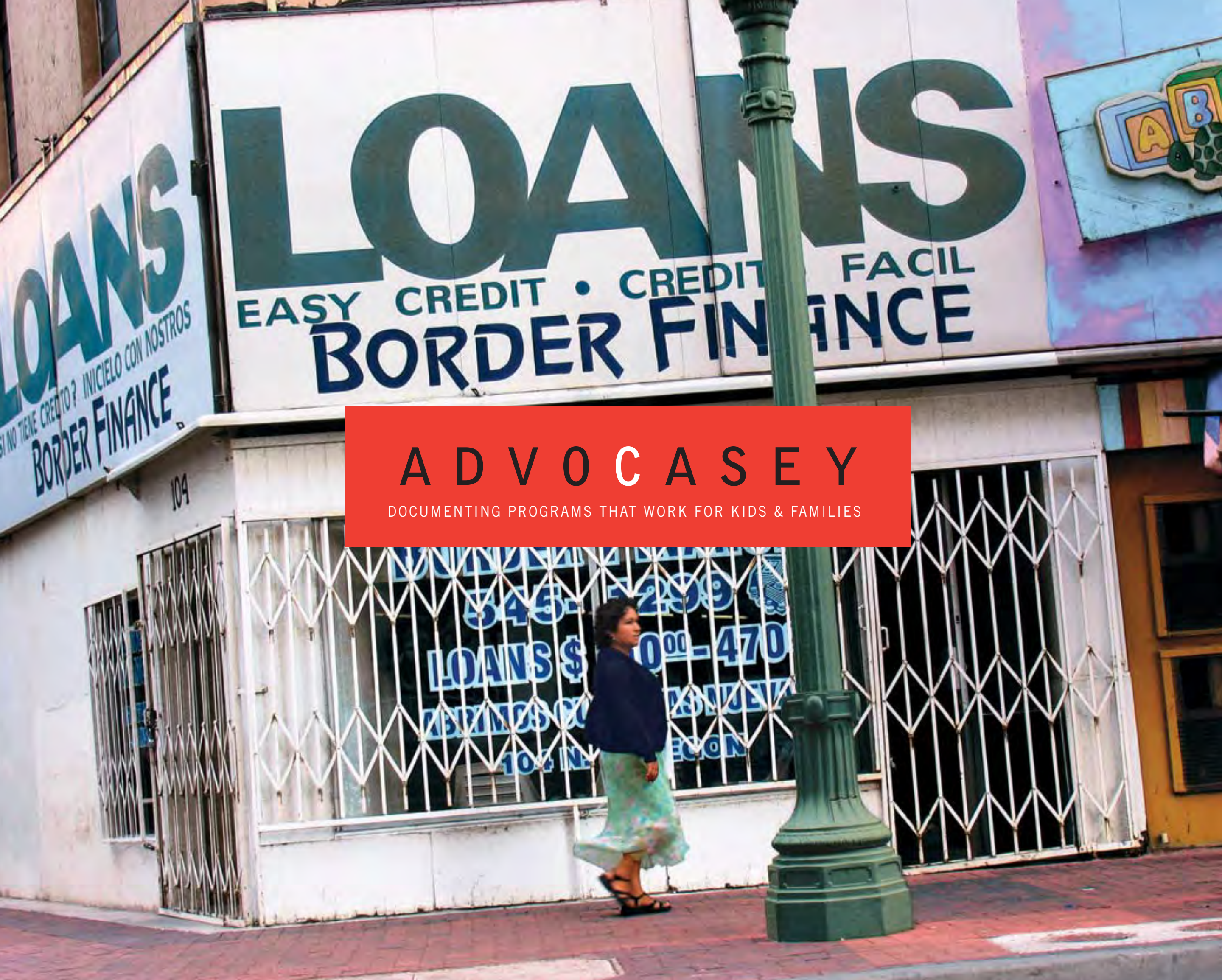

ADVOCASEY

DOCUMENTING PROGRAMS THAT WORK FOR KIDS & FAMILIES

A PUBLICATION OF THE ANNIE E. CASEY FOUNDATION | VOLUME SEVEN | NUMBER ONE | WINTER 2005

DOUBLE JEOPARDY

ADVOCASEY EXPLORES THE HIGH COST OF BEING POOR

THE POOR PAY MORE:

FINANCIAL DRAINS ON LOW-INCOME FAMILIES

CREDIT CARD CRUSH

Change from 1989 to 2001 in the number of families with incomes less than $10,000 who own a credit card and carry a balance from month to month: +72 percent

Change from 1989 to 2001 in the average balance of credit card holders with family income less than $10,000: +184 percent (from $646 to $1,837)

Increase between 1994 and 2004 in the average late fee charged by credit card companies to customers who do not make a minimum payment on time: +150 percent (from $11.96 to $29.88)

FRINGE FINANCE FIESTA

Growth in the number of pawn shops operating nationwide from 1986 to 2003: +142 percent

Ratio of “payday lending” outlets currently operating nationwide versus the number of these outlets operating in the early 1990s: more than 100:1

Average annualized interest rate of a payday (short-term cash advance) loan: 470 percent

BANKING BLUES

Amount a western Massachusetts bank charged a new customer in 2003 for “bounce protection” fees after she overdrew her balance by $98.25: $180 in the first month

Amount this customer would have paid if her account had traditional overdraft protection through a line of credit (rather than bounce protection): $1.50

Number of banks nationwide now offering bounce protection: nearly 3,000

MORTGAGE MISERY

Growth nationwide in the volume of high-interest “subprime” mortgage loans from 1994 to 2003: from $43 billion to $385 billion

Average fees charged by subprime mortgage lenders (expressed as a percentage of the loan value): 7 percent

Average fees on a conventional or “prime” mortgage: 1.1 percent

Percentage of subprime and conventional prime mortgage loans that carry prepayment penalties: 80 and 2, respectively

HEALTH CARE [MONEY] HEMORRHAGE

Average bill charged to an uninsured patient in 2001 for inpatient care at a Cook County, Illinois, hospital: $21,985

Average bill for an insured patient for care at the same hospital in 2001 (after discounts negotiated by insurers): $6,530

Percentage of income Americans earning less than $10,000 per year spend on health insurance premiums, out-of-pocket medical expenses, and wage deductions for employer-sponsored health coverage: 23

For information on the sources cited in the ADVOCASEY INDEX, send an e-mail to webmail@aecf.org.

ADVOCASEY

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DOCUMENTING PROGRAMS THAT WORK FOR KIDS & FAMILIES

Cover photo: Fringe finance outlets like this loan shop in downtown El Paso contribute to the high cost of being poor.

BY DOUGLAS W. NELSON

SAFEGUARDING THE AMERICAN DREAM: WHY WE MUST LOWER THE HIGH COST OF BEING POOR

Since welfare reform became law in 1996, almost 2.5 million parents have left the welfare rolls. Thanks in part to expanded earned income tax credits and other social policy investments, many more low-income parents are holding down jobs and bringing home paychecks than in the 1980s or early '90s.

This progress is a hopeful sign for America's at-risk kids: their prospects are inextricably tied to the economic well-being of their parents.

But the increasing work effort among low-income families is tempered by two realities. First, the slow job market and continuing decline in real wages among unskilled and semi-skilled workers leave far too many families in economic jeopardy, unable to establish financial security or build wealth.

Second, the families trapped on this financial treadmill, those who earn least in our country, often pay the most for basic goods and services. Low-income families don't merely have less to spend for necessities, they actually have to spend more to get them. From getting to work to getting ahead, *being poor costs more.*

As a result, millions of low-income working families remain one crisis away from economic catastrophe—one car breakdown, one illness, one week when a neighbor or grandmother can't tend the children.

Building on an essay in the Foundation's *2003 KIDS COUNT Data Book,* this edition of ADVOCASEY documents the "high cost of being poor" in eye-opening detail—particularly the immense cost of credit paid by many low-income families.

One story examines the ambitious efforts of a North Carolina organization to combat predatory mortgage lending—an epidemic that has depleted the finances of millions of American families. Another looks at efforts to rein in "payday lending"—costly short-term loans that have proliferated wildly in recent years. According to the Center for Responsible Lending, predatory mortgage lending costs borrowers $9.1 billion per year, and payday loans drain another $3.4 billion in fees and interest from poor workers' pockets.

High-cost credit also burdens low-income adults on their commutes to work. Given our nation's weak public transportation networks, owning a car is often a job-holding necessity. Yet low-income buyers routinely pay three or four times higher interest on car loans than middle-class borrowers: on a 5-year loan for a $13,000 car, paying 20 percent interest instead of 6 percent means $93 a month less to spend on groceries and other necessities.

> Reducing the high cost of being poor won't be a quick fix. . . [But] this challenge must be met, because it threatens the integrity of the American dream itself.

Once they own a car, drivers living in poor neighborhoods often pay far more for auto insurance than suburban drivers—even if they have identical driving records.

Low-income families also pay more for everyday goods like food, clothing, and sundries. Historically, large-scale retailers and discount outlets have avoided low-income neighborhoods. As a result, residents of low-income urban and rural communities pay 20 percent more on average for a basket of groceries than a typical suburban family.

Further, because of difficulties in saving or acquiring credit, many low-wage workers are seduced into acquiring big-ticket needs like furniture or appliances through "rent-to-own" outlets. These customers pay two to three times what the merchandise would cost if they could afford to pay cash.

For many low-income families, money itself is a high-cost commodity. Instead of maintaining bank accounts, some rely on expensive check-cashing outlets and other fringe financial institutions. Meanwhile, bank fees have increased dramatically for those who do bank but can't maintain a high minimum balance.

Some of these costs are understandable, of course. It does cost more to operate a small, mom-and-pop store in an inner-city neighborhood or rural community. And it is reasonable for an honest lender to charge higher rates for higher-risk loans. But shopping at these businesses and borrowing at high interest need not be the only options for low-income families.

Local government and community groups can work with retailers to return high-quality shopping to low-income areas. Several major retailers and communities have joined together and proved that stores can earn profits serving these neighborhoods.

We can also provide low-income consumers with more consumer education, greater access to financial services, and more opportunities to build credit. Using new tools to measure creditworthiness, like tracking whether a consumer pays utility bills on time, credit experts have documented that many low-income consumers are, in fact, good credit risks.

Emerging strategies, such as Individual Development Accounts, provide a means to encourage and reward savings among low-income families. And community credit unions are providing borrowers both low-cost, short-term loans *and* financial literacy education to help them avoid debt traps set by payday lenders and other fringe finance profiteers.

Stronger regulation is needed as well. State and federal finance agencies can do far more to protect low-income consumers from predatory lending practices.

Reducing the high cost of being poor won't be a quick fix. It will require sustained, sophisticated, innovative actions from the public and private sectors. However difficult, this challenge must be met, because it threatens the integrity of the American dream itself. It is that important.

Douglas W. Nelson is the president of the Annie E. Casey Foundation.

ADVOCASEY

WINTER 2005 VOLUME SEVEN NUMBER ONE

ADVOCASEY *is published by the Annie E. Casey Foundation. Material may be reprinted with appropriate acknowledgment. Articles are also available online at www.aecf.org.*

The Annie E. Casey Foundation is a private charitable organization dedicated to helping build better futures for disadvantaged children in the United States. The primary mission of the Foundation is to foster public policies, human-service reforms, and community supports that more effectively meet the needs of today's vulnerable children and families. In pursuit of this goal, the Foundation makes grants that help states, cities, and neighborhoods fashion more innovative, cost-effective responses to these needs.

The Annie E. Casey Foundation was established in 1948 by Jim Casey, one of the founders of United Parcel Service, and his siblings, who named the Foundation in honor of their mother.

Editor: Dick Mendel


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DOUBLE JEOPARDY

WHY THE POOR PAY MORE

BY DICK MENDEL

If you live on the tough side of town or the wrong side of the tracks, if you earn a modest hourly wage and not a lofty salary, if you're a racial or ethnic minority...watch your wallet! Chances are, you're paying higher prices than the rest of us, and you're imperiled by a thicket of deceptive money traps that can bust your budget and drain your savings.

On May 31, 2004, *Business Week* magazine—the weekly almanac of the executive set—turned its attention away from stock market fluctuations, interest rate uncertainties, and board room shake ups.

Instead, *Business Week* devoted a 4,000-word cover story to America's working poor, the 28 million U.S. workers—one-fourth of all working adults—who earn less than the $9.04 per hour wage needed to support a family of four above the poverty line.

Increasingly, these working poor "labor in a netherworld of maximum insecurity," *Business Week* declared: the minimum wage is eroding, the health care coverage gap is widening, college tuitions are soaring, trade unions are losing influence, low-wage immigrant workers are flooding the labor market, and child care costs remain sky-high.

But two alarming trends plaguing low-wage workers largely escaped *Business Week*'s attention: the explosion in high-cost lending schemes targeting less-affluent Americans and those with less financial savvy, and the absence of affordably priced merchandise and consumer services in many low-income neighborhoods.

These trends spell double jeopardy for low- and moderate-income workers and their families. Not only must they make do on a limited budget, they also pay higher prices than middle- and upper-income Americans for many of life's necessities.

Think about it. How many middle-class families face costs like…

- $12 to cash a paycheck every two weeks?
- $5 at the corner grocery for a gallon of milk that would cost $3.50 at any supermarket?
- $200 for a rapid refund loan at tax time?
- Thousands in hidden fees for a predatory mortgage?
- $35 "bounce protection" charge for overdrawing a bank debit card?
- $500 in extra finance charges to buy a television set through a rent-to-own operator?
- An ongoing spiral of debt from a $350 "no hassle" payday loan?

Together, these and other costs mire millions of hard-pressed families in economic quicksand. No matter how hard they work to get ahead, many find themselves falling farther and farther into debt—less able to provide for their children, less likely to climb up the economic ladder and taste the fruits of middle-class comfort.


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PEDESTRIANS
PEATONES
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THE HIGH COST OF CREDIT

When you look at the budgets of America's less-affluent families, one item stands out: the enormous amount spent on fees, interest, finance charges, and penalties—in short, on nothing at all.

