Alternatives to Alternative Financial Services: A Case Study of "Community-Based Loan Programs"

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Objective

This exploratory research uses a case study approach to highlight community-based alternatives to financial services (AFS). Predatory loans (esp. payday loans) can entrap clients into a cycle of debt with their high interest rates. Examples of grassroots alternatives include the Kansas Loan Pool Project (KLPP), Common Wealth Charlotte (CWC), and Common Wealth Athens (CWA). The authors coin the term "community-based loan programs" to describe these three paradigms. They emanate from non-profit organizations (NPOs) recognizing the predatory debt trap. The organizations provide low-interest, small-dollar loans that empower clients to refinance high-interest debt. Relying on the Social Capital Theory, preliminary findings discuss the programs' inputs, outputs, and outcomes via a logic model. This paper shares implications for consumer affairs professionals, welcoming dialogue for future, sustainable partnership between NPOs and banks.

Review of Literature

Unexpected medical bills, car repairs or loss of employment could be the difference between financial insecurity and just getting by for low- and moderate-income (LMI) households. Metaphorically, one more unexpected situation represents the unexpected nudge on a half-balanced Jenga Tower that could cause it to tumble. For those who are unbanked or underbanked, access to credit can be limited prompting them to fall prey to higher-cost alternatives. Nearly 7% and 18.7% of households respectively are unbanked and underbanked (FDIC, 2018). Being unbanked means not having a checking or savings account. Underbanked households have a checking or savings account but have used any AFS product in the past 12-months. FDIC (2016) showed that nearly 60% of unbanked households used an AFS within the past 12 months (p. 33). These products include money orders, check cashing, international remittances, payday loans, refund anticipation loans, rent-to-own services, pawnshop loans, or auto title loans.

Research provided many reasons why consumers are un(der)banked. Rengert and Rhine (2016) identified rejection by banks, minimum account balances and feelings of intimidation when at a bank (p.8). Other reasons include location/access and eligibility for bank products. About 45% of those who earn less than $15,000 are unbanked or underbanked as compared to other income groups. Gross, Hogarth, Manohar , and Gallegos (2012) found that in general users of AFS are less educated, represent racial

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minority groups, are between the ages of 31 and 45, have lower income, and are unemployed. Payday loans are notably the most studied AFSs given their exorbitant interest rates. Payday loan rates can reach a 400% APR. While they are illegal in some states (e.g., GA, NC), they are permitted in others (e.g., Kansas). The Pew Charitable Trusts (2012) showed on average, a borrower takes out eight payday loans of $375 each per year and spends $520 on interests.

Being un(der)banked is related to mainstream credit. Prosperity Now (2018) illustrated that "lower credit scores limit consumers' access to mainstream… credit which may result in those consumers turning to… predatory products like payday or auto—title loans" (p.15). Eighty percent of unbanked households have no mainstream credit as compared to 14.1% fully banked households (FDIC, 2018, p.53). Nearly 35% of Georgia households, 24.2% of North Carolina households and 27.2% of Kansas households lack significant access to mainstream banking products (FDIC, 2018, p.53). Additionally, having no or poor credit exacerbates other problems such as health problems, renting and expanding a business.

Significance

Given the global phenomenon of financial exclusion, there has been movement to promote financial inclusion. Bangladeshi Dr. Muhamad Yunus is known for creating microloans for low-income women which later spread to the USA. NPOs nationwide provide financial and community support to improve financial inclusion (Caplan, 2014). More than 50 cities launched "Bank On" programs that empower banks, local governments, and community groups to promote responsible banking. Conlin (2000) estimates about 250 micro-lending programs in the USA. The focus on these programs are on entrepreneurship (Conlin, 2000. p. 260). Therefore, microloan programs that are unprecedentedly focusing on predatory debt relief (e.g., KLPP) or the use of emergency assistance (e.g., CWC "opportunity loans") are worthy of study.

Conceptual Framework

Social Capital Theory and the Logic Model guide this research. Social capital includes contacts who provide opportunities to use financial and human capital (Burt, 1992, p. 58). Capital includes the "community-based loan" and financial education. The social networks are the client's connections with the credit union and the NPO (i.e., KLPP, CWA, and CWC). A logic model depicts the flow of a program's inputs, outputs, and subsequent outcomes. Inputs include the resources (e.g., financial education program) that the program uses. Outputs include specific results (e.g., improved financial knowledge) that lead to outcomes (e.g., financial security). The researchers hypothesize the following:

1. Financial education completion is related to positive financial behavior (e.g., discontinued use of predatory loans.)
2. Re-banking opportunities are related to long-term positive banking relationships.
3. Microloan repayment is related to low high-interest debt.

Methodology

This research will use a multiple case study to describe three “community-based loan programs” (i.e., KLPP, CWA, and CWC). The researchers were previously familiarity with these programs. Literature review search strings such as “zero interest loan,” “re-banking loans," and "opportunity loan," "refinance predatory loan” showed that there were no other similar models. An intrinsic multiple case study approach allows for research on the particularities and uniqueness of the three cases. These three “community-based loan programs” offer financial education, microloans, and re-banking opportunities.

