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THE LENDING PERFORMANCE OF COMMUNITY DEVELOPMENT CREDIT UNIONS

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SUMMARY

This study investigates the lending performance of seven community development credit unions (CDCUs) in the United States.

1. The seven CDCUs operate in communities that are marked for the most part by relatively low incomes and high poverty rates.
2. In some of the CDCUs, the borrowers are on average quite poor. In others, poor borrowers are balanced by middle income borrowers.
3. The ethnic composition of the membership varies widely, including concentrations among Hispanics, African Americans, Native Americans and whites.
4. The borrowers' incomes are much lower in the rural CDCUs than in the urban. When adjustments are made for differences in the cost of living and the age distribution of the borrowers, however, the typical borrower incomes in the rural CDCUs are roughly equivalent to the incomes in the poorer urban CDCUs.
5. The incomes of male borrowers are significantly higher than those of female borrowers, in each CDCU.
6. Borrowers' incomes rise with age, except at the highest ages, in most of the CDCUs.
7. The positive association of income with age is stronger for for men than for women, leading to the tentative conclusion that, among the membership of most of these CDCUs, men are more likely to have professional-type jobs.
8. The average ages of borrowers vary, from a low of 33 at the Central Appalachian People's Federal Credit Union to a high of 45 at North East Jackson Area Federal Credit Union.
9. The typical loan purpose varies considerably between CDCUs. Some CDCUs concentrate on auto loans, others on small personal lines of credit, others on small business loans and still others on credit cards.
10. In spite of skepticism from regulators about the appropriateness of credit unions' lending to businesses, many CDCUs find ways to contribute to local economic development by making a significant number of business and community development loans.
11. Interest rates on loans are higher at CDCUs than at conventional credit unions, and among CDCUs interest rates are inversely correlated with borrowers' incomes.
12. Some borrowers at CDCUs have the alternative of turning to other conventional financial institutions for loans, but for many borrowers the only option besides the CDCU is a pawn shop, a loan shark or a finance company, with significantly higher rates of interest.
13. All of the CDCUs studied had relatively low or declining rates of delinquency on loan repayments. At some time in the past, however, all faced delinquency rates so high that the future of the institution was threatened. They all found ways to recover.
14. CDCUs serving a poor membership can improve their viability as businesses by attracting participation from higher income people and institutions, through the form of non-member deposits, grants and/or of a field of membership that includes moderate-income people.
15. The National Credit Union Administration could promote the development of CDCUs by changing the regulation governing member business loans, by relaxing the limitation on non-member deposits and by agreeing to charter new low-income credit unions.

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THE LENDING PERFORMANCE OF COMMUNITY DEVELOPMENT CREDIT UNIONS

John Isbister

I
CREDIT UNIONS AND COMMUNITY DEVELOPMENT CREDIT UNIONS

Community development credit unions are institutions dedicated to providing financial services for poor people and/or to promoting community-based economic development in their neighborhoods. First and foremost, however, they are credit unions, that is to say, cooperative financial institutions.

Credit unions are owned by the people who save money in them. One becomes a member of a credit union by making a savings deposit. Thereafter, as in other cooperatives, each member has one vote in the election of the board of directors, irrespective of the amount of his or her savings.

In recognition of the fact that the savers are the owners of the institution, savings deposits in United States credit unions are called "shares." The credit union makes loans to members with these funds; only members are qualified to borrow from the credit union. In other words, credit unions are self-help organizations, allowing the members of a community to pool their resources for the benefit of each other.

In the United States, credit unions are chartered and regulated either by the National Credit Union Administration (NCUA, a federal agency)[2] or by a state government agency. Almost all credit unions, whether federally or state chartered, are insured by the NCUA Share Insurance Fund. In order to qualify for insurance, therefore, all credit unions have to meet certain federal regulatory standards.

The potential membership of a credit union is restricted by its charter to a group of people with a "common bond." In some cases the bond is associational; for example the field of membership may include all members of certain voluntary organizations or churches in a community. In some cases the field of membership is occupational, for example all teachers in a community or all doctors, and in others it is based on a place of employment. In a fairly small number of cases (about eight percent of credit union members[3]), the common bond is geographical, that is to say, all people living or working in a specified area. In most credit unions, a person who joins may remain a member even after leaving the field of membership.

At year end 1991, there were 12,960 federally insured credit unions in the United States, with just under 60 million members. Approximately two thirds of the credit unions were chartered by the NCUA, and one third by a state.[4] Compared to banks and savings and loan associations they are on average quite small; their assets constitute just 4 percent of the combined financial assets of those three types of institutions.[5]

Cooperative credit associations originated in Germany in the middle of the nineteenth century. At the beginning of the twentieth, they were introduced into Quebec, Canada, and in 1909 into New Hampshire. In Germany they had specialized in providing credit to small producers, whether farmers or urban craftsmen. In the United States, in contrast, credit unions have specialized in consumer lending.

This study is concerned with the lending experience of a small subset of American credit unions known as community development credit unions, or CDCUs. CDCUs first emerged in African American communities in the southeastern states, especially North Carolina and Mississippi, in the 1940's. Several were also associated with "settlement houses" in the poor areas of large northern cities. A large number of CDCUs were established in the 1960's under the aegis of the Johnson administration's "war on poverty." In the wake of the southern civil rights movement, and with the participation of the Credit Union National Association (CUNA), the federal Office of Economic Opportunity helped poor people to establish credit unions for their mutual help. In subsequent years the movement spread to other parts of the country. In the 1970's, CDCUs were set up to combat discriminatory "redlining" lending practices of commercial banks, and in the 1980's they were established in the wake of bank branch closings in poor neighborhoods. The majority of the CDCUs were awarded charters with geographical fields of membership.