Consider these Baltimore residents:

• Dorothy Newton spends $75 every month of her modest income from working at a Wendy's hamburger franchise to pay off a debt to the Capital One credit card company. Newton got her Capital One card in 1999 to buy school clothes for her three children. Her credit limit was $200, and Newton says she never spent more than that amount. But she began falling behind on the payments in 2000 after losing her previous job as a housekeeper in a hospital. Newton stopped using the card, but her balance soared anyway. From May to June 2001, for instance, Newton racked up $26 in interest charges (at 24.4 percent APR) and $50 in "past due" and "over limit" fees—raising the balance to $1,253. By the time Capital One took her to court in June 2004, the debt was over $2,000.

The corner of Stanton and Paisano Streets, like several other corners in downtown El Paso, is strewn with loan shops and other fringe finance outlets that make their money marketing high-cost loans to low-income borrowers.

• Rita Jameson (not her real name) didn't have much money in the bank when her refrigerator conked out in 2002. Jameson, a grocery store supervisor, instead visited a rent-to-own franchise. She settled on a no-frills Frigidaire and agreed to pay $22 per week. Jameson made the payments for a full year before gaining title to the refrigerator. By then she had paid over $1,100 for an appliance with a retail value of around $450.

• When Pamela Spriggs wanted to buy her first car in the late 1990s, she went down to a local dealership and picked out a recent model Ford Taurus. The car's price tag was $9,000, but Spriggs let the dealer arrange the financing and didn't discover until days later that the loan carried a 27 percent interest rate—four or five times the rates paid by more-affluent car buyers. Spriggs, who teaches in the Baltimore City school system, paid more than $330 per month for four years until the car was totaled in an accident. With a 5 or 6 percent loan, her monthly payments would have been at least $100 lower.

To some extent, the growing debts of low- and moderate-income families mirror a national trend. Between 1989 and 2001, the total amount of credit card debt nationwide swelled from $238 billion to $692 billion, and the average credit card balance of an American family grew from $2,697 to $4,126.

While credit card use has risen across the income spectrum, it has been most pronounced—and most costly—for low-income families.

The share of families earning less than $10,000 per year who own credit cards grew from 28 percent in 1989 to 35 percent in 2001. The share of these cardholders carrying a balance grew from 49 to 67 percent during these years, and the average amount of these balances nearly tripled from $646 to $1,837. Families earning $10,000 to $25,000 also saw increases across the board.

Meanwhile, credit card fees and interest rates have soared. The average late fee grew from $12 to $30 between 1994 and 2004. Most card issuers reduced the grace period for late payments from 14 days to zero days, and all major credit card issuers now raise the interest rates of customers the first time a payment is late—typically charging late-paying customers 22 to 29 percent interest.

"Card users, consumer advocates and some industry experts complain that banks are attempting to squeeze more and more revenue from consumers struggling to make ends meet," the *Wall Street Journal* explained in July 2004. "Instead of cutting these people off as bad credit risks, banks are letting them spend—and then hitting them with larger and larger penalties for running up their credit, going over their credit limits, paying late and getting cash advances from their credit cards."

Credit cards, though, are only one facet of the debt problems facing low-income and minority families. A booming "fringe finance" market has also taken root in America's low-income neighborhoods.

Walk along Texas Avenue in downtown El Paso, Texas, for instance, and every other storefront houses a "signature loan" outlet: Merit Finance, Cam Loans, El Cardedo Finance, El Paso Credit Plan, and Border Finance on your left, Eagle Loans and North American Investment Corp. on your right—all within a single block. Three more loan shops are just around the corner.

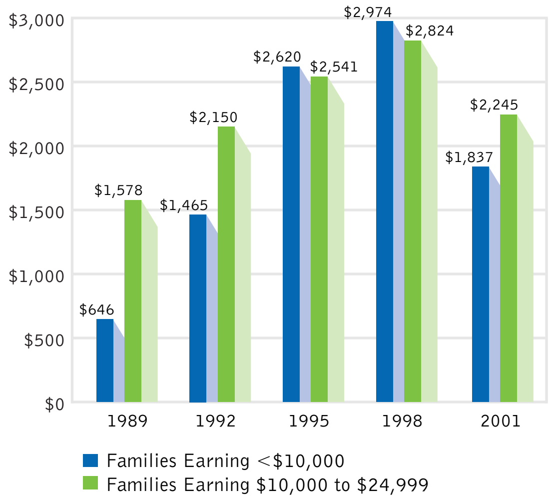
The El Paso yellow pages list 120 of these outlets, which make unsecured loans of up to $500 and charge 80 percent annualized interest.

Cecilia Fierro took out a signature loan from a company called OK Finance in late 2002 after her 1997 Chevrolet Cavalier started acting up. Fierro, a hair stylist, took the money back across the Rio Grande River to a repair shop in her hometown of Juarez, Mexico. She paid it back in installments over the next two years at $35 per month, she says—a total of more than $800 to pay off her $500 loan.

"CARD USERS, CONSUMER ADVOCATES AND SOME INDUSTRY EXPERTS COMPLAIN THAT BANKS ARE ATTEMPTING TO SQUEEZE MORE AND MORE REVENUE FROM CONSUMERS STRUGGLING TO MAKE ENDS MEET. INSTEAD OF CUTTING THESE PEOPLE OFF AS BAD CREDIT RISKS, BANKS ARE LETTING THEM SPEND—AND THEN HITTING THEM WITH LARGER AND LARGER PENALTIES."

Wall Street Journal, July 6, 2004

AVERAGE CREDIT CARD DEBT AMONG LOW-INCOME FAMILIES*



* All figures are for families who own credit cards and carry a balance from month to month.

Source: Tamara Draut and Javier Silva, *Borrowing to Make Ends Meet: The Growth of Credit Card Debt in the 1990s* (New York: Demos, September 2003).

In Memphis, Tennessee, the *Commercial Appeal* newspaper published a series of articles in July 2004 detailing an explosion of "car title" lending—short-term loans of $300 to $1,000 secured with the title of the borrower's car. These loans carry interest rates of 22 percent per month—an annual percentage rate of 264 percent. In addition, the car title lenders charge a $12 to $14 fee for every late payment.

The *Commercial Appeal* reported that one title lender—Golden Title Loans—earned $117,000 in late fees in 2003, not counting interest charges or the penalties it levied on late-paying borrowers to avert repossession ($75) or reclaim cars after they were repossessed ($175).

"This is legalized loan sharking," one local attorney complained.

Other types of fringe lending have also seen rapid growth. From 1986 to 2003, the number of pawn shops nationwide leapt from 4,800 to 11,600. Likewise, refund anticipation loans (RALs) have become an enormous moneymaker for tax preparation firms like Jackson Hewitt and H&R Block. Total RAL fees grew from $300 million in 1994 to $1.14 billion in 2002. More than half of the 12.7 million RAL customers in 2002 were low-income working families eligible for the federal Earned Income Tax Credit.

Rent-to-own sales have also risen in recent years, growing from $3.6 billion in 1991 to $5 billion in 2000. Although these transactions don't meet the strict definition of credit purchases—customers don't gain title to leased items right away, and they can return them at any time—Federal Trade Commission data show that 70 percent of customers ultimately do purchase the furniture, electronics, and other goods obtained through rent-to-own outlets. These customers typically pay two to three times the retail value of the products. More than half live in households earning less than $25,000 per year.

The fastest growing segment in the fringe finance sector, however, is "payday lending"—short-term loans providing borrowers cash in advance of their next paychecks. The borrower writes a post-dated check covering the loan amount plus a fee, which the lender will cash when the borrower deposits his or her next paycheck.

Payday loans do not come cheap. Typically, lenders charge 15 percent of the loan amount ($45 for a $300 loan, for instance), even though the loan will be repaid in two weeks or less. On an annual basis, that's equal to a 400 percent interest rate.

Yet these loans have become wildly popular. As of the early 1990s, fewer than 200 payday lenders operated nationwide. Today, there are more than 20,000—a 100-fold increase. These outlets made 100 million loans in 2003 with a total loan value of $40 billion, collecting $6 billion in fees and interest.

Most payday loans—91 percent according to one study—are made to repeat customers, cash-strapped workers who fall into a debilitating cycle of high-cost debt. Unable to repay the loans when their next paycheck arrives, borrowers roll over their payday loans and incur a new round of fees and interest charges. These repeat borrowers often pay far more in interest and fees than they ever received in cash advances. (For more on the payday loan problem, see page 22.)

THE FASTEST GROWING SEGMENT OF THE FRINGE FINANCE SECTOR IS "PAYDAY LENDING"—SHORT-TERM LOANS PROVIDING BORROWERS CASH IN ADVANCE OF THEIR NEXT PAYCHECKS...MOST PAYDAY LOANS ARE MADE TO CASH-STRAPPED REPEAT CUSTOMERS WHO FALL INTO A SPIRAL OF HIGH-COST DEBT.

Why are disadvantageous, high-cost loans attracting so many borrowers?

For many, the answer is urgent need. Because they lack savings, few low- or moderate-income families are financially prepared for setbacks like a lost job, family breakup, illness, or injury. Forty percent of all white children and 73 percent of all African-American children in the United States live in households with zero or negative net worth. When trouble comes, the only recourse is borrowing. And often, the only available credit comes with high interest rates or predatory terms.

Another key factor has been intensive salesmanship by lenders. "The credit industry began aggressively marketing to previously neglected, economically marginal consumers in the 1990s," Robert Manning, author of the book, *Credit Card Nation,* told Congress in 2003. "The most costly credit cards are marketed to the working poor," he added.

As Mercedes Lopez can attest, the sales tactics are even more aggressive in the fringe finance market. Just months after buying a new dining table and a bedroom set for her daughters two years ago, Lopez received a check in the mail—a very big check—for $5,000.

A single parent of four school-age kids in El Paso, Texas, Lopez was earning $7.50 per hour at a digital imaging firm and collecting food stamps, Medicaid, and subsidized housing to make ends meet. She had purchased the furniture on credit—a friend from the office cosigned the loan—and she made the first few payments on time.

That's when CitiFinancial, the controversial consumer finance arm of CitiCorp, the nation's largest bank holding company, sent Lopez the $5,000 check—actually, a facsimile of a check—along with a letter explaining that she had been preapproved for a $5,000 line of credit.

Lopez admits that she's terrible in math and lacks financial savvy. She didn't read the fine print from CitiFinancial, but she sensed it was a dangerous deal and tore it up.

The next month another check arrived. Lopez tore it up again. But when another arrived in early 2003, Lopez lost her resolve and phoned the CitiFinancial office to cash in the offer. Lopez used the money to pay off the furniture and several other old debts, and to buy new clothes and bedding for her children. "You see the kids, they need this and they need that, and you figure, why not?" she says. "Now I'm regretting it."

Mercedes Lopez, pictured here with her son, Christian, and daughter, Wendy, received a "live check" solicitation in the mail two years ago announcing that she had been preapproved for a $5,000 line of credit. Now she's buried under a mountain of high-interest debt.

Lopez never learned the annual percentage rate attached to the line of credit, but she was told she could pay off the loan over four years with payments of $177 per month—which put the interest rate at 29 percent.

"I'm embarrassed," Lopez says. "It wasn't like, 'Whatever, I'm just not going to pay.' I knew it was going to affect my credit, but I thought I could handle the payments. Now I'm behind and the collector is after me." ■

THE HIGH COST OF HOMEOWNERSHIP

"Buying your home should be the happiest day of your life. It's the apple pie American dream," Debora Glenn says wearily, her elbow resting on the dining room table of her ramshackle row house in Baltimore's Park Heights neighborhood.

"But I cried the day I bought this place."

That was April 1998. Glenn, a single mother who earns $8.60 per hour as a school cafeteria worker, says she was lured by two slick salesman who promised her a fully renovated home with monthly mortgage payments not much higher than the $384 rent she was paying for a cramped third-story apartment.

Pictured here in her kitchen, Debora Glenn was lured into buying a Baltimore row-house in 1998 with promises that it would be renovated top to bottom. But when Glenn moved into the house, it was barren. She's been paying the price ever since.

A first-time homebuyer—even her parents had never owned a home—Glenn jumped at the opportunity without paying close attention to the fine print. And without insisting that the sellers live up to (or put down on paper) their pledge to renovate the place top to bottom.

Glenn says that the sellers, an operation called Carter & Suggs Properties, promised her the house would be outfitted with a brand new furnace, new refrigerator and stove, overhauled water and electrical systems, solid roof—a total makeover—for $63,000.

But when Glenn and her daughter moved in six weeks after signing a mortgage contract and laying down $1,600 for closing costs, the house was barren. No furnace. No refrigerator. No stove. Within days, the sewer pipes backed up into the kitchen sink.

"None of the things that were supposed to be done were done," Glenn recalls. "I went to Legal Aid the first week after I bought the house."

But by then the damage was done. Glenn's apple pie dream had turned rancid. She's been paying the price ever since—11.9 percent interest, plus thousands of dollars in extra costs to install new pipes, purchase electric heaters, fix the roof, and equip her kitchen. And that's on top of the $8,000 in financing the city of Baltimore provided Glenn in 2000 to install a furnace and complete other repairs.

Only recently did Glenn learn that Carter & Suggs, whose firm has since vanished, had purchased her house only three weeks before selling it to her—and paid just $17,000 for it.

