Community Development Credit Unions: An Emerging Player in Low Income Communities

Charles D. Tansey

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COMMUNITY DEVELOPMENT CREDIT UNIONS: AN EMERGING PLAYER IN LOW INCOME COMMUNITIES

BY CHARLES D. TANSEY

I. INTRODUCTION

The Community Development Credit Union may be the best replicable model for providing affordable capital and financial services in low-income and very low-income areas. Why can't there be more of them?

During the summer of 1999, a three-day blackout struck parts of New York City. Particularly hard hit were large sections of Washington Heights, a low-income, largely Hispanic area in northern Manhattan. Over 300 small businesses -- florists, butchers, grocers, bodegas -- lost money due to spoiled inventory, closures, and other blackout-related causes. Losses ranged from $1,000 to $13,000. Unable to provide disaster assistance under existing regulations, the SBA decided to develop an inexpensive loan guarantee program for the businesses using its 7(a) loan guarantee program.

But there was a problem: most of the banks that back their loans with SBA guarantees found these loans too small to be profitable. However, two local Community Development Credit Unions (CDCUs), Bethex and Neighborhood Trust, showed up and said that these were exactly the kinds of loans and customers they wanted. The question was: could the CDCUs participate in the SBA's loan guarantee program? The good news was that they could. This was important since the guarantee program enhances profitability, liquidity and capitalization for its lending partners -- thereby enabling lenders to provide credit on reasonable terms to high-risk borrowers.

The bad news, as it turned out, was that the SBA policies, procedures and paperwork were too complex for the CDCUs and incompatible with their flexible, street-wise lending practices. The SBA process was frustrating not only for the lenders, but also for their intended borrowers, many of whom spoke Spanish, had not borrowed before, and had limited capital, collateral, and financial records. Not that the two credit unions were imprudent lenders-- quite the contrary, the SBA ultimately approved them for the 7(a) program because their delinquency and loss figures were perfectly acceptable. Indeed, they could demonstrate that they were able to lend prudently to higher-risk borrowers without the costly analytical, structural and administrative constraints that burden the SBA's other lenders. Nevertheless, the procedural complexity of the SBA lending was an impediment. It begged the question: why should the CDCUs change the way they lend when they are doing it so well? Or, why shouldn't the SBA adjust its program to better suit the lenders that serve the SBA's target market so effectively?

In the end, the banks and the SBA approved a small number of loans to the businesses affected by the blackout and were congratulated on meeting what had turned out to be a very difficult challenge. But the collective effort was not equal to the real task: providing for the short-run needs

of the bulk of the businesses, providing for their long-term opportunities, and building a financial platform for serving the needs of the community.

Almost two years later, in a front-page article in the New York Times on April 23, 2001, Washington Heights was used as a key example in a discussion of commercial loan-sharking and alternative lending. Titled *In Some Immigrant Enclaves, the Loan Shark is the Local Bank* , the article illustrated how and why loan sharks ("prestamistas") dominated the $10 million-dollar-a-year commercial lending market in Washington Heights while charging 2 to 5 percent a week. Their key advantages over banks: speed, little or no paperwork, no language barriers, high approval rate -- *and the prestamistas knew their customers*. The article ended with an interesting anecdote: "Milton Balacer, who operates a tiny grocery store on the Grand Concourse in the Bronx said he borrowed $14,000 from the prestamistas over the years, and paid back $28,000 with interest. Then in 1999, Mr. Balacer saw an ad in a local Spanish language newspaper for Neighborhood Trust, a nonprofit credit union in Washington Heights, from which he has borrowed several thousand dollars to spruce up his store. The interest rates are wonderfully low, he says. "'I'll never use the prestamistas again.'"

Clearly, in low-income areas like Washington Heights, the CDCU can play a critical role.

So, why aren't there more CDCUs?

In one sense, the answer is simple: like the 80-miles-per-gallon automobile, development of CDCUs over the past decades has had too few financial and human resources. Perhaps it is because conventional lenders are apprehensive about the sustainability of business in the low-income markets that CDCUs serve. Perhaps it is because CDCUs are too little known. Perhaps it is because the CDCUs themselves -- together with the credit union industry -- have not done enough with the resources they have. However, there are numerous steps that can be taken to substantially expand both the reach and the delivery capacity of these financial platforms.