It is not known exactly how many CDCUs there are. In fact "CDCU" is not an officially defined term; it is a label voluntarily adopted by some credit unions. The related but not synonymous term "limited income credit union" is used by the NCUA to identify institutions serving a predominantly poor membership, according to a series of specified criteria. At the end of 1991 there were 156 limited income credit unions, with assets averaging $1.8 million.[6] The trade association of CDCUs, the National Federation of Community Development Credit Unions (NFCDCU), had 95 dues paying members in early 1992, most but not all of which were included in the NCUA limited income category. Of the roughly 400 OEO credit unions established in the 1960's it is estimated that approximately 100 remain, and some of them are included on neither the NCUA nor the NFCDCU list. Similarly, some church-sponsored credit unions in minority communities are on neither list. As a guess then, there were approximately 300 CDCUs in the United States in 1992.

The study examines in some detail the lending experience of seven CDCUs located in different parts of the country. The purpose is to discover who the borrowers at the CDCUs are, what their income, gender, age and ethnicity are, what uses they make of the loans, and what their repayment performance is. These are interesting questions, because they help to reveal the extent to which CDCUs are making positive contributions to low-income communities. If it can be demonstrated that CDCUs are effective in addressing the financial needs of low-income people, then there is reason for leaders in poor communities to create them, for public agencies to promote their development and for socially responsible investors to channel funds to them.

II
PREVIOUS RESEARCH

There is a small recent literature on CDCUs. Kathryn Tholin and Jean Pogge of the Woodstock Institute outlined the functions of CDCUs and made extensive policy recommendations.[7] Earnest Johnson, one of the pioneers of the OEO credit unions in the south-eastern states, discussed the history and current problems of the movement in his Master's thesis.[8] A study for the Southern Growth Policy Board by Linda Hoke considered the contributions that CDCUs could make to economic development in the south.[9] The NCUA compiled basic statistical information about limited income credit unions as of the end of 1991.[10]

In the principal precursor to the current study, Clifford N. Rosenthal and Joseph Schoder examined the loan applications approved by the Lower East Side People's Federal Credit Union, LESP FCU, from the institution's inception of lending in October 1986 through May 1989.[11]

The Lower East Side of New York is one of the city's poorer neighborhoods. For generations a home to new immigrants, it is now populated by a mixture of ethnic groups. In 1984, the Manufacturers Hanover Trust Company announced the closing of its branch, the last bank in the 100 square block neighborhood. In response, a community group began plans to open a credit union in the bank's place. After extensive negotiations, some of them acrimonious, Manufacturer's Hanover agreed to refurbish the bank building, sell it to the community group at a concessionary price and provide an interest-free seed deposit of $100,000. Armed with these promises, the group was able to secure a federal charter for the credit union.

Rosenthal and Schoder analyzed the first three years of lending by LESP FCU. They found that the credit union was successful in directing its loans to low-income people. The median gross monthly income of a borrower, they found, was $1,517, and over a quarter of the borrowers earned less than $1,000. More than half of the borrowers had savings of under $500. Over two thirds of the borrowers were members of a minority ethnic group (53 percent were Hispanic, 16 percent African American). A fifth of the borrowers were unemployed or out of the labor force, and over a fifth were on some type of government assistance. Almost a third lived in public housing. Clearly the credit union was serving its target population of low-income people.

The majority of the loans were relatively small, with just over half being under $2,000 with a term of two years or less. There was a wide variety of loan purposes, the most common being debt consolidation and furniture and appliances. At the time of the study, the great majority of loans were being paid back on schedule: 4.4 percent were two months or more delinquent, and less than 1 percent were charged off.[12]

The Rosenthal and Schoder paper is encouraging, showing that at least one CDCU is meeting the borrowing needs of a low-income community. It is the study of just a single institution, however, and the question therefore persists of whether it is typical of CDCUs throughout the country.[13]

III
THE EXTENT OF THE STUDY

Seven community development credit unions are included in this study:

- Central Appalachian People's Federal Credit Union, with its office in Berea, Kentucky.
- First American Credit Union, in Window Rock, Arizona, on the Navajo Reservation.
- Mission Area Federal Credit Union, in a predominantly Hispanic neighborhood of San Francisco.
- Northeast Community Federal Credit Union, in the Chinatown area of San Francisco.
- North East Jackson Area Federal Credit Union, serving a predominantly African-American rural community in the Florida panhandle.
- Santa Cruz Community Credit Union, serving a mixed income, predominantly white population in Santa Cruz, California.
- Watts United Credit Union, in the Watts area of Los Angeles, a predominantly African-American community.

For each of the seven CDCUs, Table 1 shows the membership, assets and outstanding loans, plus two ratios: assets per member and reserves to assets. The first three columns are indicators of the relative size of the credit unions. Assets per member is an indicator of the relative wealth of the credit union and its members,[14] while the ratio of reserves to assets is an indicator of the financial condition, or stability, of the credit union.

The financial structures of CDCUs and ordinary credit unions typically differ in important ways. Most obviously, the CDCUs are smaller. In 1991, the average limited-income credit union, as defined by the NCUA, had $1.8 million in assets, while the average for all credit unions was $17.4 million.[15]

Table 2 shows the number of members and the ratio of assets to members in American credit unions as a whole, and in credit unions of roughly the same asset size as the CDCUs in the study. A comparison of Tables 1 and 2 shows that, for their asset size, CDCUs typically have more members, and fewer assets per member, than do other credit unions; this is consistent with their purpose of serving a lower income population.