Between January 1996 and July 2000, nearly 3,500 Baltimore residents were hoodwinked into

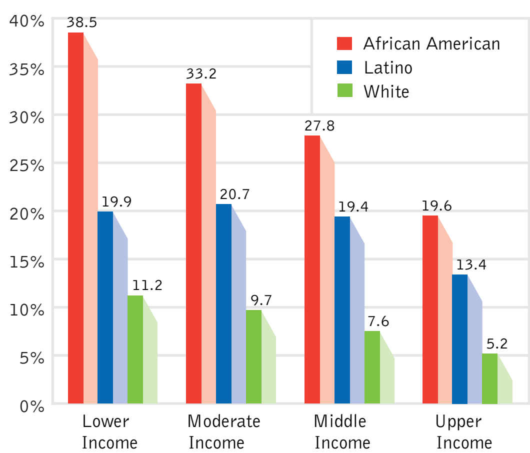
HALF THE BORROWERS PAYING THE HIGH INTEREST RATES AND HEFTY FEES ASSOCIATED WITH SUBPRIME MORTGAGES HAVE STRONG ENOUGH CREDIT TO QUALIFY FOR A CHEAPER LOAN IN THE PRIMARY MORTGAGE MARKET.

similar "house flipping" scams: in each case, profiteers purchased rundown properties at rock-bottom prices, then resold them for more than double their purchase price within six months. The house flippers typically promised complete renovations, then made only cosmetic changes. And they colluded with appraisers to inflate the assessed values of homes and the incomes of buyers to justify large mortgages.

In other parts of the nation, house flipping is less common. However, low- and moderate-income homebuyers instead face an onslaught of predatory mortgage lending.

In 1994, the market for high-cost "subprime" mortgages nationwide totaled just $43 billion. By 2003, that figure had grown to $385 billion. These mortgages charge interest rates up to 10 percent higher than prime loans: for a 30-year mortgage of $80,000, monthly payments on a 12 percent loan will be $823—almost twice the $480 monthly cost of a 6 percent loan. Over 30 years, the extra interest for this subprime loan will total $123,000.

AN UNEQUAL BURDEN:
Share of Mortgage Refinance Loans in the U.S. Provided by Subprime Lenders, by Race and Income



Source: *Separate and Unequal: Predatory Lending in America,* Association of Community Organizations for Reform Now (February 2004).

Many subprime mortgages are not predatory. For families with modest incomes or mixed credit histories, these higher-cost loans may offer the only available route to owning a home.

Unfortunately, the subprime mortgage market has become a haven for deception and exploitation. High-pressure sales tactics and misleading trade practices—even outright fraud—are commonplace.

Predatory lenders take advantage of borrowers by including expensive extras in their loans—exorbitant fees, crippling mortgage insurance charges, hefty balloon payments, and steep prepayment penalties. Such provisions often cause devastating harm to borrowers who do not see through the legalese. In many cases, the loans end in foreclosure when homeowners prove unable to meet steep financing terms. Most often, the victims are African Americans, Latinos, and other minorities.

In 2001, the Coalition for Responsible Lending (see story on page 38) estimated that predatory mortgage loans were costing borrowers $9.1 billion per year in unwarranted fees, excessive interest, and lost equity, including:

Shown here with her daughter, Chell'sie, Debora Glenn was one of nearly 3,500 Baltimore residents victimized by "house flipping" scams in the late 1990s and early 2000s.

• $1.8 billion in exorbitant loan fees exceeding 5 percent of the amount financed. In the prime mortgage market, the average borrower pays fees equal to 1.1 percent of the loan amount. Many subprime lenders charge 7 percent, 8 percent, even 10 percent of the loan value. The fees are usually rolled into the loan balance to be paid over time (at interest). Often, subprime buyers don't even realize they're paying them.

• $2.3 billion in prepayment penalties, which are imposed on 80 percent of subprime mortgages—compared to only 2 percent of loans in the prime mortgage market.

• $2.1 billion per year for disadvantageous single-premium credit insurance policies—one-time charges covering several years of insurance. The Coalition for Responsible Lending complained that prepaid credit insurance "does little more than strip equity from homeowners." Indeed, since the U.S. Department of Housing and Urban Development recommended in 2000 that "single-premium insurance products should be prohibited for all mortgage loans," several (but not all) leading subprime lenders have dropped the practice.

• $2.9 billion in unjustifiably high interest rates, where borrowers with adequate credit are nonetheless steered to high-interest subprime loans. Speaking at a Chicago housing conference in May 2004, Federal Reserve Governor Edward Gramlich explained that "borrowers with [credit] scores below 620 are viewed as higher risk and generally ineligible for prime loans unless they make significant downpayments. But it is noteworthy that about half of subprime mortgage borrowers have [credit] scores above this threshold."

In other words, half the borrowers paying the high interest rates and hefty fees associated with subprime mortgages have strong enough credit to qualify for a cheaper loan in the primary mortgage market.

And at every income level, minority borrowers are far more likely than white borrowers to end up with a subprime loan. Remarkably, federal data show, borrowers in upper-income black neighborhoods are more than twice as likely to hold subprime mortgages as borrowers in lower-income white neighborhoods. ■

THE HIGH COST OF MEDICAL DEBT

Had Marlene Woodson been insured when she suffered blood clots in her lungs in 1999, her bills from a Chicago hospital would have been less than half as high.

America is in the midst of a bankruptcy bonanza. From 1994 to 2003, the number of personal bankruptcies nationwide more than doubled to 1.6 million per year.

What's causing this bankruptcy binge? Predatory mortgage lending has been a factor, certainly. High-cost consumer credit, too. Stagnant wages and increasing job instability among hourly workers have contributed as well.

But the most important cause may lie elsewhere.

In 1999, a national study found that one-third of personal bankruptcy filers carried substantial medical debts. A more recent local study in central Illinois found that 58 percent of bankruptcies involved medical debts—and that figure did not include medical debts paid off with credit cards or consumer loans.

As Mark Rukavina, head of The Access Project, told a congressional committee in June 2004, "Medical debt can erode not only individuals' access to care, but also their overall financial security and that of their family."

The most serious medical debt problems involve the uninsured—people like the Reverend Marlene Woodson in Chicago.

Twice in 1999, Woodson found herself gasping for air, unable to breathe. Both times she checked into Advocate South Suburban Hospital and received treatment for blood clots in her lungs.

Though Woodson received no salary or health benefits from her job as director of a nonprofit agency working with homeless families, and though her husband had retired the year before and surrendered the couple's health insurance coverage, the hospital nonetheless sent Woodson two enormous bills: the first for $7,620, and the second for $15,058.

Funny thing is, had Woodson been insured, these bills would have been less than half as high.

Whereas insurance companies and government programs like Medicare and Medicaid use their bargaining power to negotiate large discounts, "uninsured patients... have no bargaining power," complained the Service Employees International Union's Hospital Accountability Project in 2003. "They are generally expected to pay the full price for hospital care, which can be two or three times more than the payment hospitals receive for insured patients."

Census Bureau data show that of the more than 40 million Americans who lacked health insurance in 2003, 64 percent were either poor (below poverty line) or nearly poor (earning less than twice the poverty level). More than four in five lived in a family with at least one working adult.

A recent survey by the Commonwealth Fund found that three-fifths of the uninsured had trouble paying medical bills or were paying off accrued medical debts. Among those with medical bill problems or medical debts, four in ten were unable to pay for basic necessities such as food, heat, or rent; more than half used all or most of their savings to pay medical bills; and one in five ran up large credit card debts or took out home equity loans to pay medical bills.

Many families with health insurance also suffer: 35 percent of adults with continuous coverage in the Commonwealth Fund survey reported difficulties with medical costs.

Though hospitals and medical clinics receive tens of billions of dollars in government support each year to cover the costs of caring for poor and uninsured patients—and nonprofit hospitals have a legal duty to provide charitable care—in recent years, the medical industry has grown increasingly aggressive in pursuing payments from those least able to pay.

The *Wall Street Journal* and other newspapers have reported on hospitals that foreclosed on the homes of former patients, attached patients' bank accounts, or had patients arrested and jailed for failing to attend court hearings related to unpaid bills.

"Doctors, hospitals, laboratories and other providers are taking tougher approaches to seeing that bills are paid," the *New York Times* explained in 2002. "Far more health care providers are turning over their accounts to [collection] agencies 30 to 60 days after a missed payment, instead of the customary 150 to 210 days."

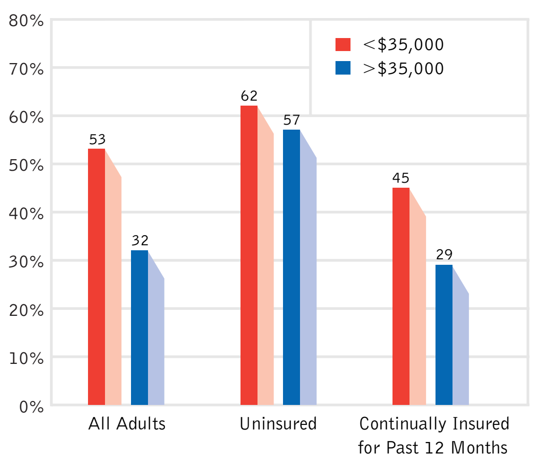
Meanwhile, many hospitals make it difficult for needy patients to learn about or access financial assistance programs designed to help them. A survey of 7,000 uninsured adults who received outpatient care in 2000 found that 48 percent were never offered or even told about the possibility of financial aid.

Thanks to these aggressive collection practices, uninsured patients paid an estimated $32.6 billion in out-of-pocket medical expenses in 2004. One-third of uninsured adults nationwide and 29 percent of working-age adults earning less than twice the poverty level paid 5 percent or more of their income on out-of-pocket medical expenses.

"Hospital collection activities, which are becoming increasingly aggressive, often result in unworkable payment plans, damaged credit ratings, court judgments that permit wage garnishment, seizure of bank accounts, forced sales of family homes, and bankruptcy," the Boston-based advocacy group, Community Catalyst, reported in 2003. ■

IN RECENT YEARS, THE MEDICAL INDUSTRY HAS GROWN INCREASINGLY AGGRESSIVE IN PURSUING PAYMENTS FROM THOSE LEAST ABLE TO PAY.

PERCENT OF ADULTS AGES 19–64 WITH MEDICAL BILL PROBLEMS OR ACCRUED MEDICAL DEBT*



*Problems paying/not able to pay medical bills, contacted by a collection agency for medical bills, had to change way of life to pay bills, or has medical debt being paid off over time.

Source: The Commonwealth Fund Biennial Health Insurance Survey (2003).

THE HIGH COST OF SHOPPING

Though the shortage of supermarkets is commonplace in low-income communities nationwide, it is not ubiquitous—nor inevitable.

If you live in the Madison/East End neighborhood of Baltimore, it's a long walk—30 blocks—to the nearest supermarket, a Stop, Shop & Save. That might not sound far to most Americans, but Madison/East End is not your typical American neighborhood: the median home price is just $49,500, and only 43 percent of working-age adults have jobs.

Many residents don't own cars. If they can't beg a ride from friends or relatives, they must hire a cab to get to the Stop, Shop & Save or wait and pay for bus rides—an additional surtax on their food budgets.

Or they can shop in the one modest food store in their own neighborhood, a small storefront crammed with canned goods, plus milk and other beverages, snack foods, and some meats. The store doesn't boast much of a produce section; indeed, there's not a green in the house—just a bin toward the back with some tired onions on the top, a few lonely potatoes beneath.

Inevitably, food prices are almost always higher in the small grocery than at a supermarket. A squeeze bottle of mustard, a dozen eggs, a can of tuna or tomato soup—all cost 10 to 50 percent less at the Stop, Shop & Save.

This situation is not unique to Madison/East End—or to Baltimore.

In Chicago, the *Tribune* newspaper reported in June 2004 that the more well-to-do North Side has 50 percent more grocery stores per capita than the city's South and West Side neighborhoods, where most low-income residents reside. As a result, the *Tribune* declared: "Chicagoans with the least amount of disposable income shop at smaller neighborhood stores and pay considerably higher grocery prices than more affluent North Siders or suburbanites do."

Likewise, the *Detroit News* investigated grocery stores in 2001 and found that—thanks to an exodus of supermarket chains from low-income city neighborhoods—"poor people often find their bills inflated at small neighborhood stores. The high cost of groceries is one factor that keeps the poor impoverished."

Nor is the problem restricted to the urban poor. The Associated Press reported in July 2004 that most "food deserts"—areas lacking supermarkets with healthy and affordable food—are located in rural areas. In Pittsfield, New Hampshire, the story reported, "There are no supermarkets, and the community's two convenience stores offer little fresh produce and plenty of high prices."

Though the shortage of supermarkets is commonplace in low-income communities nationwide, it is not ubiquitous—nor inevitable. The Initiative for a Competitive Inner City (ICIC) reported in 1998 that grocery stores located in central-city neighborhoods generate greater sales volume than stores in other locations, and a 2002 ICIC study found that "some supermarkets that have located in inner cities are

“DESPITE LOWER HOUSEHOLD INCOMES, INNER-CITY AREAS CONCENTRATE MORE BUYING POWER INTO A SQUARE MILE THAN MANY AFFLUENT SUBURBS... [AND] SOME SUPERMARKETS THAT HAVE LOCATED IN INNER CITIES ARE ACTUALLY MORE PROFITABLE THAN THEIR SUBURBAN COUNTERPARTS.”

Initiative for a Competitive Inner City

With supermarkets scarce in many low-income neighborhoods, many poor families must do some or all of their shopping at corner grocery stores like this one, where prices are 10 to 50 percent higher.

actually more profitable than their suburban counterparts.”

“Despite lower household incomes, inner-city areas concentrate more buying power into a square mile than many affluent suburbs,” the 2002 ICIC report found. “America’s inner cities possess over $85 billion in annual retail spending power, equal to the total purchasing power of Mexico…[and] $21 billion of this demand went unmet within the inner city, representing a tremendous urban retailing gap.”

Increasingly, local governments and community groups are striving to recruit supermarket operators into underserved areas. For instance, after losing 15 percent of its supermarkets between 2000 and 2002, Baltimore mounted a campaign to bring supermarkets back to the city. By promoting itself to supermarket chains, and in some cases providing concrete assistance by assembling parcels of land for new supermarkets or providing low-cost financing, Baltimore reached agreements with supermarket chains to open or expand 18 supermarkets since 2002. ■

THE HIGH COST OF BANKING

Even before low-income customers step up to the cashier and buy their groceries, many have already spent more than middle- and upper-income shoppers—just to put their hands on the money they will pay with.