Let's take a look at the industry and some of the ways it could grow.

II. BACKGROUND

Low Income or Community Development Credit Unions (the terms are often used interchangeably) are designed specifically to deliver financial services and capital to low-income individuals and communities. The term "Low Income" is an official National Credit Union Administration (NCUA) designation for credit unions that serve members, more than half of whom earn less than 80 percent of the average for all wage earners as established by the Bureau of Labor Statistics, or 80 percent of the area median household income as established by the Census Bureau.

The significant feature of the CDCU is that it is a non-profit financial institution dedicated to -- and managed by -- the members of a geographically designated low-income area. The main emphasis is the empowerment of individuals in under-served communities through responsible

money management and saving. In this respect, the CDCU effectively functions as a peer-lender -- a U.S. parallel to the more publicized international peer-lending entities like Grameen Bank. It is this “peer-lending” characteristic that affords the CDCUs their unique grasp of the needs of their members and communities, and enables them to tailor services, loans and financial education accordingly. It also enables them to educate their members and monitor loan performance on an immediate and informed basis.

CDCUs are of varying sizes and constituencies, in both rural and inner-city areas. They are generally small institutions. As of 1999, over 64 percent of the CDCUs had total assets of under $5 million and over half of these had total assets of under of $1 million. Sixty-five CDCUs had assets of under $250,000.

At year-end 1999, there were approximately 538 CDCUs in the U.S. serving low-income and very low-income populations, up from 134 in 1991. They had $6 billion in total assets with a capital ratio of 12.1 percent (the capital ratio for all credit unions was 11 percent). Loans were broken down as follows: used autos -- 24 percent, first mortgages -- 22 percent, new autos -- 16 percent, unsecured loans -- 10 percent, other real estate -- 8 percent, and credit cards -- 5 percent. Notwithstanding the higher risk profiles of their constituencies, CDCUs ran only a marginally higher delinquency and charge-off rate than the credit union sector altogether: delinquencies of 1.8 percent for the CDCUs versus .75 percent, and charge-offs for the CDCUs of .8 percent versus .6 percent. These ratios are comparable for many community banks (the charge-off ratio for all FDIC-insured banks as of September 30, 2000, for example, was .6 percent), a fact that attests to the benefits of knowing the client while providing the kinds of services and support that entry-level constituents require.

III. BRIEF HISTORY

The first credit union, St. Mary’s Bank in New Hampshire, was set up to serve low-income people in 1908, but substantive growth of the CDCU type of institution didn’t occur until the 1950s and 60s. CDCUs were established in both urban and rural environments and were sponsored primarily by churches and social service organizations. The main focus was on savings and other financial tools required for survival, and the constituents were primarily those who were excluded from the banking system, including many African-Americans. The concept was expanded dramatically during the 1960s War on Poverty, when the Office of Economic Opportunity helped create hundreds of credit unions associated with Community Action Agencies. This experiment, however, failed, largely due to a lack of financial education and discipline, planning, and management capacity. In the 1970s and 1980s the industry struggled with a variety of impediments including recessions, exceptionally rigorous regulatory standards, the absence of funding, and neglect on the part of the federal government and its agencies. In the 1990s, aggressive steps by the trade group, the National Federation of Community Development Credit Unions (NFCDCU), combined with the active support of the Clinton Administration, the Credit Union National Association (CUNA), the National Credit Union Association (NCUA), and a wide range of foundations and corporations, accelerated the growth of the industry. The reason was simple: properly deployed, the

CDCU model addresses the needs of low-income constituents and communities in an effective and efficient manner.

IV. THE CHALLENGE

But the dramatic expansion has not been without trouble. An estimated 50 percent of the start-up CDCUs in the 1990s failed. Unlike conventional lenders (with a few notable exceptions), these failures were not due to excessive risk-taking. The main reasons for failure were: under-qualified management and boards; inadequate capital, liquidity, bookkeeping, and staffing; limited range of services; inadequate economies of scale; absence of collaboration with community partners; and inadequate use of existing programs and financial institutions to support their efforts. An underlying factor was the endemic inability to pay managers a skill-appropriate wage -- an ongoing problem for successful CDCUs as well as unsuccessful start-ups -- which resulted in turnover and loss of crucial institutional knowledge. On top of this, the time it took to bring a start-up to viability was considerable -- the chartering process alone often taking between 18 and 36 months -- which tended to drain both resources and motivation.

