviation in loan cost is reduced to $5.84.

The affordable PDLs appear to be financially sustainable for most of the credit unions, although again, there is substantial variation. The net income per loan is $13.31 at Faith Community United CU to over $127 at ASI FCU (see Figure 14). The average net income is approximately $48 per loan and the standard deviation, reflecting the substantial disparity of net income estimates is over $46. The smallest credit union in the study, South Side Community FCU, has the third highest net income per loan, $37.71, and second largest credit union, West Texas CU, has the lowest net income per loan of all the credit unions. ASI FCU, which earned an average of $127.58 per loan, has the highest net income.

Figure 14
Revenue and Costs of Affordable Payday Loans
January 2005 -June 2006

	ASI	Bethex	Faith Community	Northeast Community	South Side Community	West Texas	Mean	Standard Deviation
Total Revenue	$ 8,395.81	$ 22,391.51	$ 30,059.10	$ 7,151.00	$ 10,148.46	$ 11,788.06	N/A	N/A
Revenue Per Loan	$ 152.65	$ 95.69	$ 16.46	$ 35.40	$ 48.56	$ 16.77	$ 60.92	$ 53.58
Total Cost Per Loan	$ 25.08	$ 16.00	$ 3.15	$ 12.50	$ 10.85	$ 10.00	$ 12.93	$ 7.29
Net Income Per Loan	$ 127.58	$ 79.69	$ 13.31	$ 22.90	$ 37.71	$ 6.77	$ 47.99	$ 46.85

Figure 15 documents the revenue, costs, and net income per $1,000 in loan volume and gross margin percentages of each credit union. Bethex FCU has the highest revenue per $1,000 in loan volume and the highest gross margin percentage as well. The lowest revenue per $1,000 in loan volume is Faith Community CU with $37.87, which also has the lowest cost of $8.94. Net income per $1,000 in loan volume ranges from $16.97 at West Texas CU and $96.87 at Bethex FCU.

Net margin percentages were calculated before and after loan charge-offs (charge-off data was only available for 2005). Net margin percentages before charge-offs range from 1.70 percent at West Texas CU to 9.69 percent at Bethex FCU, which did not report any charge-offs for 2005. However, even including charge-offs, it is clear that the affordable PDLs are profitable for each credit union. This is particularly notable given the innovative nature of these loan products. Given more experience to refine underwriting standards and reduce loan costs, it is possible that each credit union has the capacity to increase gross margin percentages even more. Note that West Texas CU, which has only operated their affordable PDLs for 18 months, has a modest net margin percentage of 0.42 percent, slightly greater than breakeven.

Figure 15
Net Margin of Affordable Payday Loans
January 2005 – June 2006

	ASI	Bethex	Faith Community	Northeast Community	South Side Community	West Texas
Revenue Per $1,000 Loan Volume	$ 81.74	$ 116.12	$ 37.87	$ 68.53	$ 97.11	$ 35.86
Cost Per $1,000 in Loan Volume	$ 13.43	$ 19.25	$ 8.94	$ 24.20	$ 23.15	$ 18.89
Net Income Per $1,000 Loan Volume (before charge-offs)	$ 68.31	$ 96.87	$ 28.92	$ 44.33	$ 73.96	$ 16.97
Net Margin Percentage (before charge-offs)	6.83%	9.69%	2.89%	4.43%	7.40%	1.70%
Charge-offs (2005)	5.52	$ -	11.28	2.88	29.11	12.75
Net Income Per $1,000 Loan Volume (after charge-offs)	$ 62.79	$ 96.87	$ 17.64	$ 41.45	$ 44.85	$ 4.22
Net Margin Percentage (after charge-offs)	6.28%	9.69%	1.76%	4.15%	4.49%	0.42%

Part IV
Identifying Factors of Success of Affordable Payday Loan Alternatives

This analysis of affordable PDLs and participation in state and national PDL reform efforts have suggested several key factors for the success of affordable alternative PDLs. These factors can be categorized into three areas: consumer protections, factors supporting financial and operational viability, and attractiveness of the product as an alternative to high priced PDLs.

Key Payday Loan Consumer Protections

A major part of the work of advocates has been the establishment of consumer protections for PDL borrowers. These protections include:

Consumers Should Not Be Encouraged to Over-Borrow: Initially, predatory PDLs were single payment products, necessitating the payment of the entire loan principal in additional to loan fees. Most consumers experienced great difficulties paying the entire principal and refinance or rollover their loans for an additional term. This led to a spiraling of debt for many borrowers, who experienced indebtedness for months if not years. For that reason, advocates proposed that loans should be relatively small, and designed to allow borrowers to repay the loan with a portion of their next pay check.