That's because low-income consumers often pay a premium for routine banking services. Nationwide, roughly 10 million households have no checking or savings account, the vast majority of them poor. Many of these "unbanked" families find a way to cash their checks at no cost—by going either to the payers' bank or to supermarkets and other outlets that cash checks for free.

But most unbanked families rely on alternative finance outlets that cash checks and write money orders for a price. The number of check-cashing outlets nationwide has quintupled since the mid-1980s, and these outlets now cash 180 million checks per year and earn $1.5 billion in fees. The check cashers typically charge customers 1.5 to 3 percent of a check's face value, so an unbanked worker earning $15,000 per year who relies on check-cashing outlets will spend roughly $300. The worker will pay an additional price to purchase money orders (usually $1 each) to pay rent, utilities, and other bills.

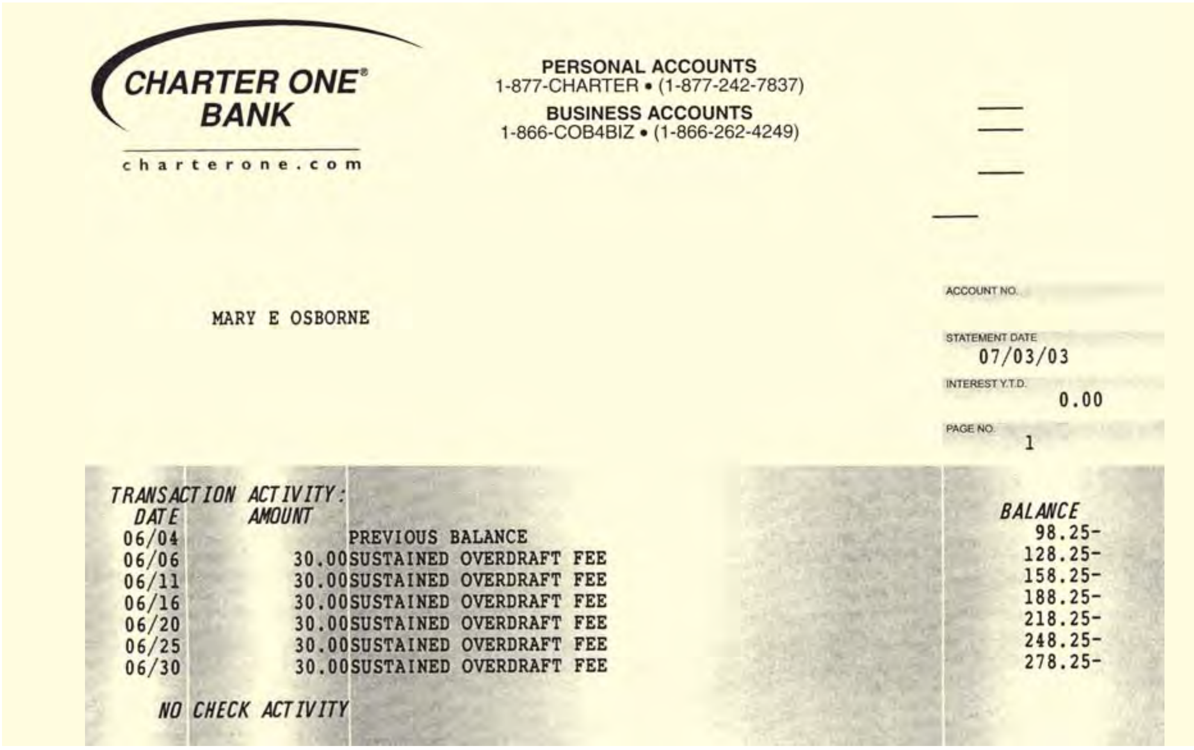
Yet increasingly, the costs for low-income families to open and maintain a bank account are also steep. According to *Consumer Reports,* banks collected $32.6 billion in 2003 for service fees on checking and other deposit accounts—20 percent more than in 2001—and fees have risen 33 to 165 percent faster than the rate of overall inflation since 1997.

ATM fees, bounced check fees, stop payment fees, debit card purchase fees…all are up substantially. And banks have introduced a variety of new fees, charging customers for depositing someone else's bad check, closing a new account too soon, or cashing the paycheck of workers who don't maintain accounts with the bank—even when the check is written by the bank's own customer.

In May 2004, CBS *MarketWatch* called the latter fee "the latest glaring example of how banks, brokerages and other financial-service firms are nickel-and-diming Americans of modest means in their relentless rush to boost 'fee-based income.'"

Consumer Reports complains that many of these fees are "no-see-ums embedded in fine print or collected so seamlessly that consumers don't realize they've paid them until long after the fact"—if they ever do.

One new bank practice, "bounce protection," has drawn particularly sharp criticism. An alternative to traditional overdraft protection, which allows customers to avoid bouncing checks by drawing on a savings account or credit card, bounce protection uses the bank's money to cover checks and ATM withdrawals that exceed the account-holder's balance. Many banks now include bounce protection as a standard feature in new accounts. Rules are



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MARY E OSBORNE

ACCOUNT NO.
STATEMENT DATE 07/03/03
INTEREST Y.T.D. 0.00
PAGE NO. 1

TRANSACTION ACTIVITY:

DATE	AMOUNT		BALANCE
06/04		PREVIOUS BALANCE	98.25-
06/06	30.00	SUSTAINED OVERDRAFT FEE	128.25-
06/11	30.00	SUSTAINED OVERDRAFT FEE	158.25-
06/16	30.00	SUSTAINED OVERDRAFT FEE	188.25-
06/20	30.00	SUSTAINED OVERDRAFT FEE	218.25-
06/25	30.00	SUSTAINED OVERDRAFT FEE	248.25-
06/30	30.00	SUSTAINED OVERDRAFT FEE	278.25-

NO CHECK ACTIVITY

often confusing for customers, and fees can be astronomical.

In October 2003, the *Valley Advocate,* a weekly newspaper in western Massachusetts, told the story of Mary Beth Osborne, a new customer at Charter One Bank. Soon after opening her account, Osborne went shopping for clothes and paid with her ATM card.

Only later did she learn that the clothes cost $98.25 more than she had in her account. Rather than rejecting the payment, however, Charter One covered it and—without informing Osborne—began charging her a "sustained overdraft fee" of $30 every four business days. When she finally received her bank statement, it showed $180 in fees to cover the $98 overdraft—the equivalent of more than 2,000 percent annualized interest.

"The bankers are trying to structure this so they don't have to tell you what it's going to cost, which we think is extremely unseemly," Jean Ann Fox, director of consumer protection for the Consumer Federation of America, told the *Advocate*.

Given the costly and sometimes confusing fees charged by banks, it is not surprising that many low-income workers avoid banks and rely on check-cashing outlets instead. Surveys consistently find that check cashers provide good or excellent customer service, whereas many low-income customers report negative experiences with banks; indeed, half of all families currently without a checking account had one in the past.

Yet economists warn that, while understandable, shunning banks can deny low-income people crucial opportunities to save and establish a positive credit history—making them more likely to fall into debt traps like payday lending and subprime borrowing.

Michael Stegman, an authority on fringe finance at the University of North Carolina, reports that "people with bank accounts are more than twice as likely to hold savings as are people who are unbanked and are more likely to add to their savings on at least a monthly basis."

"Without a bank account, it is more difficult and more costly to establish credit or qualify for a loan," writes Michael Barr of the Brookings Institution. "Low-income persons without bank accounts face higher costs of credit than low-income persons with accounts."

Stegman and Barr both argue that automated teller machines, direct deposit, and electronic funds transfer make it possible for banks to serve low-income clients profitably. But Barr warns that as yet, "Most banks are not institutionally organized to focus on this market segment." ■

Dick Mendel is the editor of ADVOCASEY.

BY MARTHA SHIRK

PAYCHECK POVERTY

In Search of Alternatives to Payday Lending

Marisol Martinez was at the end of her options when she walked into a Chicago credit union and begged for help.

For months, Martinez, 25, had been trying to pay off $2,900 in payday loans—short-term cash advances that can serve as a lifeline between paychecks, but all too often turn into a financial dead end. Martinez had paid more than $3,000 in fees without reducing the principal by one cent. "I was under a lot of stress," she recalls. "I just couldn't do it any more."

Martinez stumbled into the right place. Ed Jacob, manager of the North Side Community Federal Credit Union, had been watching with alarm as payday lenders set up shop in the mixed-income neighborhood his credit union serves. But until he met Martinez, the impact on individuals remained entirely abstract. After listening to her story, Jacob gave Martinez a $3,000 loan at 9.5 percent interest, payable over six months. He also vowed to offer people in the neighborhood an alternative to payday loans.

For Audrey Cerise, the chief executive officer of ASI Federal Credit Union in and around New Orleans, the moment of truth arrived one day in 1999 when she found herself answering phones because a bridge closure had delayed her service representatives.

"One call after another, it was somebody from a payday loan company wanting to make sure that our members had active accounts," Cerise recalls. "When my service reps finally got in, I asked them about these calls. And they said, 'Oh, yeah, we get those calls all the time. A lot of our members have payday loans.'" Within days, Cerise was working on a new loan product to help members get through emergencies.

By the time Marisol Martinez walked into the North Side Community Federal Credit Union in 2001, she had paid more than $3,000 in payday loan fees and interest without reducing her loan principal by one cent.

Today, North Side and ASI are in the vanguard of a nascent movement to provide consumers with lower-cost alternatives to payday loans. With payday lenders now running an estimated 22,000 outlets nationwide—50 percent more than McDonald's—consumer advocates say it's crucial for mainstream financial services institutions to compete with them by offering affordable small loans.

For credit unions like North Side and ASI, the challenge is daunting: financially fragile borrowers often default on loans, yet regulators limit the interest rates federal credit unions can charge to 18 percent—not enough to cover the likely losses. North Side and ASI have taken dramatically different approaches to avoiding red ink. North Side relies on a grant to offset losses, while ASI charges high enough fees to provide a tidy profit. Consumer advocates say their early experiences, while promising, show how difficult it will be for credit unions to provide viable alternatives to high-cost payday loans. Indeed, some experts say the only way to protect vulnerable consumers will be federal regulation.

CASH AMERICA

Found in just a few states before the early 1990s, payday loan outlets have proliferated wildly following the passage of industry-friendly legislation in nearly three dozen states. No government agency tracks the industry, but the estimated number of outlets has more than doubled since 2000. Stephens Inc., an Arkansas-based investment banking firm, estimated that the industry made 100 million loans totaling about $40 billion in 2003.

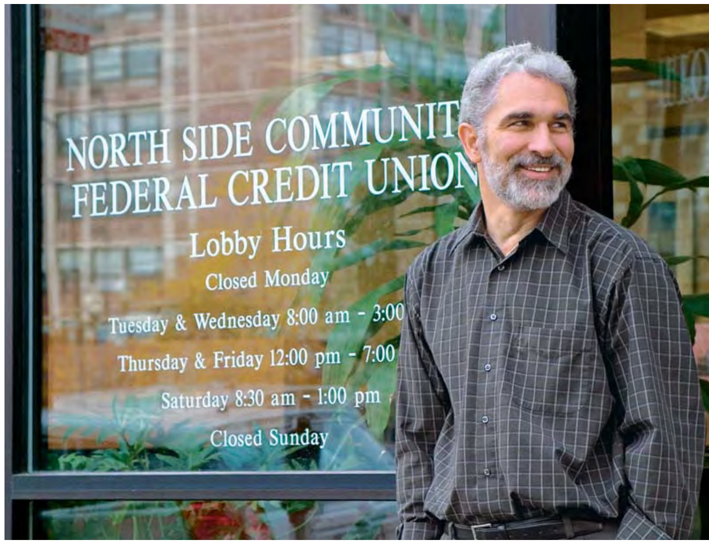
Experts believe that between 9 and 14 million people per year nationwide take out an average of 8–13 payday loans. These borrowers pay $6 billion in fees annually—money they could be saving or investing or using to pay bills. "They strip a lot of money out of low-income people's pockets and low-income neighborhoods," Jacob says.

Although some payday lending stores are mom-and-pop operations, most are owned by privately held national chains with names like "Mr. Cash," "Money Tree," "EZ Cash," and "Cash America." Their come-ons include lines like "100% Hassle-Free," "Bad Credit? OK!" and "The cash you need for the things you want!"

Unlike conventional loans, which require good credit, payday loans are made with few questions asked. Generally, a prospective borrower must only demonstrate that he/she has income and a checking account.

To secure the loan, the borrower usually writes a post-dated personal check for the amount, plus a fee ranging from $10 to $75 for each $100 borrowed. On his/her next payday, the borrower must deposit enough money to cover the check or pay a new fee to roll over the loan.

Since Ed Jacob, manager of the North Side Community Federal Credit Union, introduced the Payday Alternative Loan in April 2002, the credit union has made 1,800 loans to almost 900 borrowers.



To people who are desperate or chronically short of cash, paying $60 to borrow $300 for two weeks may not sound too steep, particularly if the alternative is being evicted or sending their children to school in tattered clothes. The problem comes when a borrower can't repay the loan as it comes due. So he/she pays another $60 to roll it over. And then two weeks later, another $60, and so on.

In Illinois, an analysis of state data by the Woodstock Institute found that the average number of rollovers is 13. By the time a $300 loan has been rolled over 13 times, the borrower has paid $780 in fees—and still owes the original $300.

The Consumer Federation of America views the fees charged as nothing short of usurious. "Payday loans are exorbitantly expensive debt traps targeted to vulnerable consumers who have trouble making ends meet," says Jean Ann Fox, the federation's director of consumer protection.

A PAYDAY ALTERNATIVE

Since most of North Side's 3,800 members have low to moderate incomes, Jacob had paid close attention to research documenting the high costs of payday loans. But he didn't realize just how pernicious the loans were until he met Martinez in November 2001.

"That's when the light bulb went off," he says."Here was this lady who had been paying rollover fees and interest for three months, huge sums of money. And she was not only not reducing the principal, but she was not building a positive credit history."