Brief descriptions of the CDCUs follow. Little is said about lending practices in these descriptions, since a fuller analysis of lending will follow.

Central Appalachian People's Federal Credit Union

The CAPFCU office is located in Berea, Kentucky, on the western edge of the southern Appalachian mountains. The region is one of the most beautiful in the country, but its people are among the most disadvantaged in terms of income, poverty, employment, housing and health. Berea is a center of Appalachian culture and education; Berea College, which dominates the town physically, was established just before the Civil War by abolitionist Christians for the purpose of educating the mountain people, and it continues that mission today.

The Commission on Religion in Appalachia, a coalition of church and community based organizations in the mountains, set up a task force on poverty in the 1970's. In 1974, the task force became a community development corporation named HEAD, the Human/Economic Appalachian Development Corpora-

Table 1
SEVEN CREDIT UNIONS: BASIC COMPARISONS (mid 1991)

Credit Union	Members	Assets ($000)	Loans ($000)	Assets/ Members ($)	Reserves/ Assets (%)
APPALACHIAN	1,978	2,018	1,126	1,020	4.8
FIRST AMERICAN	10,400	23,980	15,186	2,306	7.1
MISSION AREA	800	1,968	1,399	2,460	3.8
NORTHEAST COMM	800	2,683	1,927	3,354	6.9
NEJA	781	639	383	818	7.3
SANTA CRUZ	6,330	18,460	11,259	2,916	4.9
WATTS UNITED	2,008	1,418	1,186	706	10.9

Table 2
MEMBERSHIP AND ASSETS IN US CREDIT UNIONS, 1991[16]

Asset Size of CU ($000,000)	Members Per Cu ($)	Assets/ Member
0.5 - 1.0	482	1,477
1.0 - 2.0	776	1,831
2.0 - 5.0	1,412	2,237
10.0 - 20.0	4,490	3,110
20.0 - 50.0	9,019	3,406
TOTAL	**4,483**	**3,676**

tion, whose purpose was to receive grants and to promote economic development with a cooperative philosophy. Over the years, the HEAD Corporation has initiated cooperatives, management training programs, farming projects, and the Federation of Appalachian Housing Enterprises. It currently operates a Community Loan Fund (started in 1987) that makes seed loans to small businesses. The HEAD Corporation's major project, however, has been the Central Appalachian People's Federal Credit Union.

Jack McLanahan, a HEAD staff member with long experience in the credit union movement, was the leading force behind CAPFCU's founding in 1980. On the occasion of the credit union's tenth anniversary, he reflected, "I had a dream that it would take 25 years to solidly plan a credit union in Appalachia,"[17] and he was grateful that the project was well ahead of schedule.

In mid 1991, CAPFCU was operating in 20 mountain counties, principally in eastern Kentucky but also in Tennessee and Ohio. In fact the federal charter covers portions of eight states. As Table 1 shows, the credit union had assets of approximately $2 million, and 2,000 members. There were three staff people plus a part time employee. The HEAD Corporation was still providing a grant to support some of the salary expenses; it was a goal of the credit union to grow to such a size that this subsidy would no longer be needed.

The field of membership included members of community organizations and businesses that were affiliated with the HEAD Corporation. In mid 1991, there were 35 such organizations, ranging from a plastics company to crafts associations, children's centers, housing projects, medical clinics and schools. In some cases the membership of the credit union was restricted to just the board of directors or just the staff of the cooperating organization, but in other cases it extended to the people who used the services of the organization. Sometimes, a newly affiliating organization started with the inner circle, to see how the service was going to work, before venturing out to a broader group of people.

The member organizations were affiliated with CAPFCU in a unique way; each of the organizations was a branch of the credit union, and consequently the credit union had 35 branches. Since the branches were spread widely over the mountain region—the furthest branch was about 200 miles from Berea—the credit union was able to provide services to people who in other respects were quite isolated.

Staff members in each of the affiliated organizations acted as branch contact people, in some cases as a recognized part of their jobs, but often in a volunteer capacity. They served in effect as part time staff of the credit union. They helped people enroll in the credit union, fill out forms, walk them through the borrowing process, send in payments if the members were on payroll deduction (which many were), consult with members about projects, and called to the office for withdrawals, to check on balances or to inquire why loans were rejected. They were the face of the credit union in the local community.

In some of the branches, these organizational representatives also constituted a local credit committee. Elected within the branch, they reviewed loan applications before the applications were sent to the main office. They were in a good position to provide information about the character of loan applicants, since people are usually well known within their small rural communities.

Not only did the branch structure of CAPFCU provide for outreach to isolated people, it also helped to build leadership in communities that were sorely in need of it. John Rosenberg, director of the Appalachian Research and Defense Fund of Kentucky, stated that CAPFCU's biggest achievement was "involving low-income persons at the grassroots level and giving them something they can be part of."[18]

Like most small credit unions, CAPFCU restricted its services to the basics: savings accounts and personal lending. Neither the main office nor the branches handled cash; all withdrawals were made by checks. Many of the transactions were made by telephone calls between the branches and the main office, with checks and loan applications mailed subsequently. Some of the members thought of it as the "mail order credit union."

First American Credit Union

The main office of First American Credit Union is located in Window Rock in northern Arizona, the capital of the Navajo Nation. There is also a branch in Casa Grande in the southern part of the state.

First American was founded in 1962, chartered by the State of Arizona. At that time it was called Navajo Tribal Employees' Credit Union, its field of membership being the 1,500 employees of the tribe as well as members of the governing Tribal Council. In 1965 the name was changed to Navajoland Credit Union, and the charter expanded to include everyone working or living on the Navajo Reservation. In 1983, the name was changed again, to First American, and the charter amended to include members of all Indian tribes whose headquarters were located in Arizona.

