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Partnering with Community Development Credit Unions

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With a federally recognized mission of serving low-income communities, community development credit unions (CDCUs) can be ideal partners for banks seeking cost-effective ways to serve low-income markets. CDCUs provide small loans, low-balance savings accounts, and transaction services at minimal cost. Their members are disproportionately minority, often with imperfect or non-existent credit histories. CDCUs are government-regulated and (with a few exceptions) federally insured. As nonprofit, tax-exempt, low-overhead institutions, CDCUs are able to break even in low-income communities — in short, to target markets that banks have often had difficulty serving.

Although CDCUs have been part of the financial landscape for more than a half-century, partnerships with banks date from the mid-1980s. In New York City, for example, when Manufacturers Hanover Trust left a low-income neighborhood on the Lower East Side it negotiated a Community Reinvestment Act (CRA) agreement to provide its closed bank branch to a neighborhood coalition which was in the process of forming a CDCU. The bank provided a concessionary purchase option, as well as substantial sums for renovation and an interest-free deposit to provide start-up lending capital for the new credit union.

The Lower East Side People's Federal Credit Union grew unevenly for a decade, but in recent years it has expanded dramatically, justifying the hopes of the community activists who launched it. Today, with more than $7 million in assets, this CDCU serves more than 3,500 people, writes more than $1 million annually in new loans for personal, housing, and small-business purposes, offers ATM service in several locations, and is in the process of opening another branch — helped by a grant from Chase Bank, among other funding sources.

How banks benefit

Variations on this success story — with banks assisting the start-up and expansion of community development credit unions through outright grants, deposits, and donation of facilities — can be found in a wide variety of locales, from Vermont to Cleveland to the Mississippi Delta to California. Banks benefit from these partnerships in several ways. Support for CDCUs is explicitly recognized as an eligible CRA activity, which depending on the nature of bank support, may qualify for credit under the lending, investment, or service test. In 1991, the National Federation of CDCUs (NFCDCU) co-founded the Community Development Financial Institutions Coalition, which successfully pressed for the establishment of the CDFI Fund. This has resulted in more than 80 CDCUs (as well as NFCDCU itself) obtaining certification as CDFIs — which in turn has enabled many financial institutions to get Bank Enterprise Award (BEA) cash awards for their support of community development credit unions.

Bank support has helped CDCUs to serve many more low-income people than they would have been able to reach on their own. Equally important, banks have helped CDCUs to build their net worth and ensure their continuation as stable, self-sufficient financial institutions.

Fighting Predatory Lending

Unfortunately, one of the fastest-growing segments of the lending business is also its most problematic. Predatory lenders — an increasingly broad category that includes payday lenders, automobile title lenders, and equity-stripping mortgage lenders, all of them charging exorbitant rates and fees — often drive desperate borrowers into spiraling debt, sometimes seizing their homes or cars when they fall behind in their payments. CDCUs, while strongly advocating better borrower protections, have also moved to counter predatory lending by developing innovative products aimed at the same low-income borrowers.

North Side Community Federal Credit Union, a $5.9 million CDCU in Chicago, offers a “Hot Funds/Cold Cash” program that provides $500 loans at 16.5 percent. No credit report is required, although the borrower does have to have been a member of the credit union for at least a year. Since the program’s inception seven years ago, the credit union has made 1,800 loans totaling $900,000. Write-offs are higher than on the rest of North Side’s portfolio, but the small size of these loans has kept the losses acceptable. The credit union is now seeking to expand the loan program. Aided by a $20,000 grant from Northern Trust Bank to bulwark its reserves, North Side will be able to drop its one-year membership requirement and serve more borrowers in need.

In Cleveland, Faith Community United Credit Union, which occupies a branch donated to it by the Society National Bank, runs a “Grace Loan” program for members with direct deposit or payroll deduction with the credit union. No credit check is required, and the APR is 17 percent. ASI Federal Credit Union in Harahan, Louisiana offers a “Stretch Plan,” a revolving line of credit that members can use as an alternative to a payday loan of up to $500; direct deposit is required, and the loan is linked to a package of basic banking services and financial counseling. Both institutions report minimal losses on their anti-predatory products. Their positive experience should encourage other financial institutions to reach out to low-income borrowers with shaky credit.

The National Federation of CDCUs is in the process of launching an investment program to help many more CDCUs fight predatory lending. Aided by a $1 million program-related investment from the Ford Foundation, NFCDCU will place deposits in selected credit unions to share the risk of lending to larger numbers of high-risk borrowers.

Secondary Capital

Credit unions, like banks, have strict regulatory standards for net worth. Unlike banks, credit unions cannot sell stock; most credit unions build net worth only through internally generated surpluses. But in 1996, NFCDCU successfully pressed for a new form of equity: secondary capital, which takes the form of deeply subordinated debt available exclusively to credit unions designated by the National Credit Union Administration as "low-income."

Secondary capital counts toward the mandatory net-worth requirements of these credit unions. NFCDCU has been the largest supplier of secondary capital, providing nearly $5 million in loans raised from Ford and other foundations, the Treasury Department's CDFI Fund, and banks (particularly through the National Community Investment Fund, started by NationsBank Corp., now Bank of America Corp.). A secondary capital loan enables a low-income credit union to significantly expand its deposit base while maintaining adequate net worth. It has the same regulatory standing as the "equity equivalent" product issued by community development loan funds, allowing a bank to claim CRA credit for a share of the credit union's lending in proportion to the bank's share of the community lender's total capital.

Deposits

An investment of secondary capital, which is deeply subordinated debt, bears significant risk. But there are other ways for banks to aid CDCUs while obtaining CRA and Bank Enterprise Award credit. Federally-insured, below-market deposits are the most common method. Many CDCUs — including virtually every CDCU launched in recent years — have received deposits from banks in amounts up to $100,000 at rates generally between zero and 2%, often for terms of three years or more.

In 1997, NFCDCU devised a new mechanism to help banks manage substantial portfolios of deposits in local credit unions. NFCDCU opens time-deposit accounts in multiple credit unions as nominee for the investing bank. The principal of these deposits is federally insured, while NFCDCU collects and guarantees the interest, managing the portfolio on behalf of the bank. In 1998, Fleet Bank, N.A. became the first investor in NFCDCU's nominee deposit program, placing $2 million through the National Federation in credit unions throughout its CRA marketplace (at the time, Maine to Delaware). Fleet recently renewed its investment, and the ranks of investors under this program have grown to include Amalgamated Bank of New York and Bank Hapoalim. Deutsche Bank, through the BT Microcredit Development Fund, has extended the nominee deposit concept even further, channeling funds through NFCDCU to partially secure microenterprise loans originated by local credit unions.

Conclusion

Community development credit unions can provide an ideal bridge to low-income communities for banks otherwise unable to serve them cost-effectively. With CRA and the Bank

Enterprise Award program as incentives, and with a variety of financial mechanisms available, banks should seriously consider the advantages of partnering with CDCUs.

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