Most of the lenders in this pilot, and increasingly in the predatory PDL industry, offer installment loans which allow borrowers to make smaller payments over a longer term. In any case, whether the loan is a single payment loan, or an installment loan, the loan principal should be based on the borrower' ability to repay.

Many of the credit unions in this pilot have adopted this loan feature or instituted other practices to discourage over-borrowing. Northeast Community FCU staff work with members, many of whom are on fixed- or low-incomes and homeless, on a one-on-one basis to discourage them from over borrowing, especially during holiday seasons. In addition, Northeast Community FCU makes affordable PDLs for as low as $40. To discourage over borrowing, Bethex FCU offers a range of short-term consumer loans, for as low as $500. ASI FCU requires borrowers of its Payday Lender ReBuilder Loan to agree in writing not to take out another payday loan during the term of their loan with the credit union. Borrowers must also agree to attend financial education classes which are led by the credit union's CEO. The classes include basic budgeting but are also flexible so that concerns of participants can be addressed.

The Interest Rate of Payday Loans Should Be Affordable: Payday loans offered by predatory lenders generally have triple digit interest rates of 500 percent or more. The rates of loans should be more affordable, and reflect the cost of other short-term consumer products, such as credit cards. The interest rates of the CDCU alternative PDLs is 12-18 annual percentage rate, a fraction of the cost charged by predatory payday lenders. These interest rates are also constrained by regulation. NCUA has mandated that federal credit unions can charge no more that 18% APR for loans.

Consumers Should Not Be Encouraged to Use Payday Loans as a Long-Term Strategy: Payday loans are short-term loans but due to the prevalence of refinanced loans and the increasing use of installment loans, predatory PDLs cause longer-term cycles of debt.

An affordable PDL product should not allow borrowers to carry debt over an extended period of time. Some lenders in this study limit the number of loans that a borrower may receive to discourage chronic use. West Texas CU had limited the number of loans that borrowers can receive in one year.

Financial counseling can also play a role in this regard. All of the credit unions offer financial education, although most assert that it is challenging to attract participants to the class. They contend that one-on-one counseling with loan officers and tellers, some of whom have been trained in financial literacy, is a much more effective way to discuss financial matters with credit union members. However, financial education can be integrated into affordable PDL programs. Individuals with multiple affordable PDLs from West Texas CU are encouraged to attend the credit union's financial literacy classes. Their credit union schedules these sessions as needed and generally attracts 25-30 participants. Other credit unions, including South Side Community FCU and ASI FCU make financial education a condition of the loan for some borrowers.

Encouraging savings for borrowers is also an effective way to discourage long-term use of affordable PDLs. Faith Community United CU, ASI FCU, and Bethex FCU have mandated savings from borrowers of their affordable PDLs.

Establishing a positive credit history is also integrated into the affordable PDLs. All of the credit unions report payment history of affordable PDLs to the major credit bureaus.

Factors Supporting Financial and Operational Viability of Affordable Payday Loans

If the number of affordable PDL products offered by mainstream financial institutions is to grow, they must be financially and operationally sustainable. Some key factors supporting sustainability include:

Direct Deposit/Automatic Deduction: The lenders in the pilot program assert that requiring or encouraging borrowers to directly deposit their paychecks or benefit checks and offering automatic deduction of loan payments is critical to decreasing delinquencies and charge-offs and increasing the financial sustainability of affordable PDLs. Direct deposit strengthens the relationship between the credit union and the member. Deducting loan payments electronically from the member's account increases the likelihood that the loan will be repaid. It is also convenient for the borrower, ensuring that payments are made even if they are traveling or have other difficulties sending payments.

Federal credit union examiners have, in some cases, not allowed credit unions to mandate direct deposit as a condition of a loan. Further, in some immigrant communities, people work as casual laborers and do not receive a regular paycheck. However, there are ways to encourage direct deposit without mandating it for all affordable PDL borrowers. South Side Community FCU offers a rate reduction for borrowers with direct deposit. Some credit unions have elected to offer affordable PDLs only to customers with direct deposit.