Data was collected from the programs’ inception through December 2018 will be considered. Triangulation is common in case study analysis and included interviews, documents, observations (Simons, 2009). The authors will conduct 60-minute, semi-structured phone interview with the individual program coordinators. Table 2 shows an abbreviated interview guide. Financial statements, annual reports, and testimonials are the documents. Observations include site visits and field notes. The researchers conducted a 60-minute site at the CWA’s campus including observing an intake meeting. Interviews will be audio-recorded and transcribed. The authors will identify themes is Nvivo based on present and emergent coding. The researchers will organize findings into a logic model delineating the inputs, outputs, and outputs. See Figure 1 for the logic model.

Results

KLPP, CWC and CWA Program Descriptions

KLPP, CWC, and CWA began in 2014, 2015 and 2016 respectively. They offer loans, financial education, and re-banking opportunities. KLPP and CWA are projects of larger non-profit organizations (NPO), and CWC is an NPO. All three surfaced as an alternative to predatory debt. The participants must attend financial education and must repay the loan through a deposit account with the partnering bank. This account would lead to other asset-building programs and banking products. Grants, donor-pooled funds and partnership between financial institutions support the loan. The interest rates are low (i.e., 6%, 3.5% and 1.5%). The small loans (i.e., $500 and $700) can be used to used to pay off high-cost debt or to cover emergency expenses. Challenges include funding and program evaluation. Preliminary results from annual reports, testimonials, and CWA site visit are described in Table 1.

Kansas Loan Pool Project (KPLL). In 2014, the Catholic Charities of Northeastern Kansas (CCNK) began the KLPP initiative. CCNK noted that clients “have become trapped in the debt cycle of these predatory products with exorbitant interest rates” (CCNKS, 2018). CCNK partnered with Capital City Bank to launch the project. Loan requirements include having “stable, traceable income” with the ability to cover the monthly loan payments. Total payday and auto title loan must be under $1,500. The development of a long-term financial plan is also necessary. KLPP offers monthly support with an assigned case manager. One testimonial includes the story of Elaine who used KLPP services at 74. She was paying $275/month on interest on payday loans for a total loan amount of $1,725. The Capital-Journal Editorial Board (2017) reported that KLPP offered 62 loans and eliminated 95 payday or title loans. See Figure 2 for a flyer of the project.

Common Wealth Charlotte (CWC). CWC is a 501(c) 3 organization in Charlotte, NC that offers "trauma-informed financial education" and "opportunity loans." Trauma-informed financial education recognizes the "physical, physical, psychological and emotional trauma experienced by [Charlotte's] most fragile working poor" (Common Wealth Athens, 2018). The curriculum recognizes barriers to being banked: distrust in banks and high bank fees. The CWC "Opportunity Loan" relies on support from a donor-funded loan pool and allows participants to refinance predatory loans, provide rental deposits, manage other financial emergencies. It has served has served 3,243 clients.

Common Wealth Athens (CWA). According to the U.S. Census Bureau, over 35% of residents in Athens-Clarke County, Georgia live below the poverty line. The area is also deemed a "persistently poverty" county (CDFI, 2012). In 2015, the Ark's CWA began from the CWC model. The Ark, since inception, endearingly refers to its clients as neighbors. CWA partners with the local Georgia United Credit Union (GUCU). The loans help families cover emergency expenses or to pay off high-interest loans. To be eligible for an Ark loan, neighbors must attend financial education (e.g., budgeting, credit counseling, etc.) Neighbors may receive multiple loans, and the program has offered about 80. On average the credit scores were 41 points higher after repayment.

Conclusions/Relevance

This research coined the term "community-based loan program" and justified the need for study of the CWC, CWA, and KLPP. Preliminary findings show similarities (e.g., affordable interest rates, mandatory financial education) and differences in the program. Results offer implications for policymakers, practitioners, researchers, and educators.

This research can inform policymakers and practitioners. The National Credit Union Administration (NCUA) could provide resources for partnerships between credit unions and NPO partners. The FDIC could follow suit since its goal is to "assess the inclusiveness of the U.S. banking system" (FDIC, 2019, p. 61). Additionally, as "new products mature, measurement … may require updating … to better assess the inclusiveness of the banking system. (FDIC, 2018, p. 61)" Given the novelty and vitality of these programs, it would be an opportunity for the FDIC to explore possible small-dollar partnerships between banks and non-profit organizations (NPOs). Social workers and NPOs practitioners could consider adding financial education, microloans and re-banking opportunities in their existing interventions. Several federal agencies, (e.g., CFPB's "Your Money, Your Goals") offer extensive financial education programming to assist NPOs. This research can help social workers understand the needs of their un(der)banked clients" (Parks, 2018).

In the future, researchers and financial educators could consider the results of this research. Future studies can use evaluative case study approaches (Simmons, 2009, p. 5) to elicit the long-term outcome of "community-based loans" on consumer finances.