First American serves a poor community. While some reservation Indians are economically comfortable, the incidence of poverty, unemployment, welfare dependence, disease and alcoholism is significantly higher than in the rest of the country.

In spite of the charter expansion, still today the majority of the credit union's members live on the massive Navajo Reservation. The reservation, with a population of about 200,000 people, covers an area of 25,000 square miles (the size of West Virginia) on parts of three states, Arizona, New Mexico and Utah. Members who use the Window Rock office are mostly Navajos, with a few Hopis (the Hopi reservation is surrounded by the Navajo). With the opening of the Casa Grande branch, the credit union was able to serve Native American residents of a number of reservations that did not have credit unions, including the Ak Chin, Fort McDowell, Gila Bend, Gila River, Papago, Pasque Yaqui, Salt River and San Xavier reservations.

At the end of 1962, the credit union had 156 members, with $3,098 in savings deposits. Thirty-three loans had been made, for a total of $2,117.[19] By mid 1991 there were 10,400 members, and the credit union's assets totalled $24 million. In the history of the credit union, 311,548 loans had been made, for a total of over $69 million. From very small beginnings, First American had grown to be the largest Indian credit union in the country, and one of the largest community development credit unions.

Although it became successful and secure, it had a quite checkered past, coming close to liquidation several times. In 1974 it had assets of less than a quarter of a million dollars and a delinquency rate of over ten percent on its loans. Its records were in disarray—some of them missing—and several managers had resigned. It appeared that Navajoland Credit Union might disappear, as had a number of other Indian credit unions. Faced with this crisis, the credit union elected a new board of directors composed of business and community leaders on the reservation, under the chairmanship of Joseph R. Hardy. The new board took what turned out to be its most important action in hiring as its manager Robert P. Shipe, a recent college graduate who had grown up in the center of the credit union movement. His father, Orin Shipe, had been director of both the Credit Union National Association and the Arizona Credit Union League. The young Shipe arrived in Window Rock in 1974, expecting to stay no more than a year and help to clean up the mess he found—but he has been the credit union's manager ever since. Under Shipe's leadership, the credit union became a well administered, professional organization. It moved out of an old trailer whose doors and windows would never quite lock, and into a modern building with an attractive foyer and computerized services. Savings, assets and loans grew steadily, and the delinquency rate fell.

Since the geographical area served by the credit union is so vast, most members do not find it practical to transact their business in person at one of the two offices. Most savings deposits and loan payments are made by payroll deduction from the member's place of employment, and most loan requests are made by telephone or through the mail. Three women, dressed in the neat, attractive uniforms of the credit union, sit in the front office all day taking loan requests from members over the phone, while at the same time talking with a smaller number of people in person.

The use of payroll deduction is a central feature of First American Credit Union. While all residents of the reservations are welcome to join the credit union as members, loans are made only to people who can sign up for payroll deduction to make their payments. This rule has been critical to the credit union's success in keeping its delinquency rate under control.

Mission Area Federal Credit Union

Mission Area Federal Credit Union is located in the downtown, south-of-Market neighborhood of San Francisco. It is a predominantly low-income neighborhood, with a rich ethnic mix; the largest single group, although less than a majority, is Latino. The Credit Union offices are on the third floor of a large building that houses a number of community organizations.

MAFCU was chartered in 1971, sponsored by a group of community organizations in the Mission Area. Initially its field of membership included people who lived in the area, plus members of the sponsoring community groups. Later the field was extended to include anyone who lives in the area, or who works for any community based organization in the area, including businesses.

In 1991, the credit union had assets of almost $2 million, loans of $1.4 million and a membership of about 800 people.

According to manager Raquel Castillo and board member David Lewis, the most meaningful feature of the credit union is democracy, the idea that the credit union is fully accountable to its members. Self-sufficiency is also a central concept, because it is important for community members to see themselves as standing on their own feet. There is a tension between being a self-sufficient business on the one hand, and being a social agency, that is to say, offering as much as possible to the community, on the other hand. As the Credit Union works out this tension, it has to retain responsibility and accountability to the people in the community.

The annual meeting, with its elections to the board of directors, is an occasion when people in the community can take responsibility to see that the credit union is meeting their needs. The elections are frequently contested, and at times there are factions on the board.

The problems of factionalism within the board, and struggle over the basic direction of the credit union, were much more severe in the first years, during the early 1970's. At that time, some of the chartering community organizations were in competition with each other for control of the credit union, as part of their overall competition for funds, power and recognition. For a time the credit union was controlled by the local Community Action Program, and at other times by the health center and by the vocational center. Each organization would try to stack the board with its own people. There was often hostility at the annual meeting. In fact the credit union was very small at this time, with only a few thousand dollars in assets. The consequence of its being treated like a political football in its early years was that it suffered in terms of growth and organization, and actually almost died. Many of the leaders did not understand the basic structure and function of a credit union. They tended to treat the Board of Directors as a self-appointed body (which was the model of a non-profit board structure with which they were familiar) rather than as a democratically elected body.

After several years of this political struggle, the credit union was in danger of being liquidated by the NCUA. There were no systems in place, not even a bookkeeping system. At one point, the credit union had just $8,000 in assets, of which $4,000 was kept in a non-interest bearing checking account. The outstanding loans totalled $3,000, all of which were in delinquent status. The credit union barely existed.

In the latter part of the 1970's, the situation began to change. The credit union's weakness may have been an advantage, strangely, because the various community groups stopped vying for control over it. Actually, many of those organizations were becoming weaker themselves, as their funding declined, and so they had fewer resources to put into the political struggle. A group of disinterested community people were able to take control of the institution, and put it on a positive course.