Loan Loss Reserve: Some of the credit unions participating in this program used part of their funding to establish a separate loan loss reserve. Having a separate reserve allowed them to assume greater risk in making the loans. In addition, ASI FCU reported that a separate loan loss reserve helped them to track loan losses and determine the feasibility of the program. Further, their federal examiners gave the affordable PDLs less scrutiny due to a separate loan loss reserve. ASI FCU also reported that given the financial challenges it is experiencing post Hurricane Katrina, the credit union would have most likely discontinued their Payday Lender ReBuilder Loan program if grant funding had not been available for a loan loss reserve. South Side Community FCU also reported that due to their small size, they would not have been able to provide the program without funding of the loan loss reserve. Several credit unions also stated that having a separate loan loss reserve allowed them decreased product risk and therefore allowed them to charge a lower interest rate. Bethex FCU reported that the losses from this program were very low, and therefore a loan loss reserve is less critical for the credit union.

Credit Reports: The credit unions differed on their opinions of usefulness of credit reports. ASI FCU, Faith Community United CU, and Bethex FCU noted that using credit reports as part of the underwriting decision would eliminate many members from qualifying for an affordable PDL. In addition, they reported that obtaining credit reports makes the loan process longer and more expensive. Northeast Community FCU waives this requirement if the member has direct deposit with the credit union because many of their members are recent immigrants that do not have adequate credit histories.

South Side Community FCU, which uses credit reports as part of the credit decision, rolls the cost into the loan application fee. In addition, borrowers with poor credit scores must have a larger deposit on hold at the credit union than those with better credit scores. West Texas CU and South Side Community FCU also contend that requiring credit reports introduced their members, many of whom were previously unbanked, to the practices of mainstream financial institutions. It also helps to distinguish credit unions from high costs PDL lenders, which conduct no underwriting of loans. Some of the credit unions that do examine borrower's credit reports say that it is only one part of the credit decision—they also consider length of relationship with the credit union, work history, and other factors.

Several of the credit unions use credit reports to help members understand their credit status and determine what kind of financial counseling or classes the borrower may need. Although they are not a condition of loan approval, Bethex FCU uses credit reports to identify the borrower's record of collections or charge-off accounts because it is much more predictive of repayment than delinquent loans and other factors. In addition, Bethex FCU has found that obtaining credit reports allows the credit union staff and the borrower to identify and correct erroneous data, which happens quite often with immigrants.

Tenure of the Relationship with Borrower: Although only ASI FCU, Northeast Community FCU, and West Texas CU require a minimum tenure requirement for borrowers of an affordable PDL (from 3-6 months), most of the lenders participating in the pilot reported that borrowers that have belonged to the credit union one year or more have lower delinquency and default rates than new members. In fact, ASI FCU reported that members with longer tenures often make repaying their credit union obligations a priority when they experience financial difficulties. ASI FCU and Northeast Community FCU will waive the minimum tenure requirement depending on the borrower's credit rating, work history, or if they have direct deposit.

Bethex FCU and Faith Community United CU do not have minimum tenure requirements. Bethex FCU observed that the tenure of the member had little impact on repayment rates. They asserted that the most important criterion was the member's commitment to the credit union. They also reported that most of the borrowers for the affordable PDL are long-term members that have other credit union loans. Faith Community United CU requires that the borrower's first direct deposit must be made before they are eligible for an affordable PDL.

Size of Financial Institution: Most of the credit unions participating in this evaluation agreed that smaller financial institutions may face more challenges in offering an affordable PDL than their larger counterparts. One CDCU reported that if a credit union is so small that it does not have the capacity to offer direct deposit or automatic bill payment, that it should not offer affordable PDLs. Another asserted that small CDCUs may encounter greater opportunity costs than larger credit unions. That is, it may be necessary for staff of smaller institutions to take time away from another product or service to develop and market a new loan product. Staff and processing costs are a significant factor in the financial sustainability of lending. A good computer system that automates loan processing is integral to lowering costs. South Side Community FCU advised that larger credit unions can more readily absorb the risks of new innovative products because a PDL alternative would constitute a smaller portion of their loan portfolio. Last, a credit union noted a further limitation for smaller institutions. It asserted that it is important to be able to offer home refinance, auto loans, and other products with higher returns, to offset loan products with lower returns, such as unsecured consumer loans.

However, other credit unions disagreed. Bethex FCU noted that if a smaller institution already offers an unsecured consumer loan, that the development and implementation of an affordable PDL is less time consuming. It is also interesting to note in this study, the smallest credit union, South Side Community FCU, had the third highest net income per affordable PDL of credit unions participating in this study.