Research could focus on these program's long-term re-banking efforts. FDIC (2018) reports that 47% of unbanked households once had a bank account. This fact underscores the need to examine why banking relationships discontinued and how to reinstate them. Additionally, the relationship between financial education and financial behavior is understudied and thus has heuristic value. A plethora of financial education research addresses the un(der)banked populations and AFS usage. Curriculum such as National Endowment for Financial Education could reflect how consumers can form, navigate and reinstate bank relationships.

Current efforts to deal with alternative financial services (esp. payday loans) rest at the federal and state level. Amid regulation prohibiting payday loans, these "community-based loan programs" are providing grassroot solutions. Non-profit organizations engage in advocacy and financial education. However, KLPP, CWA, and CWC are addressing the issue in more innovative ways. They recognize their the needs of their un(der)banked, LMI clients and responded with alternatives. Dovetailing financial education with re-banking opportunities and microloans is one concrete solution to predatory debt. These three models underscore the need for additional cities to follow suit.

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Table 1. CWC, CWA and KLPP Program Description

Description	CWC (Charlotte)	CWA (Athens)	KLPP (Kansas)
Inception	April 2015	2016, but piloted in 2015 as "Jubilee Loan Program"	2014
Partners	Charlotte Metro Credit Union	Georgia United Credit Union	Capital City Bank, Sunflower Bank
Nuances	"Trauma-informed financial education" ; "Opportunity Loans"	Clients are referred to as neighbors.	"Predatory Debt Relief Loans"
Amount	up to $750	$500, $750	
# of loans		80 loans	67 (Dec 2017)
APR	3.15% and 1.5%	6%	6%
Repayment Rates	80 % - 85%; Participants repay with direct paycheck drafts		3 paid in full in the first year

Table 2. Program Coordinator Interview Guide

List of Questions
1. How does this program work? 2. Who is being served? 3. What are the inputs and outputs? 4. What are the goals and objectives of the services? 5. How might this program fit with other communities? 6. How can this information be shared with policymakers to make policy changes? 7. What are the outcomes for the client population? (specific things that are expected to change in peoples' lives as a result of the program, typically in behavior, skills, knowledge, attitudes; need clear statements) 8. How are these outcomes measured?

Figure 1. Inputs and Outcomes of CWC, CWA and KLPP

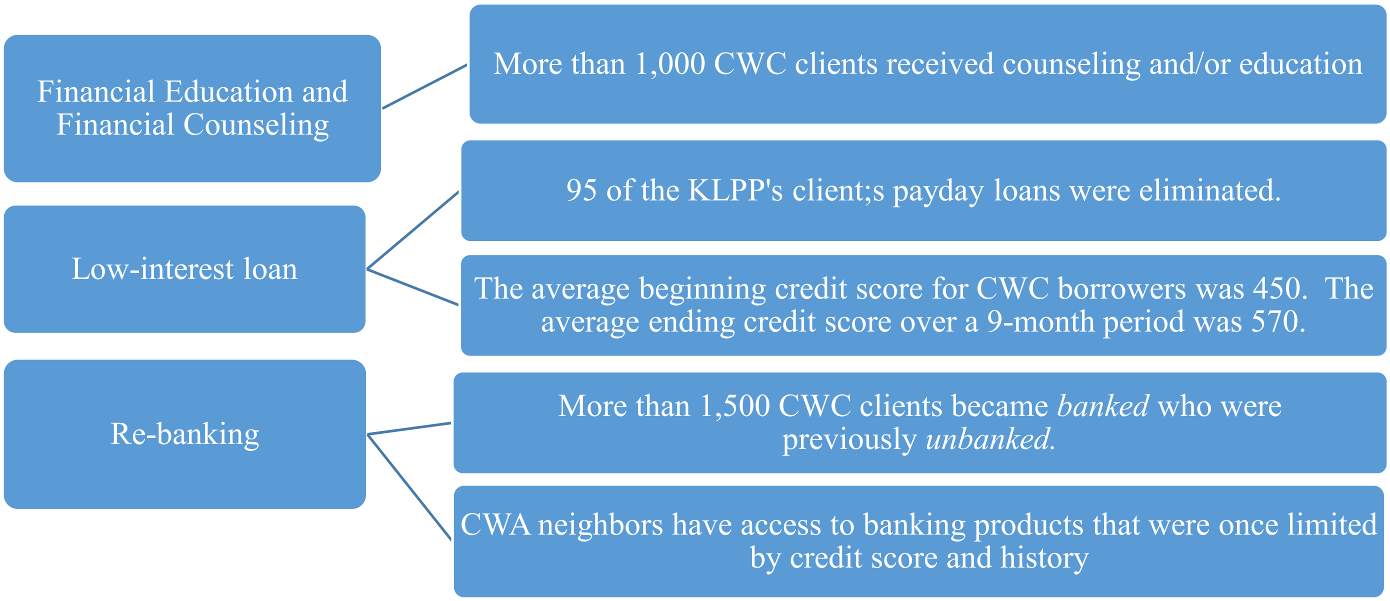

Figure 2. Kansas Loan Pool Project Flyer