Deposits and assets began to grow slowly. The credit union was helped considerably by a $200,000 deposit from the NCUA Revolving Loan Fund in 1979, which tripled its size overnight. In 1991, assets stood at $2 million, with 800 members, and the credit union was fully self-sufficient.

The credit union offers the usual savings and lending services, plus share drafts and automated teller machine cards that are on a network.[20] In mid 1991, it paid a dividend of 6 percent on regular savings, and higher, variable rates on certificates of deposit.

Northeast Community Federal Credit Union

Northeast Community Federal Credit Union is located in the heart of San Francisco's Chinatown, in a suite of offices on the second floor of a building overlooking the area's main square. Outside, old men crowd around board games in the park, while just a block away is the crowded commercial bustle of Grant Avenue. It is an active, congested, colorful part of the city.

The credit union was chartered by the NCUA in 1980. It was sponsored by the local Community Development Corporation, ASIAN, Inc., which provided it space in the early years, and which obtained a grant from the City of San Francisco to cover all or some of its expenses up until 1987.

The purpose of the credit union was, and remains, to help meet the needs of Asian immigrants who do not have easy access to the financial system. The Board sees the credit union as having two primary roles: first to meet the savings and credit needs of its individual members, and second, to promote community development in the neighborhood.

Credit union membership is open to anyone who lives, works or has associational ties in a defined geographical area of the city, including the Chinatown and North of Market (sometimes known as the Tenderloin) areas, and part of North Beach. It is a mixed income region of the city, but the Tenderloin in particular is predominantly low-income. Of a potential of 90,000, there are just over 800 members.

The credit union is still true to its original purpose of serving immigrants, and so as the immigrant population has changed, so has the credit union membership. While the leadership is totally Chinese American, about half of the members are Vietnamese. The Vietnamese tend to live in the poorest part of the credit union's area, the Tenderloin.

Downtown San Francisco is not lacking for banks which actively seek the savings of the local people. There is a financial institution on almost every corner, and the west coast's financial center is only a few blocks away on Montgomery Street. So there is no particularly urgent need for a community development credit union to provide savings accounts for the local people.

In fact, the Asian immigrants in this community are especially adept at seeking out the best savings opportunities for themselves. They are very conscious of interest rates, and sensitive to changes in rates. Some credit union members are so concerned with their interest that they come to the office at the beginning of each quarter just to have the interest entered in their passbook. So the credit union has to position itself carefully, with relatively high dividend rates, to attract an asset base. In 1991, the dividend accounted for about 50 percent of gross income.

A more important mission of the credit union, therefore, is to provide loans to people who cannot qualify at the local banks, and to help people to establish credit. It is for this reason that the credit union still appeals to immigrants.

The credit union offers basic savings accounts and loans, but little else in the way of financial services. There is no cash in the office, except for a small amount of petty cash. There were some efforts in the past to establish checking accounts and credit cards, but these did not get off the ground because an insufficient number of people were willing to sign up.

The credit union is growing slowly but steadily in terms of assets. At the end of 1989 it had about $2.2 million, at the end of 1990 $2.4 million, and at the end of 1991 $3.2 million. The membership has stayed fairly constant, with new members balanced by departing members who leave the neighborhood.

In 1991, the institution's financial position was strong, with a steady profit each month, and with reserves equal to about 8 percent of assets. There were one and a half paid staff positions, and a nine person board of directors made up mostly of local professional people active in community affairs. The credit union has been self supporting since 1987, covering all its expenses from its own income.

North East Jackson Area Federal Credit Union

NEJA Federal Credit Union[21] is located in a rural area between the towns of Marianna and Bascom, in Florida's northwestern panhandle. The office is just ten miles from the Alabama border, and fifteen miles from Georgia.

Jackson is a relatively poor county, with 30 percent of the population living at or below the poverty line, according to the last estimate. The credit union is located in the poorest part of the county, the northeastern corner. The field of membership consists of residents of Bascom, Florida and people living within a nine mile radius of the Bascom Post Office, as well as organizations in that area. The population of this area is predominantly African American and rural. The credit union attempts to meet the needs of a poor rural community; in particular it makes business loans to black farmers on the security of their crops.

NEJA FCU is one of about 400 credit unions founded by the Office of Economic Opportunity in the 1960's. The impetus for the founding of these credit unions came from the civil rights movement. Demonstrators and other movement partisans in the southern states frequently found that their access to credit was cut off. One weapon the white power structure had for retaliating against civil rights proponents was that the banks and finance companies refused to lend, and retailers refused to extend installment credit to them. When movement leaders brought this problem to the attention of White House officials, the latter suggested that black communities turn to cooperative credit unions, as a way of providing finance for themselves on a self-help basis. The idea took hold, and with the technical assistance of CUNA, OEO undertook the establishment of credit unions as one of its major projects.[22]

In most communities, the credit unions were sponsored by the local umbrella anti-poverty agency, the Community Action Program (CAP). A CAP, with its grant funding, was able to provide for the credit union's expenses as it got started, paying the staff salaries, for example, and allocating office space in its own building.

NEJA FCU was founded in 1965, in cooperation with the OEO, but without the benefit of a CAP sponsor. The local leader was a Baptist pastor from Bascom, Reverend A. H. Bowers. The signatories to the charter, and the founding board members, were for the most part activists in the local civil rights movement, people who had been inspired by Dr. Martin Luther King, Jr., and who had experience fighting for racial justice in their own community.