Clearly, acolytes of the "survival-of-the-fittest" school could chalk these failures up as just another statistic in a myriad of statistics that define marginal financial models. But CDCU charter applications aren't approved unless there is a demonstrated and compelling need for financial products and services in the targeted community. What happened to those low-income communities where these start-ups failed? Has some other entity stepped up to assist these constituents? We don't know. But is there a better (replicable) model out there for delivering financial products and services? No, and it's a good bet that those low-income communities remain without service.

So, should more effort and resources be dedicated to the CDCU model? Given the compelling needs, we'd like to say yes. But, before we jump ahead to a conclusion, there are several key questions that require investigation.

A. Why are small loans to low and very low-income constituencies unattractive to conventional lenders?

There are numerous reasons that the CDCU model is moving to the forefront of financial delivery in low-income areas. Many of the reasons derive from trends in the banking business:

- Banks have been under increasing pressure to produce competitive Price to Earnings (P/E) and Earnings Per Share (EPS) ratios, and stock prices. These pressures force the banks to focus on profitability and high rates of growth. As these pressures translate through service and loan pricing, staffing, and volume, they essentially prevent banks from taking the individual risk, the necessarily customized product for entry-level and low-income constituents.
- Technological developments accelerate and intensify this trend: credit scoring, securitization and portfolio management all represent major departures from traditional commitment and

delivery of lending and other services on a localized, individual loan basis. It used to be said that it costs just as much to book a $25,000 loan as a $250,000 loan. That is no longer true: nowadays the commercial borrower looking for $250,000 is more likely to credit score well than the borrower looking for $25,000, and credit scoring costs substantially less.

- The regulatory approach, which focuses on safety and soundness, reinforces the trends towards homogeneity and high volume at the institutional level; e.g., efficiency ratios, delinquency rates, and reductions in the cost of origination and underwriting all add up to improved profit margins and capital. Regulatory and accounting standards, which require absolute declarations about (i) when to charge a loan off; (ii) how much collateral is required; (iii) justification of the loss provisions on the basis of actual loans identified, and the like, militate against the kind of hand-holding and customization that many low-income individuals require.
- In the new financial services realm created by the Gramm-Leach-Bliley Financial Modernization Act, banks can go horizontal, rather than vertical: e.g., the smart growth strategy now means a wide array of services that fit limited socio-economic niches. Through these niches the banks drive insurance, retail, travel, affinity cards etc. looking for profitability in low-margin businesses on the basis of dollar volume. It's a manifestation of the traditional "80/20 theory": targeting the 20 percent of the customers who generate 80 percent of the profit results in full service for the customers who make cross-selling profitable, e.g., the ones who have the money. (To wit, the growth of the Private Banking Division).
- Anecdotal evidence strongly suggests that centralized loan approvals and reductions in workout capability ensure that the "story" credit -- which doesn't fit the "cookie cutter" model -- does not get served or served well. Low-income individuals often don't fit the cookie cutter in a number of particulars: credit history, home ownership, collateral, and capital to name a few. But there are other non-financial particulars as well: language, familiarity with administrative requirements, financial literacy.

Clearly, in today's financial environment, there is an increasing need to firmly lock in the capital flow to low-income communities in a replicable, mainstream (disciplined) manner.

B. Why can community development credit unions – as a group – produce such low loan loss rates while lending to the high-risk profiles that conventional lenders avoid?

In rural Georgia, there is a CDCU named the Unified Singers Credit Union. It was established in 1968 by the members of three African American churches. Staffed by one full time and one part time employee, it provided personal loans, home improvement loans and equipment loans to rural African Americans who had no other access to financial services or capital. In 1997, Unified applied to the CDFI Fund for some capital. Unified had about $700,000 in assets, and demand for an additional $300,000 in loans from its members -- with no other way of raising funds to serve the need. What was striking about Unified was that, despite the very low income of its constituents, it had experienced only one bad loan in over a decade. And a relative of the delinquent borrower "went all the way to Tennessee" to get the money back. Unified Singers was awarded the CDFI capital. Such a performance is the envy of all banks.