Other Factors: The interest rates for affordable PDLs described in this report are no higher than 18 percent. However, to offset processing costs, some of the credit unions have initiated other loan fees, including loan application fees, fees for returned checks, late loan fees, or fees to cancel direct deposit.

The income of borrowers was cited as a major factor of financial sustainability by one credit union. Bethex FCU asserted that the overall financial sustainability of their credit union is constrained because they serve lower-income members that require higher levels of personal service. In addition, their average loans and accounts balances are lower than other credit unions, constraining investment and loan income.

All the CDCUs reported that although operational and financial sustainability is important, their priority was to be responsive to member demand. They noted that members without access to affordable PDL product would otherwise rely on predatory payday lenders.

Faith Community United CU stressed that encouraging member savings and improving financial management skills is integral to the financial sustainability of the credit union. In addition to enabling borrowers to build wealth and decrease their reliance on PDLs, members with stronger financial skills mean a more viable CDCU with higher account balances and lower loan delinquencies and defaults.

Increasing the Attractiveness of Affordable Payday Loans

A major advantage of predatory payday lenders is that their loans are relatively easy to obtain. Predatory payday lenders have truncated requirements; typically pay stubs, a post dated check, or a contract to allow automatic deductions from checking or savings accounts. Further, most use quick automated systems to verify social security numbers, and home addresses. Although customer convenience must be balanced with underwriting procedures, affordable PDL lenders should consider ways to make their loan products relatively easy for borrowers to access, including the following:

Convenience: Credit unions in this report recognize that affordable PDLs need to be convenient for their members; otherwise they will resort to a predatory PDL. The credit unions employ several tools to shorten the application and underwriting process. Several of the credit unions reported that in addition to enhancing financial sustainability, that PDL borrowers value the convenience of automatic loan deductions from accounts and direct deposit of wages. Northeast Community FCU, Faith Community United CU, and South Side Community FCU offer shorter loan application forms for affordable PDLs. Further, Faith Community United CU’s line of credit product necessitates only one loan application that is good for one year. To expedite the loan process, ASI FCU allows branch managers and member service representatives to process and approve affordable PDLs without having to refer to a loan officer for approval.

However, expediting loan applications is dependent on the capacity of the credit union. Due to high demand for affordable PDLs, South Side Community FCU requires a one day waiting period before loans can be closed.

Credit Union Membership Tenure: Although membership tenure may be an important underwriting factor, some credit unions do not have a minimum tenure requirement in order to make affordable PDLs more accessible for new members. Those CDCUs that do mandate a minimum membership tenure for these loans may waive that requirement if the borrower can demonstrate a sufficient work history, good credit, and has established direct deposit.

Interest Rate and Fees: Compared to the triple digit interest rates offered by predatory payday lenders, the finance fees of the CDCUs participating in this pilot are very affordable.

Closing

The affordable PDLs documented in this report are important in the effort to protect consumers from predatory and high cost PDLs by offering affordable alternatives. The credit unions participating in this program adopted loan features that discourage over-borrowing by limiting the number of loans a borrower may receive and encouraging or requiring financial education. They also encourage the borrowers to accrue savings during the term of the loans, so that they do not need to rely on loans to pay future emergency expenses.

While the revenue and costs of the products varies, these loans are financially and operationally viable. The credit unions utilize direct deposit, automatic payment of loans, special loan loss reserves, and credit reports to improve repayment. In addition, some also target longer-term members, who may have better repayment records, to decrease the credit risk of these products.

The size of the financial institution is a major factor in financial and operational sustainability. Larger institutions can lower program costs by offering direct deposit and automatic loan payments, and utilize loan processing software to decrease staff costs. Larger institutions can also minimize the opportunity costs of new products and because these loans are a smaller portion of their loan portfolios, spread the risk across multiple loan products.

These products have also been designed to serve as a convenient alternative to predatory PDLs. Many of the credit unions have adopted expedited loan applications and processing, which allows borrowers to receive their loans proceeds in just a few minutes. Some are also allowing new members to apply for affordable PDLs.