The credit union began very small. After one month, assets on July 31, 1965 stood at $160.42. During the first year, the credit union's income consisted of 35 cents in interest. Even after five years, assets were under $15,000 as the decade of the 1970's began. Growth proceeded steadily but slowly. In 1975, the assets were $135,000, and in early 1991, they were still just $400,000, with a membership of 800 people. Then in mid year, a loan of $200,000 from the NCUA Revolving Loan Fund brought the total to over $600,000.

Lacking a subsidy, the credit union has been unable to afford many expenses. It was run exclusively by volunteers from its founding until 1983, when the first salary expenses were incurred. In 1991 there was one paid staff member, but the credit union still depended heavily on volunteer participation. Much of the spirit and energy is provided by Mrs. Pearl Long, a retired school teacher and widow of a founding board member and manager, Gye Long. Mrs. Long became the credit union's treasurer in 1979 after her husband's death.

The credit union was located initially in the treasurer's family room, then in 1975 in the Long family's storage room. In 1980, it moved into an office trailer on Mrs. Long's front yard, where it has remained. It is on a secluded rural road, surrounded by fields of peanuts.

Most of the original OEO credit unions eventually failed or were merged and lost their identity. Of the 400, perhaps 100 remain.[23] NEJA FCU came very close to being closed down by the federal examiners several times, including in 1980 and again in 1987. There were many problems, among them a delinquency rate on loans that reached 30 percent in 1980. The credit union found itself frequently with inadequate records for its loans, and faulty accounting. Its survival is a testament to the determination of its leaders, and also to the extraordinary help rendered by Earnest Johnson. Johnson, the director of credit unions for the Federation of Southern Cooperatives and a board member of the National Federation of Community Development Credit Unions, is a veteran of the Civil Rights movement. Since the 1960's, he has devoted his professional life to the nurturing and rescue of black rural credit unions in the south-east. He spent countless hours at NEJA, doing the accounting and helping the board develop policies that would permit the credit union's survival. On several occasions he has done battle for the credit union with the federal examiners, and he has always been successful in preserving it.

In 1991 the credit union was actually in a strong financial position, with a loan delinquency rate of less than 3 percent, and reserves equal to 7.3 percent of assets.

Santa Cruz Community Credit Union

Santa Cruz Community Credit Union is located in Santa Cruz, California, on the Pacific coast south of San Francisco. It was founded in 1977 by a group of community activists who had experience working politically for progressive causes such as environmental controls, increases in social services and criminal justice reform. After years of being supplicants, continuously asking local governments for funding, they decided that they would be in a stronger position if they controlled their own financial institution and could make decisions themselves about the allocation of funds.

They initially investigated forming a bank, but discovered quickly that the capital requirements were far beyond their means. They then learned about credit unions, and decided that the form of a credit union was more to their liking than that of a bank, since it was a cooperative, controlled democratically by its members. With assistance from the California Credit Union League,[24] they were able to secure a broad charter from the state of California, specifying a field of membership that included residents of the entire county of Santa Cruz.

From the beginning, the purpose of the SCCCU has been somewhat different from that of other CDCUs. The community it serves is not exclusively or even predominantly poor. There are pockets of severe poverty, and certainly the housing costs are high, but Santa Cruz is a mixed income community, with a very wide spectrum of living standards. This presented an opportunity to the credit union leaders; if they could succeed in attracting middle income people to the credit union, they would be able to alleviate some of the severe financial problems faced by credit unions whose members are predominantly poor.

A second distinctive feature of SCCCU is that its board decided it could make a more positive impact on local people by stressing what it called "community development lending," rather than financial services to individuals and personal lending. What is meant by community development lending is loans to small, locally owned businesses and non-profit organizations, with particular emphasis on cooperatives and enterprises improving the quality of life in the local community. The model that some credit union leaders had in mind was Mondragon in the Basque country of Spain, where the cooperative bank is at the center of a network of cooperative business development, and where the bank often takes the initiative in starting new cooperatives. While the Mondragon model is still just a dream, nevertheless the SCCCU has made a substantial impact on small business development in the county. It has been willing to make small business loans, including start-up loans, that are below the size that most banks consider viable.

For its first dozen years, the SCCCU held a goal of "60-40" in its lending: 60 percent of the money was to go to community development, and just 40 percent to personal purposes. As the credit union grew, community development lending also grew, but eventually the growth in assets outstripped the credit union's ability to make community development loans, and the 60-40 policy had to be dropped. In addition, the NCUA adopted increasing barriers to business lending. Nevertheless, the community development portfolio grows steadily, and it remains the most distinctive aspect of the credit union.

Initially the credit union depended upon grants to pay its staff, and it was fortunate in securing substantial outside support. In the early years it was able to pay only a very low dividend rate, and in some periods none at all. Still, there was a core of members who believed so strongly in the mission of the institution that they were willing to provide about a half million dollars in deposits. Over time the financial condition of the credit union improved, the dividend rate rose and steady growth ensued. In 1991, assets stood at about $18 million, with a membership of approximately 6,000 people.

As the credit union grew in assets, it also grew in services and staff. Its leaders decided that if it was to have the resources to make a substantial impact through its lending, it would have to compete with the local banks to attract deposits. So it has developed a broader array of services than have most CDCUs, including share drafts (checking accounts), money orders, travelers' checks, certificates of deposits, individual retirement accounts, automated teller machines and credit cards. The strategy has worked, in terms of attracting members and deposits; in fact on most days the lobby is crowded and three or four tellers are hard at work. But of course the staff required to provide these services represent a substantial expense for the credit union. At last count there were 23 full time equivalent staff positions, in such areas as tellers, lending, bookkeeping, marketing and management. As a consequence, while the credit union has managed to show a surplus each year but one, it has had to be very careful about its bottom line.