Ironically, Martinez was more knowledgeable about credit than most people because she worked for an auto finance company. She had previously taken out payday loans with no problem. However, when her fiancé moved out of their apartment in 2001, her finances collapsed. "I got stuck paying the whole rent and all the bills," she recalls. "I wasn't earning enough to cover it on my own, so I went to a payday lender."

This time, Martinez couldn't repay the loan in two weeks, so she paid $60 to roll it over. Twice more, she paid rollover fees. After the third extension, the most that lender would allow, she still didn't have the money, so she borrowed from another payday lender to pay off the first, and started the cycle all over again. By the time she walked into North Side, she had paid more than $3,000 in fees for seven loans.

At the time, North Side wasn't lending to walk-ins. But after listening to Martinez's story and determining that she was creditworthy, Jacob made an exception. "That same day, I went out and paid off all my payday loans, and I haven't taken one out since," Martinez says.

With Martinez's problem resolved, Jacob set out to devise a loan that could compete with payday loans. North Side already offered a short-term loan product to longtime members. "It wasn't a real competitor to a payday loan because nobody comes in a year before an emergency to take out a membership," Jacob notes. "Marisol's experience told us we had to figure out how to match the payday lenders on convenience, because that is what they really offer."

Jacob knew that North Side was likely to lose money on a payday-type loan because of high defaults, which North Side couldn't afford. He approached Northern Trust Bank, which, like all banks, is required by the 1977 Community Reinvestment Act (CRA) to serve low-income people in its community. "I said, 'You don't want to make $500 loans, but I do, so give me $20,000 for a loan-loss reserve,'" he recalls. Northern Trust gave him the money.

In April 2002, North Side unveiled its Payday Alternative Loan (PAL). The eligibility requirements are minimal. Borrowers must earn at least $1,000 a month, but a bad credit rating is no problem. The loan ceiling is $500. There's a $10 application fee and an APR of 16.5 percent, resulting in interest payments of about $25 over six months.

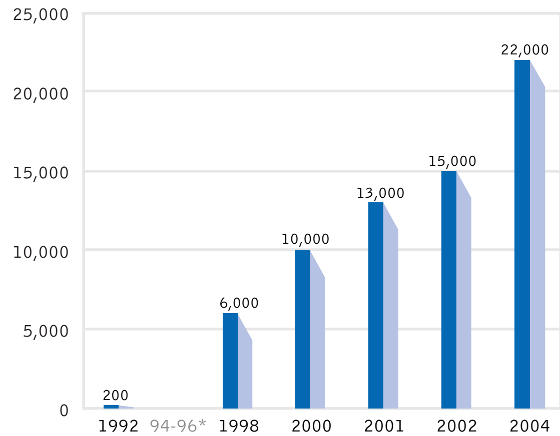
When PAL borrowers began seeking second loans even before paying off the first, Jacob imposed a two-loans-a-year limit. "I would love to tell you that people wanted these loans for true emergencies, but most of them have ongoing liquidity problems and much deeper issues," he says. Jacob also solicited a $20,000 grant from Private Bank to pay for financial literacy classes. As an incentive to attend, North Side makes a borrower's last loan payment (up to $50) or puts $50 into a savings account. More than 100 borrowers and several hundred other North Side members have completed the classes.

Since 2002, North Side has made almost 1,800 PALs to 900 individuals. Had these borrowers instead rolled over a payday loan for six months, a common pattern, Jacob estimates they would have paid an additional $1.7 million in fees.

Although North Side's payday alternative is clearly saving members money, its long-term viability remains in doubt. The 60-day delinquency rate is 19 percent, more than six times the rate for other loans. Without continuing grants to cover losses, North Side won't be able to continue the product.

When talking about how to develop alternatives to payday loans, Jacob tells other credit union executives that it's essential not only to cover the likely losses, but also to help borrowers become more future oriented, a goal of North Side's financial literacy training. "I think a lot of low-income people are worried about the very, very short term," Jacob says. "They probably know that a payday loan is a bad deal for them, but it will get them through next Friday, which is their focus. I'm trying to stretch people's focus to a year rather than a week."

PAYDAY LENDING OUTLETS IN USA



Source: Compiled from industry estimates by Ms. Jean Ann Fox, Consumer Federation of America.

*No data available for these years.

THE STRETCH PLAN

Nine hundred miles away, Audrey Cerise came up with an entirely different way for ASI to provide its 77,000 members with an alternative to payday loans without losing money itself.

After researching the law, ASI put together the "Stretch Plan"—a $4-a-week club with numerous benefits: a 10-minute phone card; free travelers' checks; overdraft protection; a free refund anticipation loan at tax time; and inexpensive (25-cent) money orders. But the main attraction is the "Stretch Loan"—a $200 to $1,000 line of credit at just 12 percent interest.

To minimize defaults, ASI limits participation to members with a six-month history of direct deposit. "The risk with these loans is tremendous," Cerise says. "They are the kind of people who work six months here and six months there. They're the first to lose their jobs when something goes bad." A payback of $101 is required every pay period, but borrowers can withdraw the money immediately. With a positive repayment history and a good enough credit rating, a borrower can qualify after six months for an enhanced loan of up to $3,000.

COMPARING PAYDAY LOAN ALTERNATIVES

	ASI FEDERAL CREDIT UNION	NORTH SIDE COMMUNITY FEDERAL CREDIT UNION
Assets	$190 million	$9.2 million
Members	77,000	3,800
Product	Stretch Loan*	Payday Alternative Loan
Date of inception	June 1999	April 1, 2002
Loans outstanding	5,722	626
Average loan balance	$321	N/A
Maximum loan	$1,000	$500
Term	Open-ended line of credit	Six months
Payback required	$101 per pay period (can be borrowed immediately)	$87.43/month
Limit on loans per year	N/A (line of credit)	Two
Interest rate	12%	16.5%
Fees	$4/week**	$10 application fee
Effective interest rate (including fees)	34 to 122%	16.5%
60-day delinquency rate	2%	19%
Profit per account	$80 to $90	$0 (requires grants to break even)
Qualifications	Six-month history of direct deposit	$1,000 monthly income
Financial literacy training	Optional	Optional

* The figures presented here are for the basic Stretch Loan. ASI's enhanced and Asset-Builder loans carry higher interest rates (15%) but lower repayment requirements.
**The fee covers membership in ASI's Stretch Plan, which provides other benefits besides the loan.

From the start, the Stretch Plan was big hit. In March 2004, 5,722 ASI members were participating, with an average loan balance of $321. Another 1,841 members had enhanced loans, with an average balance of $1,438. The volume of these loans almost doubled between 2002 and the spring of 2004.

To Cerise's surprise, the Stretch Plan has not just broken even; it's become extremely profitable—so much so that Cerise is wrestling with whether ASI may be charging borrowers too much. After deducting operating expenses, including a $360,000 write-off for defaults, ASI made a net profit on these loans of about $600,000 in 2003—$80 to $90 per account—almost one-third of its net operating income.

Like Jacob, Cerise is concerned that her borrowers aren't using the Stretch Loan to get through difficult times, but instead are staying almost constantly in debt. "They make their payment, and then they get right back up to their maximum again," Cerise says. "My gut feeling is that 99 percent of our members just keep recycling the loan."

After several expensive experiences with payday loans, Sandra Thornton, 54, was thrilled when ASI unveiled the Stretch Plan. After she paid back her first $200 loan four years ago, Thornton qualified for an enhanced loan of $1,000. The required $101 payback is deducted from her account every two weeks. Almost immediately, she takes back $90 to $100. In April 2004, the balance on her account was $996.

"Any time I need to, I dip into it," says Thornton, a housekeeping manager at a hotel. "It's the best thing that could have happened to me. I know it costs me $4 a week, but that's a lot better than $45 every two weeks for a payday loan."

In fact, the structure of the Stretch Plan encourages borrowers like Thornton to maintain high balances, since they pay the same $4 weekly fee whether they owe nothing or $200 or $1,000. In combined fees and interest, a borrower pays $340 a year (an effective interest rate of 34 percent) to maintain a $1,000 balance. For a $200 loan balance, the annual cost is $244, for an effective interest rate of 122 percent. (In Louisiana, the prevailing APR for a payday loan is 520 percent.)

Cerise says she would like to see more Stretch Plan participants graduate to ASI's Asset-Builder Loan. As with the enhanced loan, the ceiling is $3,000, and the interest rate is 15 percent (slightly higher than the basic Stretch Loan). The key difference is that under the Asset-Builder Loan, $15 of each payment goes into an interest-bearing savings account so borrowers amass savings while paying down their loans. In addition, there's no weekly fee.

“We are in the early days of experimentation in this area. I think there needs to be some serious product development work around alternative debt instruments that will actually help people become more financially engaged and empowered, as opposed to putting them in the hole.” *Kirstin Moy, Director, Aspen Institute Economic Opportunities Program*

Shown here with her husband and daughter, ASI Federal Credit Union member Sandra Thornton calls ASI’s Stretch Plan “the best thing that could have happened to me. I know it costs me $4 a week, but that’s a lot better than $45 every two weeks for a payday loan.”

The Asset-Builder Loan is clearly more advantageous than the enhanced or basic Stretch Loan, yet only 230 ASI members have switched. “It means our members aren’t moving forward, which concerns me,” Cerise says.

Early in 2004, Cerise challenged the ASI staff to nudge more Stretch Plan borrowers into Asset-Builder Loans. She also contracted with Balance, a national financial counseling and education program, to help ASI members get their financial houses in order.

“This is the product we want to grow,” Cerise says. “The whole idea with the Stretch Plan was to give our members a safety net. Once they prove they can pay their bills, we want them to move on.”

CONTINUED ON P. 29

REGULATING PAYDAY LENDING

Even as pioneering credit unions experiment with alternatives to payday loans, many advocates believe the only way to protect desperate consumers from exploitation is to regulate these loans much more stringently—or outlaw them entirely.

"We would like to see payday lenders disappear," says Cliff Rosenthal, executive director of the National Federation of Community Development Credit Unions, whose members serve largely low-income communities. "Short of that, we would certainly like to see them strictly and regularly regulated, particularly on the matter of rollovers, and certainly on the matter of disclosure."

In 33 states and the District of Columbia, payday lenders have persuaded legislators to pass what consumer advocates call "safe-harbor laws," which authorize check holding or electronic debits for cash advances and exempt lenders from state usury laws. Texas has the lowest annual interest cap in a safe-harbor state—309 percent—while eight safe-harbor states have no cap at all. Payday lenders also operate easily in Wisconsin and New Mexico, which don't regulate loan terms.

The payday loan industry operates less freely in the 15 states, mostly in the Northeast, where remaining usury or credit-cap laws make payday loans only marginally profitable. "You just do not see these things on every street corner in those states," notes Jean Ann Fox, director of consumer protection for the Consumer Federation of America.

After being outmaneuvered in state legislatures for years, consumer advocates introduced legislation in 22 states in 2004. The advocates prevailed recently in Georgia, Michigan, Pennsylvania, West Virginia, and Wisconsin, while payday lenders triumphed in Arizona, Indiana, and Utah. The uneven results illustrate the problems inherent in combating the payday loan industry state by state:

— The industry aggressively fights any attempt to restrict its operations, contributing generously to political candidates and deploying savvy lobbyists to argue that the industry provides a needed service to the working poor.

— The industry is adept at exploiting loopholes. In 2001, Illinois placed new restrictions on loans made for terms of fewer than 30 days. Almost overnight, payday lenders changed the standard term to 31 days, evading the new rules.

— To skirt some states' usury laws or caps on interest rates, payday lenders sometimes partner with banks chartered in states with weak laws. (Banks in Delaware, South Dakota, and Utah are favorites.)

— Payday lenders are increasingly marketing loans through the Internet, outside the reach of state regulators. Lenders send cash to borrowers using electronic funds transfers through offshore banks. When payback time comes, the banks simply debit the borrowers' accounts.

Even as they press for reforms at the state level, advocates concede that it will probably take federal regulation to substantially rein in payday loan profiteering. They want Congress to force the FDIC to prohibit state-chartered banks from partnering with payday lenders in other states. (The Federal Reserve, the Comptroller of the Currency, and the Office of Thrift Supervision already prevent federally chartered banks and thrift institutions from teaming up with payday lenders.)

Reform bills have been introduced in Congress in the past, without success. A bill introduced in June 2003 by Democratic Rep. Bobby L. Rush of Illinois remained stuck in committee. Members of Congress may need to see more evidence of harm to their constituents before they're willing to act. "You tend to get reform when you have a firestorm in your midst," notes Fox.

CONTINUED FROM P. 27

FINDING A BALANCE

The experiences of North Side and ASI make it clear how difficult it is for mainstream financial institutions to devise payday loan alternatives that operate in the black, are affordable to borrowers, and help move them out of the debt cycle.

"For community development credit unions, profitability is not the primary reason to get into this business," says Christopher Tan, a consultant with ShoreBank Advisory Services in Chicago, which helps develop financial services products for low-income consumers. "However, if they want to be viable alternatives to payday lenders, they need to cover cost and price for risk. The interesting conversation here is where to find the balance. ASI might be charging more than some advocates are comfortable with. But if credit unions don't offer people an alternative, they don't have any other option but to go to payday lenders. Credit unions need to meet the customer where they are, but find a way to move them to asset building."

"We are in the early days of experimentation in this area," points out Kirstin Moy, director of the Aspen Institute's economic opportunities program. "I think there needs to be some serious product development work around alternative debt instruments that will actually help people become more financially engaged and empowered, as opposed to putting them in the hole."

Martha Shirk is a freelance journalist in Palo Alto, California. She is coauthor of the books, Lives on the Line, Kitchen Table Entrepreneurs, *and* On Their Own, *all published by Westview Press.*

Shown here with the children of her employees, ASI Federal Credit Union CEO Audrey Cerise is concerned that too many Stretch Plan borrowers are remaining in constant debt.