The growth of affordable PDLs is important for lower-income families who live pay check to pay check. These products serve as competition to predatory PDL lenders, which may be forced to lower their costs due to competitive pressure. It is imperative that regulators encourage and enable large credit unions, banks, and thrifts to establish affordable PDLs as an alternative to predatory PDLs and high cost bounce protection programs. The FDIC's Affordable Small Loan Guidelines issued by Chairman Sheila Bair are integral to the effort to develop affordable consumer loans. Last, these products document that it is financial feasible to offer loans at an affordable rate. Predatory PDL lenders assert that they mostly charge triple digit interest rates because of the high risk of these loans. However, the CDCUs in this report document that by instituting common sense underwriting procedures, risk can be greatly minimized. This evidence should demonstrate to policy makers and regulators that the cost structure of predatory payday loans is indefensible.

Appendix A

APPLE – Alternative Products to Payday Lending
Woodstock Institute Evaluation

Month 18 Survey
January 2006 to June 2006

Please complete and send this survey and supplementary materials to Marva E. Williams at the Woodstock Institute at marvaw@woodstockinst.org by **Friday July 28th**. I have also sent a copy of this form to you by email so you can complete it in electronic form. Supplementary materials include alternative products to payday lending brochures, flyers, loan documents, loan applications, loan policies, etc. If you have any questions, please call Marva at 312/427-8070.

Name of Credit Union____

Name of Payday Loan Alternative Product____

Date Payday Loan Alternative Product was made available to members________________________

Name of Person completing survey____

Email and Phone number of person completing the survey_______________________________

____

Description of the Payday Loan Alternative Product

Changes to Product after December 2005		
1.	Please describe any changes to payday loan alternative product that occurred after December 2005: Loan terms: minimum and maximum loan amount; type of loan; loan term; interest rate; loan fees; loan restrictions; other. Underwriting criteria: membership tenures; requirement or encouragement of direct deposit or payroll deduction; employment, income ratios; financial literacy workshops, frozen deposits or accounts; etc. Product Administration: collection practices; marketing; use of technology; financial literacy workshops; community partnerships	Click here to edit.

Loan Activity January 2006 to June 2006

Loan Capacity		
2.	Number of borrowers over past six months:	Click here to edit.
3.	Number of loans made over past six months:	Click here to edit.
4.	Loan volume of loans made over past six months	Click here to edit.

Member Tenure of Borrowers (of borrowers receiving their first loan)		
Please fill in number of borrowers over the last six months with tenure…		
5.	Less than one month:	Click here to edit.
6.	1-5 months:	Click here to edit.
7.	6-12 months:	Click here to edit.
8.	12-48 months:	Click here to edit.
9.	Over 4 years	Click here to edit.

Purpose of Loans		
Please fill in number of loans over the last six months intended for:		
10.	medical expenses:	Click here to edit.
11.	car repair:	Click here to edit.
12.	children (tuition, school supplies, clothing, etc.)	Click here to edit.
13.	work-related expenses:	Click here to edit.
14.	pay bills:	Click here to edit.
15.	other (please specify):	Click here to edit.

Credit Scores of Borrowers		
Please fill in number the number of borrowers over the last six months within each range:		
16.	No score:	Click here to edit.
17.	400-499:	Click here to edit.
18.	500-599:	Click here to edit.
19.	600-699:	Click here to edit.
20.	700-199:	Click here to edit.
21.	Average number of collections accounts per borrower:	Click here to edit.
22.	Number of borrowers who have ever declared bankruptcy:	Click here to edit.

Loan Delinquencies for Loans Made from January 2006 to June 2006			
Please fill in the number of loans and total amount of loans per range:			
		Number of loans:	**Total amount of loans:**
23.	1-29 days:	Click here to edit.	Click here to edit.
24.	30-59 days:	Click here to edit.	Click here to edit.
25.	60-89 days:	Click here to edit.	Click here to edit.
26.	90 days or more:	Click here to edit.	Click here to edit.
27.	Defaults:	Click here to edit.	Click here to edit.
28.	Amount of loan-loss reserve used:	Click here to edit.	Click here to edit.
29.	Total Charge offs since **January 2005**	Click here to edit.	Click here to edit.

Payday Loan Alternative Product
Estimates of Cost and Income
January 2006 to June 2006

Credit Union Cost			
Please fill in the estimated number of hours and cost per hour for **EACH** loan:			
		Avg. number of hours for EACH loan:	**Cost per hour:**
30.	Take each application:	Click here to edit.	Click here to edit.
31.	Review application:	Click here to edit.	Click here to edit.
32.	Close loan:	Click here to edit.	Click here to edit.
33.	Service loans (sending bills, crediting payments, etc.):	Click here to edit.	Click here to edit.
Please fill in the estimated costs for payday affordable loans:			
34.	Loan collections:	Click here to edit.	
35.	Cost of marketing materials:	Click here to edit.	
36.	Staff training:	Click here to edit.	
37.	Other expenses (please specify):	Click here to edit.	