Some of the reasons this works over and over again are based in the structure of the CDCUs:

- They are based in the community they serve, and their survival depends largely on the relationship to that community.
- As non-profits, they are free to grow in concert with the local economy and constituent needs instead of growing at rates dictated by P/E, EPS and stock prices.
- The boards of directors consist primarily of volunteers drawn directly from the community.
- They cultivate long term relationships with their members, from entry level transactional activity through home and business ownership.
- Because they can combine training for clients with services and capital, each step of the educational process can have identifiable rewards -- as well as a seamless transition to the next step.
- As depositories, they can monitor the cash activity of their members -- often the best indicator of credit risk.
- They can provide technical assistance at the teller window.
- They are often the only “game in town” for their members.
- They are non-hierarchical and maintain an equal relationship among lenders, depositors and borrowers.
- The door is open and there’s somebody to talk to, most likely someone who is seen regularly around the neighborhood.

Effectively, the CDCU provides financial capacity in the context of the cultural and/or socio-economic attributes of the constituents it serves. And it serves communities that other financial institutions most often cannot serve. It is an optimal structure. At a time when increased immigration and ethnic diversity are combining with economic polarization and commodification in the banking industry, the need for this kind of entity is rapidly increasing.

C. What can CDCUs and the credit union industry as a whole do to improve service to low-income clients and communities?

Together with several institutional contributors, the National Federation of Community Development Credit Unions (NFCDCU) has concluded that there should be at least 2,000 of these kinds of institutions around the country. The 50 percent failure rate of start-ups over the past decade, however, attests to the magnitude of the changes required to achieve such a goal.

Perhaps the most immutable of the many impediments to this kind of growth is availability of qualified management. Many of the most successful CDCUs have been developed and managed by a few highly disciplined and motivated individuals. It has typically taken years for them to usher their institutions to the level of success they enjoy – on top of the 18 to 36 month chartering process. One of the key reasons is that it takes time to develop the capacity to provide a full range of services – e.g., from taking deposits and making personal loans to providing ATMs, home mortgages and

commercial loans. It requires a strong sense of mission to override the generally poor pay and prospects for personal growth that tend to correspond with this work over an extended period of time. To find several thousand such people, conversant with financial products and services, who can step up, initiate and manage a new generation of CDCUs on a national scale is an unlikely proposition. And this is on top of the difficulty of finding the capital and other resources required for a successful startup and consequent delivery of the full range of products. The fact that *existing* CDCUs, which serve as the platform for future industry growth, are also in need of additional capital, liquidity, resources, information and educational capacity, merely adds to the challenge of growing the industry.

Under the circumstances, talk about quadrupling the number of CDCUs verges on irrational exuberance. Though much has been done, the sector remains tiny in the face of the needs.

The following proposals are structured to rationalize the exuberance through a combination of strategies that strengthen and expand resources, delivery capability and constituent participation:

1. Work more effectively with existing resources in the credit union industry

In response to the key challenges of time and management, the NCUA has taken two key steps over the past several years:

- Initiated the "express charter" program which abbreviates the chartering process through the use of boilerplate business plans and documentation. This dramatically reduces the burden on time and resources for start-up CDCUs.
- Initiated a program to require existing credit unions to file community action plans with an eye towards encouraging them to set up branches in low-income neighborhoods. These branches can be spun off as CDCUs once they are up and running -- a step that could ensure the incorporation of critical community-based knowledge and management in the ongoing operations of the unit. In the last several years, the number of credit unions expanding into low-income areas as part of this initiative has risen from nine to 150.