DEALS ON WHEELS

EXPANDING AUTOMOTIVE OPPORTUNITY IN NEW ENGLAND

BY SUSAN BRENNA

The first time Robyn Harris ducked into the below-ground office of Fannie CLAC, a nonprofit car ownership program in Lebanon, New Hampshire, she was in a bad fix. A divorced mother of two teens, she was hiring cabs, begging rides, and walking unlit roadways to get to her night shift at a factory and her day job on the sales floor at J.C. Penney. She was $7,000 in debt, partly from two disastrous used car purchases. The first car, a 12-year-old Chevrolet Beretta, expired days after Harris sank $3,000 into repairs and just six months after she bought the car for $2,000. The second, a 10-year-old Ford Taurus, failed inspection before she could pay off the loan (at 25 percent interest).

Despite her dire financial straits, Fannie CLAC counselors told Harris she was a strong candidate to buy a brand new Honda. She had a steady income—enough to handle a monthly car payment of approximately $240. She would have to clean up her credit first and learn to budget. But Fannie CLAC would teach her how to do that.

Harris could hardly believe her ears.

Shown here atop her new Honda, Robyn Harris could hardly believe her ears when Fannie CLAC counselors told her she could afford a brand new car.

Once in budget counseling, though, Harris began to see how she could make the leap. "One thing they made me realize was that I was spending $60 a month on Dunkin' Donuts coffee," Harris says ruefully. That's one-fourth of a car payment.

By February 2003, nine months after first visiting Fannie CLAC, Harris walked into a Honda showroom, bought a $15,000 Honda Accord, and signed a loan at 6.6 percent guaranteed by Fannie CLAC (which often secures loans at 4.75 percent). She now drives her sons around in a safe car, and she earns overtime wages some days without missing her ride. "It has made all the difference," she says.

Harris's story is uplifting. But it is also uncommon.

Nearly 10 percent of U.S. families, including one-fourth of families earning $25,000 or less, have no cars. Lacking solid credit, these families typically face exorbitant interest rates when they try to buy a car. Then they are stuck with costly and unpredictable repair bills as their aging vehicles break down.

Yet programs to help low-income families obtain affordable used cars are not widespread, and most of those programs offer only temporary relief. Fannie CLAC is the first and only program in the nation that aims to bypass the used car market entirely by enabling low-income families to buy new vehicles.

A Ticket to Jobs and Self-Sufficiency

In spread-out states like Vermont and New Hampshire, in fact throughout most of America, if you want to get and retain a job you need to own a car and keep it running. Eighty-eight percent of American workers drive to their jobs in cars; only 5 percent commute by public transit, while just 4 percent walk or ride a bicycle.

LACKING SOLID CREDIT, AMERICA'S LOW-INCOME FAMILIES TYPICALLY FACE EXORBITANT INTEREST RATES WHEN THEY TRY TO BUY A CAR. THEN THEY ARE STUCK WITH COSTLY AND UNPREDICTABLE REPAIR BILLS AS THEIR AGING VEHICLES BREAK DOWN. YET PROGRAMS TO HELP LOW-INCOME FAMILIES BUY AND MAINTAIN (ESPECIALLY MAINTAIN) AFFORDABLE USED CARS ARE NOT WIDESPREAD.

Nationwide, less than 5 percent of roadways are served by public transit. Rural residents are particularly disadvantaged: the Federal Transit Administration estimates that 40 percent of rural counties have no public transit service at all. Many car-less urban dwellers suffer as well, stranded by bus and rail systems that miss vast portions of city and suburb and offer spotty off-hours service. In Seattle, for instance, "Poor people tend to have the worst shifts, which makes them the least likely to have public transportation work for them," says Susan Crane, executive director of Port Jobs, which backs Seattle's Working Wheels program. Without rides, Crane notes, many can't even get to job sites to apply.

Studies throughout the United States show that welfare recipients are more likely to find work and to raise their incomes when they have access to a car. The Progressive Policy Institute reported in 2002 that "aside from the lack of child care, lack of transportation is perhaps the most common problem facing low-income workers trying to get and keep a job."

The High Costs of Auto Ownership

If you don't have much money in your pocket, though, and especially if you don't have strong credit, owning a car is alarmingly expensive.

Low-income buyers typically get the worst available terms on car financing. Banks and credit unions calculate rates based on the buyer's credit history (and few low-income people have blemish-free records), as well as the age and condition of the car. Less-creditworthy purchasers of high-mileage cars can pay double or triple the rates of more-creditworthy borrowers buying new cars.

Buyers who don't qualify for even the steepest bank loans are pushed into the subprime lending market, where finance companies typically charge interest rates of 17 to 25 percent. And the poorest of the poor can't even qualify for subprime loans. They are left to patronize streetcorner "Buy Here, Pay Here" lots that steer around usury laws and advertise "zero percent interest." These dealers often sell cars at inflated prices and require 50 percent or more of the price up front—then collect the remainder in weekly installments.

Often, the least-affluent consumers are further drained by driving the least-reliable cars, with the lowest fuel efficiency and the most frequent breakdowns.

Good News Garage

Given these high costs, it is no surprise that many low-income families can't afford a car. Only recently, with the advent of welfare reform, have programs emerged to help put low-income drivers behind the wheel.

Hal Colston (below right) founded the Good News Garage in 1996 with a $35,000 start-up grant. Charlene Wallace (above) is acting director of the original Good News Garage project in Burlington, Vermont.

The Good News Garage, based in Burlington, Vermont, was one of the first nonprofits in the nation to take up the challenge. The project took root in 1996 when Hal Colston, head of a local community action agency, hooked up with Lutheran Social Services and secured a $35,000 start-up grant to begin providing cars for families impacted by the national welfare reform law. Since then, the idea has spread to 19 states and the District of Columbia. Currently there are 40 nonprofit car ownership programs in operation, according to the National Economic Development and Law Center. Most programs are small scale, providing as many as a few hundred cars a year, or as few as five. Like Good News Garage, many have waiting lists of hundreds of families.

While no one tracks how well these programs meet the overall needs of American families without cars, “We know that to call it ‘inadequate’ is a serious understatement,” says Margy Waller, a visiting fellow in Economic Studies at the Brookings Institution.

Shown with her husband and three of the couple's nine children in their new vehicle, Denise Johnson says that Fannie CLAC's financial literacy course "changed the way we looked at what we've got, and what we could have."

Good News Garage solicits donations of used cars, inspects them thoroughly, and then repairs the most roadworthy donations. After fixing up these cars, Good News Garage offers them to needy families for the cost of repairs (usually less than $1,200) and provides a 30-day warranty. In 2003, the organization provided 210 cars, most through state-subsidized contracts, to people like Amaryllis Bogue, who was moving from welfare to work.

A married mother of two, Bogue had been depending on rides from relatives and friends to get to work, sometimes taking a bus that dropped her a mile from her job as a hotel housekeeper. She was about to lose that job for repeated lateness when Good News Garage provided her with a 10-year-old Toyota Corolla in November 2003. Now both she and her husband work; she during the day, he drives to work at night. Not only can Bogue get her children to the doctor and save money by shopping more selectively, but she's also cut down on the hours she pays for day care. "At the end of a long day of work, I don't have to sit for an hour and wait for somebody to pick me up before I get my child," she says.

The Good News Garage model has proven both sustainable and replicable. There are now four other Good News Garages around New England, and similar programs in many states. But the acting director of the original Burlington project, Charlene Wallace, says that soliciting donated cars in sufficient numbers is a constant challenge. So is generating income to cover operating costs. Vermont's welfare department gives Good News Garage $175,000 to provide 180 cars each year for welfare-to-work participants like Bogue, and a state jobs program subsidizes another three cars per month. Good News Garage also strives to serve working poor families. But in 2003, while conducting a $1.7 million fundraising campaign to buy a garage and expand its repair capacity, the program subsidized car sales to only 30 low-income families not on the state's caseload. (Wallace expected to provide vehicles for 70 to 120 non-welfare families in 2004.)

The main drawback of the Good News Garage model is the age of the cars. Bogue's Toyota had 160,000 miles on the odometer before she got it. Fortunately, the car didn't need any repairs in the first six months, Bogue reports. Tanya Jordan, another Good News Garage client, says that the 1992 Honda Civic she received in January 2004 also came with 160,000 miles. "I've had no problems," Jordan reported in November. "It's been a blessing to have it."

According to Wallace, Good News Garage rejects about three-fourths of the cars it receives and sells these cars at wholesale auctions to subsidize operating costs. Nonetheless, Wallace admits that the lifespan of the donated cars may be limited. “We make sure it’s in good solid shape for a year or more,” she says. “It’s a car to get you back on your feet and get you financially stable so you can hopefully get a loan of your own for a newer car.”

A New Approach

Some car ownership programs connect low-income buyers with more recent vintage autos. The Working Wheels program in Seattle provides clients with late-model vehicles donated by government agencies, for instance. The Driven to Succeed project in Detroit provides needy car buyers with previously leased cars.

Fannie CLAC takes an entirely different approach. Formed in 2001 by agency president Robert Chambers and other auto industry veterans, Fannie CLAC—an acronym for “car loans and counseling”—helps low-income people afford brand new cars and avoid the used car market altogether.

To make the new cars affordable, Chambers—once the e-commerce manager for an auto dealership—approached several dealerships and ultimately convinced two to offer Fannie CLAC clients base model cars for $100 over the dealer’s list price.

Chambers then reached out and negotiated with banks to secure loans for his clients at favorable rates. Even when Fannie CLAC offered to guarantee the loans, however, this proved a tough sell. Most small banks and credit unions avoid auto loans, which are time consuming and potentially risky. Most large banks use automated underwriting systems to evaluate car loans, rejecting loans for those—like Fannie CLAC’s clients—who don’t meet standard credit requirements.

Ultimately, Chambers did forge a deal with Chittenden Bank, a regional depository, which uses the program to satisfy its responsibilities under the federal Community Reinvestment Act. The loans typically last 66 months and carry an interest rate of 4.75 percent—allowing borrowers to pay just $243 per month. Fannie CLAC guarantees the value of each loan, eliminating risk for Chittenden. It’s a risky proposition, Chambers says, because if clients default on their loans, “then we fail.”

So far, though, the default rate on Fannie CLAC’s 240 loans has been less than 3 percent—below the industry average, Chambers says. Fannie CLAC requires most clients to take financial literacy classes and undergo credit counseling before it will guarantee their loans. Many spend months driving and making payments on “bridge cars” that Fannie CLAC lends to clients for $200 per month as they build a good credit history and get used to making car payments.

Denise Johnson, a waitress and mother of nine children, needed that time to convince herself she could handle a new car loan. “We had always driven clunkers,” she said of herself and her husband, a restaurant cook. “My husband was kind of hyperventilating at the thought of signing away his life for the next 60 months” with a new car loan, she says. “But the financial literacy course changed the way we looked at what we’ve got, and what we could have.”

Fannie CLAC cofounder and president, Robert Chambers, has negotiated deals with auto dealerships and banks to make owning a new car possible for many low-wage workers.

Looking Beyond New Hampshire

To thrive over the long term and prove itself a replicable model for other jurisdictions, however, Fannie CLAC will need to generate additional revenues to cover its roughly $50,000 per month budget.

Fannie CLAC's main source of income is the $800 fee it charges each car-buying client (and rolls into each car loan). But at the present pace of 20 car purchases per month, these fees provide just $16,000. The agency also earns income through monthly charges on its bridge cars ($10,000 per month), sales of other donated vehicles ($4,000 per month), and scholarships from employers and civic organizations ($2,000 per month) for the financial literacy training Fannie CLAC offers to workers and residents in the community.

"Hopefully, once we get the volume up it will pay for itself," Chambers says. "It does not right now, and foundations are helping us with the costs in the start-up and development phase we're in now. We need to get to a volume of 40 cars per month to reach a break-even basis."

Chambers says that Fannie CLAC will soon reach this "break-even" point in New Hampshire, and he believes the model can be adopted in other regions as well. But for the program to expand, each new office will need leaders like Chambers and program manager Mary Burnett, a 28-year industry veteran—executives with experience in the auto industry and the negotiating skills to forge partnerships with auto dealers and lenders.

"There's an enormous need for this service," Chambers says. "Most people have been conditioned to believe that they can never afford a new car. But the truth is that—with our assistance—new cars are more affordable than unreliable older cars bought at high interest rates. So it takes a lot of education."

Room for Many Approaches

The Fannie CLAC program will never serve the poorest of the poor. Of the 1,200 potential car buyers who had come to speak with Fannie CLAC counselors as of late May 2004, 240 had purchased cars, and 48 were using bridge cars. Another 160 were attending budgeting classes or waiting for a bridge car. That left about 800 who had dropped away, either because they lost interest in the program or lacked the income necessary to make the monthly car payments.

Shown here with her son, Logan, Tanya Jordan calls the car she received from Good News Garage "a blessing," even though it came with 160,000 miles on the odometer.

"There's almost no way to buy a new car unless you've got $200 a month to make a payment," Chambers admits.

That's one reason why Margy Waller of the Brookings Institution doesn't believe that new cars are the only answer to the auto needs of low-income workers. However, Waller thinks Fannie CLAC's approach is worth a close look. "There is a real benefit to getting cars that are not likely to have immediate repair costs, or run the risk of needing replacement very soon," Waller says. "I think there is real promise here."

Carolyn Hayden, who oversees the National Economic Development and Law Center's Driven to Succeed project in Detroit, argues that "recent model, certified used cars provide an excellent value both by cost standards and reliability." But given the immense need among car-less workers, Hayden says, "There is room in the marketplace for all of these approaches."

Susan Brenna is a freelance writer based in Potomac, Maryland

HOW MUCH DOES FANNIE CLAC SAVE ITS CAR-BUYING CLIENTS?

Fannie CLAC President Robert Chambers estimates that it will cost a car buyer $3,000 more to purchase and operate a 9-year-old Ford Taurus for three years than to buy a brand new Honda Civic through Fannie CLAC. The Honda buyer will have higher monthly payments ($243 vs. $175) and will pay them for a longer period (66 months instead of 36 months). But monthly costs for fuel, maintenance, and repairs, Chambers estimates, will average three times as much for the Taurus ($231 per month) as for a new Honda Civic under warranty ($83 per month). And unlike the Honda buyer, the Taurus owner will likely miss many workdays (and possibly lose his or her job) due to car problems.