With such a large and differentiated staff, SCCCU has faced interesting problems of work organization. In the early years, when there were just a few employees, salaries were equal, and the staff and board members shared decision-making authority on an informal and common basis. But as the staff grew, it became necessary to differentiate functions, to separate out financial management from teller work, for example. Salaries began to diverge. Still, there was an ideology of workplace democracy, a commitment to keep as much decision making authority among the staff as possible. The idea of workplace democracy ran into two barriers. First is the undeniable fact that a credit union is a member cooperative, not a worker cooperative, and that ultimate authority has to rest with the board of directors, as the representatives of the members. Second is the equally undeniable fact that in a complex organization, managers have to be given both the responsibility and the authority to make decisions, if the institution is not to grind to a halt. So the challenge to the SCCCU has been to find ways to honor workplace democracy—through workers' councils, through formal consultations and through an informal atmosphere of respect—while recognizing its necessary limitations.

Watts United Credit Union

Watts United Credit Union is located in a small suite on the first floor of a two story office building at the corner of Wilmington Avenue and 103rd Street in the heart of the Watts district of Los Angeles. Across Wilmington is the large 102nd Street Elementary School, and across the road from that is a row of boarded over and barred shops. The area is primarily residential, with a small shopping center a few blocks west on 103rd. The famed Watts Towers are several blocks south. It is a poor neighborhood, and the site of two of the worst urban riots in modern American history, in 1965 and 1992. Inside the small credit union lobby are three large portraits, of Martin Luther King, Jr., Malcolm X and Nelson Mandela.

The credit union's field of membership is everyone who lives or works in the Watts area of South Central

Los Angeles—from about 80th to 120th Streets. In mid 1991, there were 2,008 members, of whom 414 were borrowers. Most of the members are African-American, but about a third are Hispanic, reflecting the changing demographics of the neighborhood.

While most members conduct their business in person at the office, there are nine institutions on payroll deduction. One of them is the Watts Health Foundation, which includes health professionals—but for the most part the membership is quite low-income. Mervyn Dymally and Maxine Waters, both prominent California politicians, are members of the credit union.

In 1991 there were two and a half staff positions, including the manager, James Taylor.

Watts United Credit Union was chartered by the State of California in 1966, shortly after the 1965 riots. It was sponsored by the Westminster Neighborhood Association, a social agency that in turn was sponsored by the Presbyterian Church. Westminster had been in existence for a number of years at that point, but it was very small, with an annual budget of just $25,000. After the riots, a number of groups—including public bodies, churches and charities—wanted to give money to agencies in Watts. But there were almost no agencies; Westminster was one of the few. So, almost overnight, its budget rose from $25,000 to $2 million, as it took on new programs. Among the new ventures were a community action program, and also the credit union.

James Taylor was in on the organizing of the credit union from the beginning. He was the accountant for the Westminster Association, and it was thought that he could handle the task of being credit union treasurer. He recalls the credit union at that time as being a kind of "experiment," to see if people on welfare would pay their debts. The founding group knew almost nothing about financial institutions, and certainly nothing about credit unions. They approached the state, and got permission to begin, although the state authorities were reluctant. While they were willing in the end to grant a charter, Taylor recalls, they said they did not expect the credit union to survive.

Initially, Westminster and the associated CAP program paid some of the salary expenses of the credit union, but that subsidy has long since ended, and the credit union is completely on its own now. There is still a warm relationship between Westminster and the credit union though; in fact the director of Westminster has been the chair of the Supervisory Committee.

In the first years, a principal goal was to help people survive between welfare checks, and many $50 loans were made for that purpose. Taylor recalls that it was a struggle at first to get people to grasp the idea of a loan; they were embedded in the grant mentality. But still, the borrowers paid back those $50 loans. Later the size of the loans grew, and the credit union had to develop more of a structure.

The credit union has been growing. It was at an asset size of three to four hundred thousand dollars for many years. In 1988 it passed one million, and in 1991 it was close to a million and a half. Taylor would like to see the credit union reach two million in the near future, but he thinks it has not actually reached ten percent of its full potential. The credit union was in a strong financial position, with a reserve ratio of over ten percent, remarkably high for a CDCU, in 1991.

IV
NEIGHBORHOOD INCOME AND POVERTY

Table 3 shows that five of the seven CDCUs are located in areas with relatively low incomes and high poverty levels, compared to the rest of the country.[25]

The poorest area is the Watts neighborhood of Los Angeles, with a per capita income barely a quarter of the United States average, and a poverty rate, as estimated in the 1980 census, of over one half. Almost as poor, in money terms, is the Navajo Reservation, although lower housing costs in this area mean that the real standard of living is not as low.[26] The Mission Area of San Francisco has a per capita income just 57 percent of the United States average, and a poverty rate twice as high. Jackson County, Florida, where NEJA is

Table 3
NEIGHBORHOOD INCOME AND POVERTY[27]

Neighborhood	Per Capita Income (1985)	Ratio of Income to US Average	Proportion of Persons in Poverty (1979)
Madison County, KY	7,600	.70	.21
Navajo Reservation, AZ[28]	3,240	.30	.50
Mission Area, SF CA	6,109	.57	.24
Jackson County, FL	7,240	.67	.23
Chinatown, SF CA	9,262	.86	.27
Santa Cruz County, CA	11,882	1.10	.12
Watts, LA CA	3,003	.27	.53
United States	10,797	1.00	.12

located, and Madison County, Kentucky, where the headquarters of CAPFCU is located, have average incomes about two thirds of the US level, and correspondingly higher poverty rates.