The credit union industry also benefits from the availability of the Credit Union Service Organization (CUSO) structure. CUSOs can be established by groups of credit unions or CDCUs for the purposes of gaining economies of scale by joining resources and collectively delivering products and services on a local, regional, or national basis. There is also a comprehensive network of Credit Union Leagues throughout the United States that can be used to achieve similar objectives. CUSOs and Credit Union Leagues can and should be used to greater advantage by CDCUs in developing ATMs, credit card, data processing, home mortgage, business lending and other more advanced financial services through the CDCU platform. In addition, there are about 30 central credit unions which can provide liquidity, using a range of depository and investment vehicles. All of these entities are dedicated to facilitating the growth and effectiveness of credit unions, and a sure test of the viability of a CDCU is the extent to which it takes advantage of them. What is needed most in this equation, however, is a concerted effort among these industry resources to coordinate and package

financial products and services for low and very low-income constituencies – to show how, in effect, lending and investment can be profitably and easily conducted by regular credit unions as well as CDCUs. This is a job that the trade organizations, CUNA and the Credit Union Leagues would do well to pursue.

2. Develop replicable portfolio liquidity and capitalization strategies

The industry has been very creative in its various approaches to providing and supporting CDCU funding. The NCUA's $10.6 million Revolving Loan Fund, with its liquidity capability and annual technical assistance grants, is an excellent resource. Even more critical is the NFCDCU's secondary capital product. The regulatory emphasis on capital is particularly challenging for many CDCUs, often translating into asset restrictions that work against their mission and in some cases leading to lending paralysis. Under the secondary capital program, CDCUs can borrow five- to seven-year low-cost money on a subordinated basis that counts as capital for a period of time. As long as the emphasis remains, much more work needs to be done in terms of expanding capital for CDCUs. Three areas in particular need work:

- Many CDCUs have a low loan to deposit ratio. Others have an excessively high ratio. Both groups have an ongoing need for low-cost deposits. A centralized "Federal Reserve" that can reallocate unused funds at liquid CDCUs for short periods to CDCUs with a funding need would be very helpful. This function is currently performed by some credit union centrals, but it is fragmented. The concept could be augmented to include management of loan participations that could serve both to increase loan balances at excessively liquid CDCUs, while diversifying risk for all participants.
- Moneys for secondary capital need to be expanded significantly and the terms and conditions need to be altered to better support CDCU operations and to better meet regulatory requirements.
- While CDCUs are excellent street lenders, very few CDCUs have staff and boards that can perform the various key functions of portfolio management. Specifically, there are limits to their ability to project capital needs in the context of growth, deposit and portfolio mix, pricing versus risk, staffing cost to delivery and the like. These capabilities can dramatically improve the management of scarce resources. The NFCDCU in coordination with Southern New Hampshire University has established a training program for CDCU managers, staff and boards. Additional capacity is required to make this training available to all CDCUs on an ongoing, inter-active basis.

Again, this is a task that the trade organizations, CUNA and the Credit Union Leagues could spearhead.

3. Develop and promote entrepreneurial training

Development in low-income areas is not confined to mortgages, car loans, personal loans, home equity and savings. Small businesses must be served as well. Although a number of CDCUs

successfully lend to businesses, the majority are geared primarily to consumer lending, and do not have depth in either entrepreneurial training or lending. Nevertheless, their members -- and the communities they serve -- have considerable need for capabilities in this arena. Standardized, simple training modules should be developed to increase capacity. Collaboration with entities that have already developed basic training modules such as the National Foundation for Teaching Entrepreneurship, the SBA's Business Information Centers and Small Business Development Centers, and numerous microenterprise development organizations, would eliminate the need to reinvent the wheel.

Training should be broken down into two parts, one for the members and one for the CDCU management:

a. For CDCU members:

Many organizations (e.g., SBDCs, Microenterprise Development Organizations) have standardized educational and financial modules that delineate the size, type, requirements and cost of savings and credit at various stages of entrepreneurial development. They could be provided directly *through* the CDCUs within the following general guidelines:

- There should be a general order of priorities by stage: savings, transactional, personal credit (cards, home-buying), micro-credit, conventional business credit, equity instruments
- Options should exist for participants to adjust local products and services in keeping with the market and their credit appetites
- The training and personal credit development should guide entrepreneurs into actions and performance that coincide with the CDCU's credit criteria, thus providing them with a seamless transition from training to finance
- The module should further work entrepreneurs towards the arrangement of conventional financing beyond the CDCU (e.g., conventional banking)

b. For CDCU staff and boards of directors

The educational and financial modules for CDCU staff and boards could be web-based and include the following features:

- Basic credit analysis and guidelines
- Basic risk/price analysis and forecasting for business loan portfolios
- An on-line help desk established for all participating CDCUs
- A bulletin board where participants can post information through hot links for the benefit of local initiatives
- A supervised chat room
- A newsletter
- Push-button simplicity

These modules should be sufficiently flexible to enable participating CDCUs to adjust to the varying needs of their communities. To be sure, not all CDCU's are in a position to implement these kinds of strategies, but with proper packaging by the trade organizations in cooperation with funders, CUNA, and the Credit Union Leagues, they could be successfully pursued.

4. Expand Individual Development Accounts

"Forty acres and a mule" worked before. So did the GI Plan. Among low-income constituents, the discipline of saving is at least as difficult as -- and often more critical than -- the business of borrowing. Much more needs to be done to encourage savings and wealth-building generally. The Individual Development Account (IDA) is a great place to start, and the CDCUs, their trade organizations and funders should work to substantially expand this product.

The Individual Development Account is a savings account in which the individual's savings are matched by an outside source. Moneys in the account are restricted to certain purposes, such as promoting home ownership, building a business, vocational training and higher education. There is a fragmented -- but national -- movement to build these kinds of accounts as a crucial mechanism for wealth building in low- income communities. Because of (i) the unique relationship that CDCUs have with their members; (ii) the fact that all of the restricted uses can be accommodated in-house; and (iii) the fact that they are managed in the context of regulators and accountants, CDCUs represent an ideal platform for delivering this service in low- income communities across the country.

The NFCDCU has initiated a program for 25 of its CDCUs to begin providing these kinds of accounts. But the money available for matching measures only in the tens of thousands. It should be in the millions -- particularly since these accounts often represent the first savings the individuals have ever set aside. Additional funds should also make possible a new approach: *initiation of an IDA program focused on high-school students and administered in collaboration with high schools by the local CDCU.*

5. Establish youth credit unions

Because credit unions target the fundamentals in financial intermediation, they are the ideal platform for educating youth on financial issues in a hands-on manner. Many regular credit unions around the country cultivate relationships with high schools. The objective, however, is more than educational: it is to help them establish credit by the time that many of them will be starting work.

A number of CUs and CDCUs have established youth credit unions. The primary emphasis is on saving, but could be expanded to include consumer finance and developing a personal credit history. It could be even more effective if coupled with youth IDAs. One way or another, the concept needs to be standardized, formalized and expanded with a target junior high and high school population.

In addition to training youth in financial dynamics, the activity could prove an excellent source of new members. This is the kind of initiative that must be launched at the CDCU level in the context of its specific community. But the NFCDCU and CUNA could provide additional assistance in packaging the concept for broader application and acceptance.

6. Adjust regulatory policies and procedures to better suit the context of CDCU objectives

NCUA policies and procedures have a significant influence on the ability of CDCUs to survive and thrive. In the regulatory arena at large, the traditional standards for underwriting, evaluating and monitoring loan and portfolio performance are increasingly codified and applied on a blanket basis. Risk assessment appears to be approaching a science with clear "boiling points". Well and good. But these are largely defined in the context of the conventional lending business and the peer ratios associated with the capital, leverage, profitability, ROE, and liquidity that banks share. These ratios all add up to a demand that credit losses on an average portfolio stay below the 1 percent margin (this is a ballpark figure: the rates differ by type of asset), and that credit extension be governed by this maximum margin. These constraints leave a lot of people out. Moreover, they don't necessarily accommodate the high cost transactional structure that many CDCUs sustain in their efforts to serve a lower-income population.