At the end of three years, the Taurus buyer will own the car outright, but the car's retail value will be only $275—if it hasn't already suffered a catastrophic breakdown. The Honda owner will still owe two-and-a-half years of car payments, but the car will remain under warranty for two more years, its retail value will exceed the loan balance by almost $800, and it will have many years of reliable service ahead.

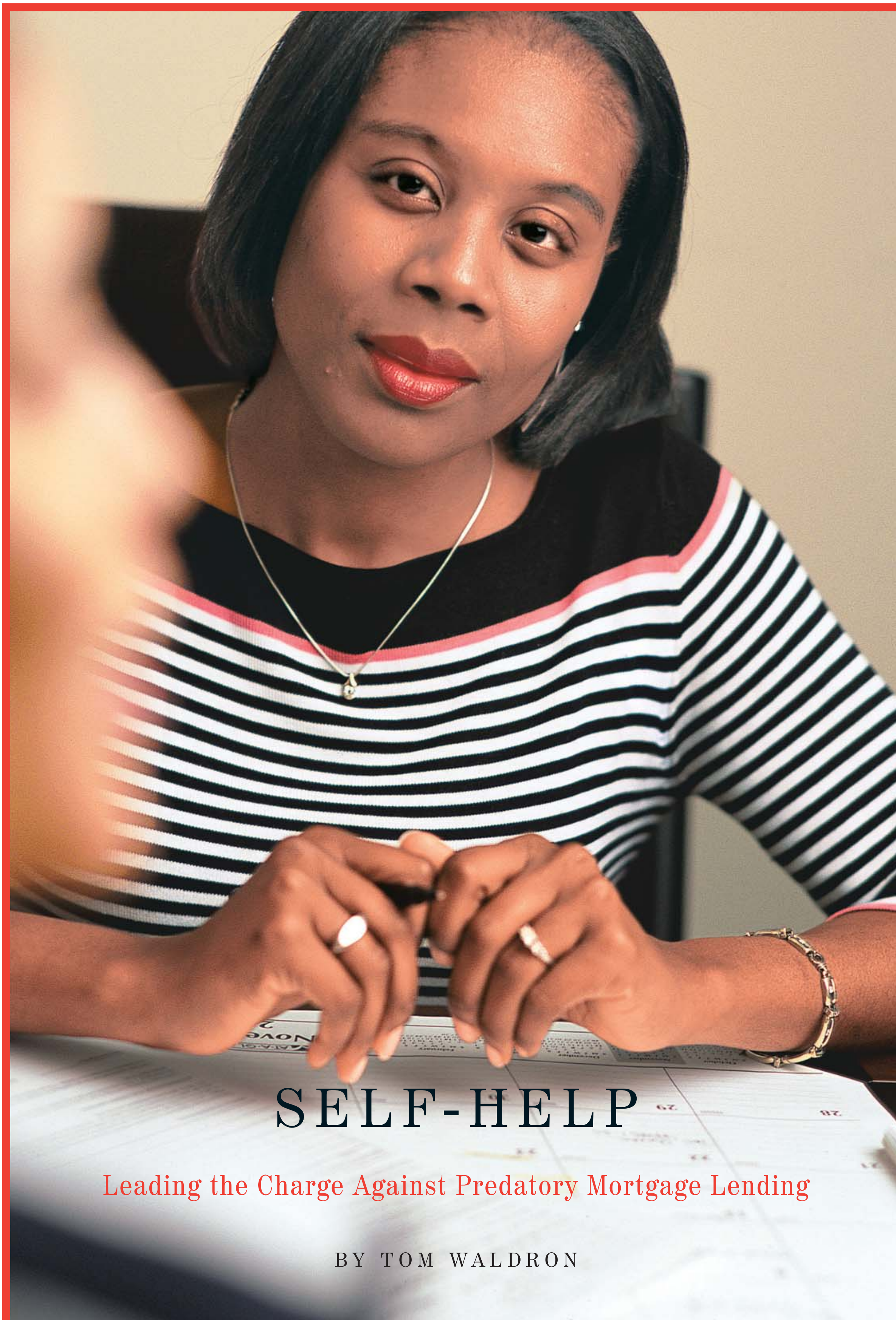
"An older, cheaper car is one of the worst traps low-income people fall into," Chambers says. "They are heading for disaster, unless they have great mechanical skills and lots of money in reserve" for repairs.

BRAND NEW FANNIE CLAC CIVIC VS. NINE-YEAR-OLD TAURUS: TALLYING UP THE COSTS

	2004 HONDA CIVIC DX 4 DOOR 5 SPEED	1995 FORD TAURUS 86,000 MILES	
Retail price	$13,500	$4,250	
Sale price	$12,487	$4,250	
Document fee	$119	$119	
Fannie CLAC fees	$800	$0	
Extended warranty	$645	$0	
TOTAL COST	**$14,051**	**$4,369**	
LOAN TERMS	Fannie CLAC 66 months @ 4.75%	Subprime Auto Loan 36 months @ 17%	
Monthly payment	$242.33	$155.77	
3-YEAR COST AND SAVINGS COMPARISON			NET SAVINGS
Monthly payments over 36 months	$8,724	$5,608	-$3,116
Anticipated 3-year fuel cost	$2,211	$3,930	$1,719
Estimated 3-year maintenance and repairs	$500	$4,320	$3,820
TOTAL OUT-OF-POCKET COSTS IN 1ST 3 YEARS	**$11,435**	**$13,858**	**$2,423**
Blue Book trade-in value after 3 years	$7,910	$275	$7,635
Remaining loan balance after 3 years	$6,842	$0	-$6,842
Net equity after 3 years	$1,068	$275	$793
TOTAL SAVINGS			**$3,216**
REMAINING WARRANTY	two years	none	
Likelihood of catastrophic breakdown	extremely unlikely	likely	
Work days missed due to car breakdowns	few	many	

Fuel costs are calculated using fuel efficiency data from www.fueleconomy.org, with gasoline priced at $2 per gallon. Repair costs estimated by Fannie CLAC staff.

Source: Fannie CLAC



SELF-HELP

Leading the Charge Against Predatory Mortgage Lending

BY TOM WALDRON

In 1998, school bus driver Joe Johnson (not his real name) was looking for advice. A widowed father with a young daughter, Johnson was struggling to make ends meet and hoping to refinance his home and cash out some of his equity.

Johnson and his since-deceased wife had taken a $29,000 mortgage at 14 percent interest to purchase their Durham home ten years earlier. Now the mortgage company was refusing to cooperate with Johnson as he tried to refinance the loan.

So Johnson walked into the offices of the Center for Community Self-Help in Durham, N.C., and shared his mortgage papers with Self-Help's chief executive, Martin Eakes. The documents showed that the actual loan amount for the Johnson's mortgage had been only $14,000. But the lender, a firm called "The Associates," had tacked on an additional $10,000 premium for so-called "credit insurance" plus another $5,000 in fees. In other words, more than half of the loan went to fees and insurance.

To Eakes, who cofounded Self-Help in 1980, the Johnsons' abusive loan was a wake-up call. For 15 years his organization had been providing home loans to low-income and minority homeowners who couldn't qualify for conventional bank mortgages, and Eakes had heard many tales of lending inequities.

But it was not until he helped Johnson initiate a lawsuit against The Associates that Eakes discovered just how pervasive and pernicious the "predatory lending" business had become. In the discovery process, Self-Help learned that The Associates—mirroring the explosive growth in abusive mortgage financing nationwide—was making 18,000 mortgage loans per year in North Carolina alone. Many of these loans were loaded with excessive fees and charges that stripped equity from the borrowers and often endangered them with foreclosure.

As a loan officer for the Center for Community Self-Help in Durham, N.C., Teresa Dickey helps low-income families secure affordable mortgages and avoid the expensive and often predatory subprime mortgage market.

"As I attempted to help this man refinance his loan with Self-Help—and to help others who followed him—I learned how an unscrupulous lender can steal a lifetime's accumulation of wealth in the few seconds it takes a homeowner to sign his name," Eakes recalled in April 2004.

The lawsuit enabled Johnson to get out of his loan and hold on to his house, where he still lives. (The details of the case, including the man's name and terms of the actual settlement, were sealed in the settlement agreement.)

But for Eakes, the case did not end there. "We realized all our efforts to build wealth through homeownership are unlikely to result in lasting changes for the communities we work in unless we also work to protect wealth from predatory practices and unscrupulous lenders."

Quickly, Eakes launched a new prong in Self-Help's groundbreaking efforts to promote homeownership among low-income and minority families: a well-financed advocacy campaign to combat predatory lenders and the onerous lending practices they use to burden fragile homeowners.

Self-Help scored significant victories in 1999 and again in 2001 when North Carolina passed the strongest anti-predatory lending legislation in the nation. Since then, Self-Help has established a separate advocacy office, the Center for Responsible Lending, to promote similar reforms in other states and in federal law as well.

These advocacy efforts have complemented Self-Help's innovative work as a mortgage lender. First as an independent lender, and more recently through partnerships with banks, foundations, and the Federal National Mortgage Association (Fannie Mae), Self-Help has created a $2.5 billion financing pool to expand mortgage financing opportunities nationwide for families like the Johnsons who don't qualify for market-rate mortgages.

These accomplishments place Self-Help at the forefront of the nationwide movement to make homeownership affordable for vulnerable families and protect them from abusive lenders. Eakes acknowledges, however, that the battle against predatory mortgage lending remains an uphill struggle.

"Since the beginnings of time, we've always had individuals willing to prey on others who are less sophisticated," he says. "But in the last eight years it has been raised to an art form. It's an epidemic."

STRIPPING BORROWER'S EQUITY

Predatory lending generally thrives in what credit experts call the "subprime" lending market—geared to providing high-cost loans to customers with impaired or limited credit histories. Three-quarters of these loans involve refinancing.

Predatory subprime lenders often target lower-income homeowners, particularly those who have accrued substantial equity in a home, by offering them a chance to consolidate bills and take some cash out of the home. Using deceptive sales pitches and the salesman's sleight of hand, predatory lenders talk unsophisticated borrowers into disadvantageous loans by burying excessive fees and costly loan terms in a mountain of paperwork. Some predatory lenders scour neighborhoods and land records for vulnerable homeowners who might sign a refinancing package they cannot actually afford, with the unspoken goal of spurring a foreclosure.

"All our efforts to build wealth through homeownership are unlikely to result in lasting changes for the communities we work in unless we also work to protect wealth from predatory practices and unscrupulous lenders."

Martin Eakes, President and CEO, Self-Help

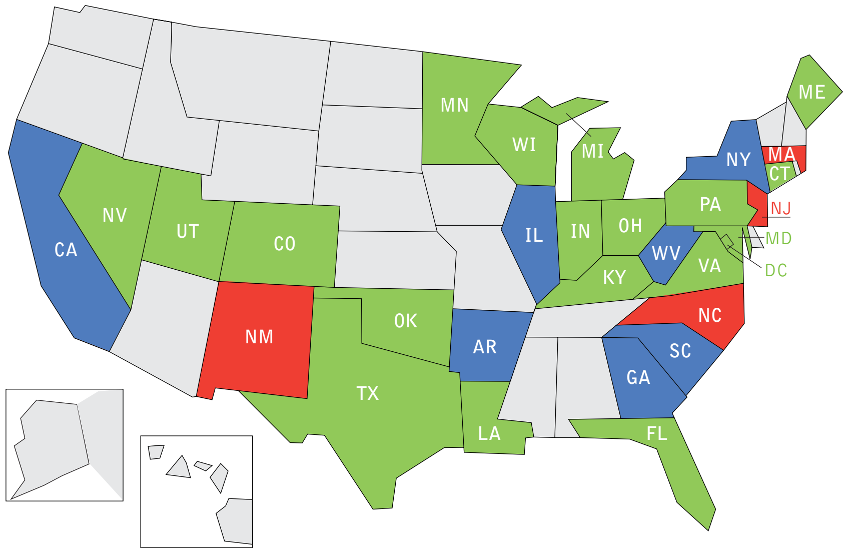
Predatory loans often carry extraordinarily high fees and point charges that strip equity out of a borrower's home. The loans usually obligate the homeowner to make costly prepayment penalties if they later attempt to escape the mortgage. These penalties can reach 5 percent of the loan value; on a $150,000 loan, such a penalty would be $7,500, an enormous equity loss for many families.

In many cases, predatory lenders include high-cost credit insurance in their financing packages. Unlike the more affordable credit insurance usually offered to borrowers in the prime lending market, some predatory lenders convince borrowers to pay for the entire policy in a single up-front payment, often thousands of dollars. Typically, the lender will roll that cost into the loan, meaning the borrower ends up paying far more in interest to finance the insurance.

Finally, predatory lenders aggressively push borrowers to refinance their loans, sometimes repeatedly. Each time a new loan is taken out in such "loan flipping" operations, the borrower pays more in fees, loses equity, and goes deeper into debt. In many cases, the people being flipped realize little or no benefit from the loans, even as they rack up thousands of dollars in new fees. Some properties are flipped several times, all but guaranteeing a financial meltdown for the unwary homeowner.

As it delved deeper into the predatory lending problem in the late 1990s, Self-Help branched out of its lending business and into public policy, joining forces with other advocacy groups to pass a strong anti-predatory lending bill in the North Carolina legislature in 1999—the first such law in the nation. Among other changes, the bill prohibited single-premium credit insurance, fee-loaded refinance loans that provide no benefit to borrowers, and prepayment penalties on loans of less than $150,000.

STATES ENACTING PREDATORY MORTGAGE LENDING REFORM LAWS SINCE 1999*



- States with predatory lending reform laws considered "strong" by the Center for Responsible Lending.
- States with predatory lending reform laws considered "moderately strong" by the Center for Responsible Lending.
- States with predatory lending reform laws considered "less strong" by the Center for Responsible Lending.