Credit Union Revenue/Income for January 2006 to June 2006		
38.	Interest earned:	Click here to edit.
39.	Loan application fees:	Click here to edit.
40.	Late loan fees:	Click here to edit.
41.	Other fees (please specify):	Click here to edit.
42.	Interest earned on loan loss reserve:	Click here to edit.

Identifying Factors of Success of Affordable Payday Loan Alternatives

The purpose of this evaluation is to identify how affordable PDLs can be replicated in other communities. In order to be operational, affordable PDLs need to be financially and operationally sustainable and an attractive alternative to high priced payday loans being offered in the community.

Please provide your comments in the space below on factors that you think are instrumental to financial and operational sustainability of affordable PDLs for credit unions and appeal for credit union members.

Factors Supporting Financial and Operational Viability

43.	**Direct Deposit/Automatic Deduction:** Please comment on the role of direct deposit or automatic deductions to underwriting or securing affordable PDLs and reducing delinquencies and charge-offs.	Click here to comment.
44.	**Loan Loss Reserve:** How important is it to have a separate loan loss reserve for affordable PDLs? Would your credit union offer this product without a separate loan loss reserve funded by banks, foundations or others?	Click here to comment.
45.	**Credit Reports:** should credit reports be part of the credit decision? If so, how? How else can credit reports increase the financial sustainability of affordable PDLs or to improve member education?	Click here to comment.
46.	**Size of Financial Institution**: do you believe there are disadvantages to smaller institutions offering affordable PDLs? What are those disadvantages? Is there an economy of scale to making affordable PDLs?	Click here to comment.
47.	**Tenure of the Relationship with Borrower:** do longer term members have a better record of repayment of affordable PDLs? If so, what tenure is best? Over 6 months? One year?	Click here to comment.
48.	**Other:** please provide information on other factors you believe are instrumental to the financial and operational sustainability of affordable PDLs.	Click here to comment.

Attractiveness As an Alternative to High Priced Payday Loans

49.	**Convenience:** what features would you recommend to make affordable PDLs more convenient for members to obtain?	Click here to comment.
50.	**Membership tenure:** Does your credit union have a shorter member tenure requirement for affordable PDLs than other loan products? Do you think this is an important feature to offer?	Click here to comment.
51.	**Application process:** Has your credit union established a shorter or expedited loan application and process for affordable PDLs?	Click here to comment.
52.	**Other:** please comment on other factors you believe are instrumental to making affordable PDLs more convenient for borrowers.	Click here to comment.

Appendix B

Other Costs of Affordable Payday Loans

In addition to estimating costs to take, review, close, and service loans, the credit unions were also asked to estimate the variable costs, including loan collections (not covered by staff costs), marketing materials, staff training, and other costs, such as research, forms, financial literacy seminars, etc (as shown in Figure 13). Here again, there is significant variation in cost estimates due to varying time estimates and staff costs. Some credit unions, like ASI FCU and Northeast Community FCU have very low estimates of costs for marketing materials and staff training. West Texas CU and Faith Community United CU estimate the highest other costs.

Other Costs of Affordable Payday Loans

	ASI	Bethex	Faith Community	Northeast Community	South Side Community	West Texas
Loan Collections	$ 100.00	N/A	$ 450.00	$ 150.00	$ 510.00	$ 303.94
Marketing Materials	$ 0.00	$ 400.00	$ 1,200.00	$ 100.00	$ 1,000.00	$ 4,000.00
Staff Training	$ 0.00	$ 750.00	$ 500.00	$ 300.00	N/A	$ 775.10
Other Expenses	$ 0.00	$ 186.00	$ 2,500.00	N/A	$ 700.00	N/A
Total	**$ 100.00**	**$ 1,336.00**	**$ 4,650.00**	**$ 550.00**	**$ 2,210.00**	**$ 5,079.04**

WOODSTOCK INSTITUTE

Woodstock Institute, a Chicago nonprofit incorporated in 1973, works locally and nationally to promote sound community reinvestment and economic development in lower-income and minority communities. It collaborates with community organizations, financial institutions, foundations, government agencies, and others to promote its goals.

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