At the low-income end, delinquencies can be expected to be higher and so can credit losses. Regulators comfort themselves by requiring higher levels of capital. It is a blunt instrument, an easy way of addressing the concern. But it can also impose constraints on the CDCU that inhibit the performance of its mission -- *without necessarily making the institution any safer or better at what it does.*

What is needed is a change in emphasis. A lender who runs a 5 percent delinquency rate and a 1 percent loss rate is a much better lender than one who runs a 2 percent delinquency rate and a 1 percent loss rate: the first lender is targeting a higher risk credit profile (e.g., the client may not credit score well) and marshalling CDCU resources to keep that client current, while the second lender isn't giving that client the chance. In short, the first lender is managing risk; the second lender is just taking orders. The quality of an institution whose mission is to serve a higher-risk population is defined more by the ability to manage its borrowers than by the level of delinquencies or losses relative to the norm. While additional capital is certainly required, it is not the key issue, nor should it be the acid test. If anything is key, it is the discretionary cash flow of the lender (and this is true for all lenders). Discretionary cash flow refers to the amount of discretion that a lender has in making decisions about pricing, term, risk, services, staffing and growth as determined by the strength and consistency of its historical and projected operating cash flows. In addition to discretionary cash flow, there are other qualifying factors that determine the level of prudent capitalization, and these should be incorporated into the regulatory ratio analysis more explicitly in the context of the CDCU mission.

D. How can banks, agencies and other institutions with a commitment to community development maximize the benefits and returns of the community development credit union structure?

1. Bank Investment Module

In 1984, Manufacturers Hanover Bank announced its intention to close a branch on the lower east side of Manhattan. Activists in the community launched a CRA challenge to the move and simultaneously enlisted the NFCDCU to determine if a CDCU could fill the gap. Under pressure, the bank ended up providing grants, low interest deposits and a discounted price for their vacated branch. Fourteen years later, the Lower East Side FCU, with its wide-ranging and innovative products and services, is now a $6 million business with over 3,000 members and two branches, commanding a vital position in the economic well-being of its community.

There are a number of examples of CDCUs stepping into areas abandoned by banks, picking up the book of business and expanding the base of participants. As noted above, maintaining a bank branch in a low-income area is increasingly a loss leader for commercial banks from a strictly technical financial standpoint. At the same time, banks have obligations to serve these populations. So do insurance companies, utilities, the communications industries and others. The question is: why not support entities like the CDCUs that can do a better and more sustainable job of providing capital and services? If it costs between $250,000 and $500,000 to capitalize a CDCU, why shouldn't a bank consider it from the standpoint of profitability -- a full service branch might lose that much in the space of two or three years.

A standardized package for bank investment in CDCUs should be developed, and a model for including the contributions from other interested corporate entities (e.g., utilities) should be appended.

Here are some of the elements that could be put into a package that would demonstrate benefits to a bank over and above the benefit of being able to close an unprofitable branch:

- *Referrals*: Loans that don't fit the bank portfolio parameters can be referred to the CDCU
- *Origination*: If the bank wants loans for CRA purposes, e.g., home mortgages, the CDCU can serve as an underwriter for a fee. This could be particularly helpful for undercapitalized CDCUs that need to sell home mortgages, commercial loans and other large ticket items.
- *Loan participations or joint lending*: The CDCU will be keeping an eye on the bank borrower, which serves to reduce the risk at no extra cost to the bank.
- *Deposits*: Some banks may want the deposits of low income clients, but lack the capability to make good loans and service them. Why not create a modestly profitable mechanism that funds and/or supports the CDCU's lending efforts? The terms and conditions could be based on the cost and term of the deposits.
- *Cross-selling*: A bank wants to sell a product like credit cards or insurance to the target constituency? Sell the product through the CDCU.

- *High volume- high end products and services*: Not all people in a low-income area are low income, and not all low-income people are outside the socio-economic parameters for high volume products. Can banks arrange collaborations with CDCUs to provide qualified CDCU members with low-cost commodified mortgages and car loans, as well as crucial ATM capabilities? Yes, with benefits to all three parties.

The point is to demonstrate that banks and other institutions with a commitment to a community can maximize the benefits and returns by investing in a CDCU structure. What's in it for them? Interest on capital notes, deposits, deal flow, outlet for certain products. These can all be measured and managed for growth and profitability. But there is another key benefit: with the CDCU, there are decision-makers who are knowledgeable about the needs and personalities of the community; and they are working hard and efficiently at building capital in areas that the bank (insurance company or utility) are designed to serve. At a time when even full service branches no longer have decision-makers, this makes the CDCU an even more vital community partner.