* The map displays states with laws banning or limiting a range of specific lending practices—not those with general prohibitions against fraudulent/deceptive trade practices or those prohibiting only single-premium credit insurance.

Sources: State reform laws identified through lists compiled by Butera & Andrews, Attorneys at Law (www.butera-andrews.com) and the Mortgage Bankers Association (www.mortgagebankers.org).

Self-Help had to overcome arguments from subprime lenders that the law would prevent them from doing business in the state. Self-Help's long history of lending money to low-income borrowers provided ammunition to rebut these arguments, and many lenders ultimately supported the legislation.

In 2003, researchers at the University of North Carolina (UNC) examined mortgage data following the enactment of the 1999 law and concluded that the subprime lending market in the state remained strong, even as the number of predatory loans decreased. "The North Carolina predatory lending law is doing what it was intended to do: purge the market of abusive loans without restricting the supply of subprime mortgage capital accessible to North Carolina borrowers with blemished credit records," says Michael A. Stegman, a UNC researcher and one of the authors of the study.

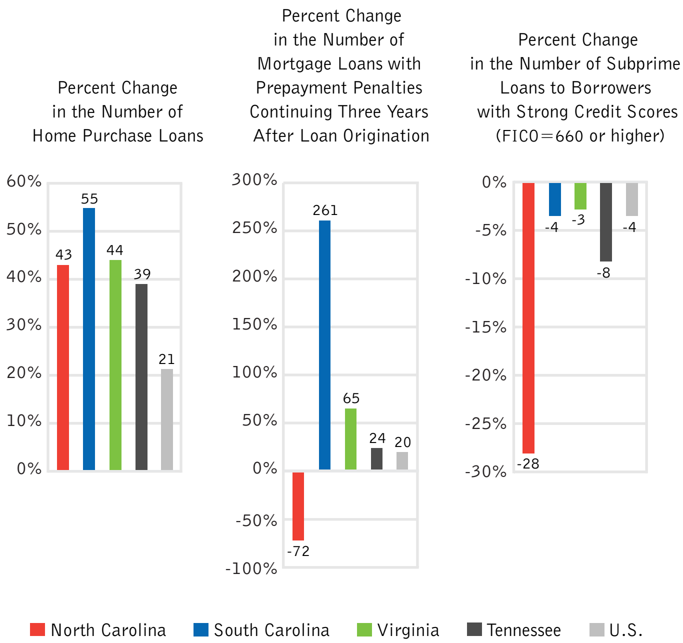
The number of subprime home purchase loans increased 43 percent in North Carolina in the 21 months after the law was enacted—well above the regional and national averages. But, during the same time frame, loans with abusive prepayment penalties declined by 72 percent in the state, while loans with these penalties increased rapidly in surrounding states and nationwide. (See chart on page 42.)

But the predatory lending market continues to trap unwary borrowers who live in states without effective prohibitions. In addition, financial institutions not covered by state laws, including many that are federally chartered, continue to make such loans.

A 2001 study by Eric Stein, a senior Self-Help official, estimated that each year, borrowers across the country lose $9.1 billion to predatory lending practices.

SUBPRIME MORTGAGE LENDING AFTER NORTH CAROLINA REFORMS*

Continued Growth in the Subprime Market,
But a Steep Decline in Predatory Loan Terms



*All figures compare loan totals from July 2000 through March 2002 (after passage of the law) versus the totals from January 1998 through September 1999 (prior to passage of the NC reform law).

Source: R.G. Quercia, M.A. Stegman, and W.R. Davis, *The Impact of North Carolina's Anti-Predatory Lending Law: A Descriptive Assessment.* (Chapel Hill: Center for Community Capitalism, University of North Carolina, 2003).

"The magnitude of the problem, we believe, demonstrates that the most important lending issue today is no longer the denial of credit, but rather the terms of credit," Stein concluded.

BAKE SALE BEGINNINGS

Predatory lending was not on Martin Eakes's mind when he and his wife, Bonnie Wright, launched Self-Help in 1980. Their goal was to build on the gains of the civil rights movement by improving the financial situation of African Americans and other minorities. Eakes, who is white, says his commitment developed during his childhood in a largely African-American neighborhood on the south side of Greensboro, N.C.

"I grew up believing that having legal rights alone would be very hollow without the chance to develop economic security at the same time," Eakes says.

Initially he conceived of an organization helping workers turn some of North Carolina's struggling factories into employee-owned enterprises. While Eakes reached out to workers and provided advice, however, his organization—which began with a bake sale that netted $77—did not have access to capital. Neither did the workers he was trying to help.

"A lot of the families we worked with didn't have even two dollars to invest in the factory," Eakes recalls.

He points out that, like today, blacks in the early 1980s suffered from an enormous disparity in wealth compared to whites. The average white family had ten times the wealth of black families. Similarly, white families were far more likely than blacks to own their own homes.

In 1984, Eakes's organization shifted its focus and began helping minorities and other disadvantaged North Carolina residents develop wealth by offering them loans to buy homes. Self-Help launched a credit union and began lending money—mainly for homes, but also for small business ventures, child care centers, and charter schools.

The new strategy paid off. As Eakes puts it, "I made a great bet 20 years ago, that African-American single mothers would do whatever it takes to pay back their home loans."

Even as Self-Help's mortgage lending efforts grew, however, many lending institutions remained reluctant to offer loans with affordable terms to low-income workers. The reluctance was fueled by the fact that no "secondary market" existed into which banks could sell their loans to low-income borrowers, as they do with most conventional mortgages.

In 1994, Self-Help entered the secondary loan market itself and began buying up millions of dollars of loans made by North Carolina banks to low-income borrowers. Unlike many secondary mortgage buyers, Self-Help held on to the loans—and the risk associated with them. The portfolio fared so well that the Ford Foundation gave the organization a $50 million grant in 1998 to expand its work—among the largest gifts ever made to a community

Dale Rogers, with her children, Camille and Kendrick, outside the home she purchased in 2004 with Self-Help's financing and assistance.

development group. This money allowed Self-Help to take its work outside North Carolina with a goal of buying $2 billion worth of mortgages over five years. In turn, Fannie Mae, the federally chartered mortgage company, agreed to purchase loan portfolios from Self-Help.

By October 2003, Self-Help had purchased mortgages for nearly 30,000 low-income families from 22 direct lenders, a portfolio valued at more than $2 billion. Fannie Mae recommitted to the program in 2003 by agreeing to purchase another $2.5 billion in loans to low-income homeowners over five years.

"Due to the partnership…Fannie Mae has been able to do much more to help low-income families achieve homeownership," former Fannie Mae CEO Franklin D. Raines said when the renewed effort was announced.

A study of the Self-Help program by UNC found that the homeowners had seen the equity in their homes increase by an average of $20,619 from 1998 to 2003—a critical accumulation of wealth.

The study also found that lenders participating in the initiative experienced a 0.7 percent foreclosure rate, below the 2003 national rate of 1.1 percent, as calculated by the Mortgage Bankers Association. More than four out of five borrowers never missed a payment and 12 percent were never more than 30 days late.

"Our losses are pathetically small," Eakes says. "I knew for a fact that the mothers of kids like the ones I grew up with would be good credit risks. I knew it in my heart."

ADVOCATES WITH CREDIBILITY

Following its successful state-level lobbying campaigns in 1999 and 2001 to reign in predatory lending practices in North Carolina, like-minded advocates in other states began asking Self-Help for assistance.

In 2002, Self-Help created a separate organization, the Center for Responsible Lending, to focus more intently on policy and advocacy nationwide. The center has emerged as an important source of research and technical information, and it has assembled a team of advocates who are working in several state capitals and in Washington, D.C.

"People were doing it as a side thing from their main job," says Mark Pearce, executive vice president of the center. "Creating the center is when we really became intentional about reaching out to other states."

Along with support from Self-Help, the center secured funding from several foundations and now has a budget of about $5 million and a staff of about 35, including 15 in Washington. On staff are a dozen researchers and lawyers who work on regulatory rules and policies, and sometimes get involved in the legislative trenches.

The center's Keith Corbett has worked on predatory lending legislation and efforts to curb payday lending, facing off against lending industry lobbyists with deep pockets. "There is so much money on the other side," Corbett says. "We don't have the money to wine and dine [legislators], or for their [reelection] campaigns. All we have is the truth."

As in the legislative battles in North Carolina, the center's advocacy is bolstered by Self-Help's two decades of hands-on lending experience.

"In a lot of cases, when lenders raise concerns about a piece of legislation, we look at it from both sides. As a lender, would we want to operate under the restrictions?" says Debbie Goldstein, a senior policy counsel for the center.

Kenneth Zimmerman, executive director of the New Jersey Institute for Social Justice, said Self-Help's long experience in the lending business was crucial during a successful effort in 2003 to pass a strong anti-predatory lending bill in Trenton.

"One of the challenges advocates have is understanding the industry well enough to appreciate what are legitimate concerns," Zimmerman says. "They bring a credibility that's really important."

STILL BUSY AT THE GRASSROOTS

While Self-Help plays an increasingly prominent role in lawmaking and the secondary mortgage market, it continues its hands-on work to help aspiring homeowners like Dale Rogers.

A 39-year-old, single mother of two, Rogers was paying $315 a month in rent for a three-bedroom apartment in Durham. Rogers didn't like writing the rent check every month for 15 years, since that money was lost to her forever. But she figured that her lack of savings and her $10.30-per-hour salary at a local bottling plant made buying a house impossible.

Rogers kept dreaming about a home of her own however, and eventually she visited Self-Help. Although her income was modest, Rogers had a good record of paying debts. A loan officer worked with her to qualify for a mortgage from Self-Help's credit union—a loan charging only basic fees and an affordable interest rate.

Self-Help also helped Rogers secure generous home-buying assistance through the city of Durham, a North Carolina agency, and a local foundation. Rogers had to come up with only $760 herself for a downpayment.

On March 31, 2004, Rogers signed the paperwork and became the owner of a three-bedroom white house on Berkeley Street. Her combined mortgage and tax payment is $500—more than her rent, but she is relieved finally to be building equity and a measure of financial security. "I was so tired of paying rent," Rogers says. "It was, to me, like throwing money away."

After a quarter century in the lending and community development business, such stories are commonplace at Self-Help. With more than $1 billion in assets, Self-Help has become perhaps the largest community development financial institution in the country. It has provided more than $3.5 billion in financing to borrowers in 47 states, helping more than 38,000 families buy homes. It has also become a powerful force in battles with predatory lenders.

But Martin Eakes sees much left to be done.

"It should be intolerable that a person who works full time should not be able to purchase an 800- to 1,000-square-foot house," he says.

"I don't feel satisfied. I never do," he adds, pointing out the huge numbers of working people, especially minorities, who do not own homes and the widespread practice of predatory lending that saps equity from low-wage homeowners.

The struggle reminds Eakes of a backwoods description of an arduous task—like trying to drain a swamp with a spoon.

"We're making progress, but it's still a swamp and it's still a spoon."

Tom Waldron, previously a reporter for the Baltimore Sun, *is a freelance writer in Baltimore, Maryland.*

COMBATING A COUNTERATTACK IN WASHINGTON

The Center for Community Self-Help and consumer advocates have had significant success in recent years strengthening state laws to combat predatory lending. In New Jersey, New Mexico, North Carolina, and more than 20 other states, legislatures have imposed new limits on lending practices that hurt borrowers in the subprime market.

In response, the subprime lending industry has launched a counter-offensive to expand federal oversight of the mortgage lending industry and invalidate stricter state and local laws.

In 2003, Rep. Robert Ney, an Ohio Republican, and Rep. Kenneth Lucas, a Kentucky Democrat, both members of the House Financial Services Committee, sponsored a bill to override any state or local law that regulates lenders more strictly than federal laws.

While Rep. Ney decried predatory lending, he also warned against overreaching by state legislatures.

"Though well-intentioned, these efforts have led to a patchwork of hundreds of laws, all with different requirements, different degrees of consumer protections, and different definitions of compliance and liability."

The Center for Responsible Lending, an affiliate of Self-Help in Durham, N.C., has participated in many state-level legislative battles and is now working in Washington to fight federal preemption.

The center and other advocacy groups argue that the states are better suited than Washington to craft consumer-oriented lending laws and can more quickly respond to new predatory practices in the marketplace.

"States have always been able to provide more consumer protections," says Keith Ernst, a senior policy counsel with the center. "What will happen [if a federal preemption law is passed] is a race to the bottom for these lenders who use preemption as a loophole."

Maude Hurd, national president of the community-activist group ACORN, calls the Ney bill "an outrageous attack on homeowners and on states' right to protect their homeowners," and she says the bill "would not benefit anyone but predatory lenders."

Instead, consumer advocates support federal bills to clamp down on lending abuses. North Carolina Reps. Melvin Watt and Brad Miller—both Democrats—proposed a bill modeled on the North Carolina anti-predatory lending laws. Despite lobbying from both sides, however, no legislation emerged from Congress in 2004.

While congressional preemption may not be near, federal regulators are taking action. In early 2004, the Office of the Comptroller of the Currency (OCC) ruled that nationally chartered banks and their subsidiaries (unlike state banks regulated by the FDIC) are not governed by state anti-predatory lending laws. Rulings by other agencies have also exempted nationally chartered credit unions and savings and loans from state lending laws.

The federal regulatory rulings have made it harder to challenge predatory lenders in court, advocates say. And several groups, along with state attorneys general, are urging Congress to overturn the regulatory rulings.

In April 2004, Martin Eakes, chief executive of Self-Help, joined in the call for Congress to overturn the OCC's regulatory change. "We cannot afford to have our collective efforts to protect borrowers from losing their homes and the lifetime of savings built up in home equity to be diminished by a renegade federal agency," Eakes told the Senate Banking Committee.

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Design and Production:
Kathryn Shagas Design

Design: Kathryn Shagas
Charts: Joanne Cooper
Typesetting: Rebecca Wheeler

Photography:
Cover, pages 4 (top right), 6, 11: Will van Overbeek
Page 3: Martin O'Neill
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Printing: Finlay Printing