2. Agency Modules

Many federal, state and local agencies aim to serve the same constituencies that are served by the CDCUs. Some CDCUs have maximized the use of these agencies, but by and large, there is significant room for improvement and expansion. Replicable modules for use on a national basis should be developed for working with:

- The Federal Home Loan Banks. With their affordable housing and community investment advances, the FHLBs can provide substantial liquidity at very low rates for a range of critical community development activities.
- The Small Business Administration (SBA). The SBA 7(a) and Microloan programs represent crucial opportunities for CDCUs to improve the range of services to their constituents and to boost surpluses, capital and liquidity. Assistance with entrepreneurial lending is also an attractive feature of a closer relationship with the SBA.
- Department of Housing and Urban Development (HUD). The CDBG and HUD 108 programs are both targeted to low-income populations and census tracts. Planning money and project capital are available, and the CDCUs could, in many cases, put the money to use more prudently and specifically.
- Economic Development Administration (EDA). Joint lending with EDA revolving loan funds (RLFs) is a clear winner, particularly for CDCUs with size constraints.
- USDA Intermediary Relending Program (IRP). These revolving loan funds in rural areas can provide excellent low-cost funding on a participation basis with CDCU loans.
- Bureau of Indian Affairs (BIA). The credit union's peer lending mechanism combined with the emphasis on step-by-step savings is an excellent structure for tribal nations.
- State and local agencies. Standardized relationships based on successful collaborations should be designed, explained and made available to all CDCUs. Advances in home ownership, home rehab and home equity loans in particular could be made by working with state housing finance agencies.

In addition to establishing models for partnerships and points of contact, the agency programs need to be reviewed in the context of “friendliness.” As the SBA found out in Washington Heights, it is one thing to find the right partner, it is another to structure a program that helps that partner deliver at the street level.

V. CONCLUSION

One CDCU that has pushed in every conceivable direction to take advantage of financial resources, and to maximize service to its low-income constituents is Bethex Federal Credit Union in the Bronx. Bethex was one of the CDCUs – along with Neighborhood Trust – that showed up at the SBA in 1999 demanding to do business in Washington Heights.

Bethex, with $7 million in assets and 7,750 members, is opening up three branches, two branches in areas with no banks, and a third branch in Hunts Point, where hundreds of low-income wage earners in the food distribution industry are finding their specific transactional needs inadequately accommodated by existing bank branches. Bethex has also been in the news for establishing a partnership with check cashing outfits throughout New York City. While the partnership is criticized by some in the industry because it does not lower the cost of check cashing to the consumer, it enables Bethex members to make deposits and cash paychecks anywhere in the city – a critical timesaving innovation. Another innovation: the use of a credit union industry-based service that provides credit counseling to members 12 hours a day in seven different languages. Bethex has also been instrumental in developing the New York City Financial Network Action Consortium (“NYCNAC”), a service organization serving four New York CDCUs that is helping them expand ATMs, set up credit and debit cards, do loan participations, use the New York City Economic Development Corporation’s Capital Access Program for small business loans, arrange pro bono legal services, and raise funds, among other things. NYCNAC was the key architect in helping Bethex open up its additional branches.

All of these initiatives are on top of the work that Bethex has done over the past 30 years, which includes: arranging low interest deposits from several major banks, active use of the state Credit Union League’s mortgage company and VISA card services, grants from the Department of Treasury’s CDFI Fund, and grants and financing from the NFCDCU. Bethex has also diversified its portfolio by taking over two former employee credit unions serving moderate income people in the area – a critical portfolio strategy for promoting sustainability.

All of these initiatives are replicable. Bethex clearly serves as a model for how CDCUs can get to scale and effectively and efficiently serve their low-income constituencies. But there’s one (unfortunately all-too-replicable) part of the model that epitomizes the weakness of the industry: Bethex did not have the money to pay its manager a salary for the first 18 years of its existence. Given the energy and benefits that Bethex has brought to the Bronx – and that other CDCUs can bring to their areas – that’s the kind of weakness the industry must overcome. With the proper commitment and a concerted effort on all sides – banks, regular credit unions, regulators, trade

organizations and agencies – combined with some of the strategies explored above, it's the kind of weakness that can be overcome.

WORK CITED

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