Chinatown in San Francisco has a greater dispersal of incomes than the other areas. Its average income is fairly close to the United States average, but its poverty rate is more than twice as high. The highest income level is in Santa Cruz County, California, with per capita incomes slightly above the United States average, and a poverty rate just at the average.

V
THE DATA

Data were collected from the loan files in each of the seven credit unions. An attempt was made to look at approximately 200 loans in each credit union, disbursed during 1990. The loans were selected randomly from lists available in the credit union offices. Because NEJA is such a small credit union, with so few loans each month, the period was extended from 1989 through mid 1991, and even so only 103 files were available. At Santa Cruz the sample consisted of about 400 files, so as to obtain a sufficient number of credit card and business loans, as well as personal loans. At First American, all of the files were taken from Window Rock office on the Navajo reservation, and none from the Casa Grande branch.

The material in the loan files is not uniform from credit union to credit union, and even within a single credit union's files pieces of information are sometimes missing. In the comparisons between credit unions, therefore, the usable variables were restricted, and not all of the files could be used.

The information comes from different documents in the loan files. A loan file always contains an application, filled out by the member, and a promissory note, filled out by the credit union and signed by the member. In some but not all credit unions there is also a work sheet containing relevant information and calculations, filled out by a loan officer.

Some arbitrary decisions were necessary. The first had to do with the income of the borrower. Wherever possible, the figure used was the gross monthly income of the principal borrower. Taxes and other paycheck deductions were not subtracted. In the case of the self-employed, the attempt was made to deduct expenses related to the generation of income, although as explained below, this may not always have been possible. Note that individual income, not household income, was used, even when several incomes in a household were required to make the borrowers eligible for a loan. There were two reasons for using individual rather than household income: first, because the study was attempting to discover the characteristics of the borrowers, not to assess the decision-making process of the credit union, and second, because in some of the communities the concept of "household" was quite ambiguous. In the great majority of cases, the borrower's income was by a large margin the highest income in the household.

Each loan was assigned to a single borrower, even when the loan was legally made to a couple. In these cases, an attempt was made to decide, from looking at the complete file, who the principal borrower was, and to gather information about that person. This seemed the wisest choice, since otherwise the information would not be comparable between loans.

Some of the information in the files is certainly inaccurate. Some of the errors are inadvertent, and unlikely to be damaging to the analysis. There are probably errors in the self-reported ages of the borrowers, for example. Students of population censuses almost always find a higher than expected concentration of people at ages divisible by 5, and this is likely to be the case in the credit unions also.

Some of the errors are probably purposeful, however. A person seeking a loan may have an incentive either to overrepresent or to underrepresent his or her income. The tendency to overrepresent comes from a desire to appear more credit-worthy than the person actually is, while the tendency to underrepresent may come from people on public assistance who wish to conceal some of their income from the authorities. In some files, figures are confirmed by employers or by tax returns, but this does not happen in every case. Some credit union loan officers have said that they are particularly suspicious of income reported from self-employment, since the figures they are shown may not be net of income-related expenses. Errors such as these are unfortunate, but since they affect all of the credit unions, they are unlikely (with one exception) to influence the comparison between the credit unions. The one exception is NEJA Federal Credit Union in Florida, where many of the members are self-employed farmers, and where the overstatement of income may therefore be somewhat greater than in the other credit unions.

VI
MEDIAN VALUES

Table 4 selects the median value for each of a dozen variables in the loan files of the seven credit unions. The first four rows are characteristics of the loans, while the last eight are characteristics of the borrowers. Many of the variables will be discussed in greater detail in subsequent sections, but Table 4 allows a quick overview of some of the findings.

There is considerable variation in the sizes of loans made by the different credit unions. In two of the rural credit unions, Central Appalachian People's and First American, the typical loan is small, just a few hundred dollars, while in some of the urban credit unions a typical loan is in the neighborhood of $5,000. The lengths of the loans also vary, with the rural credit unions—Appalachian and NEJA—making much shorter loans than the urban credit unions (no term is given for First American since all of its lending is in the form of line-of-credit loans). There is some variation in typical interest rates. In terms of interest, however, the rural credit unions are not distinct from the urban; the largest gap occurs between two urban credit unions, Northeast Community and Watts United.

The median ages of the borrowers range from a low of 31 at the Appalachian credit union to a high of 43 at NEJA. In four of the credit unions the majority of borrowers are women, and in three men.

There is a wide range of monthly incomes. In the three rural credit unions, the median income is at or just above $1,000. In Watts and Mission Area it is higher but below $2,000, and in Santa Cruz and Northeast Community it is closer to $2,500.

The majority of borrowers in all of the credit unions are employed, and the median length of employment in the current job varies between two years in Santa Cruz and eight years at NEJA. In the Appalachian and NEJA credit unions, the majority of borrowers own their homes, while in the others they rent. There is a remarkably high number of years in the current residence among the borrowers at First American on the Navajo Reservation.

VII
BORROWER INCOMES

One of the purposes of the study is to discover the extent to which CDCUs succeed in directing their lending to low and moderate income people. Rosenthal and Schoder found that the median gross income of a borrower household at the Lower East Side People's Federal Credit Union in New York, over the period 1986-1989 was $1,517 per month.

Table 5 displays the percentage of borrowers in different income categories in each credit union, as well as the overall median and average incomes of the borrowers. The table shows significant contrasts between the credit unions. Incomes were lowest at the Appalachian credit union and highest at Northeast Community.

Table 4
MEDIAN VALUES OF LOANS

	APPAL	FIRST AMER	MISSION AREA	NORTH EAST	NEJA	SANTA CRUZ	WATTS UNITED
AMOUNT ($)	504	300	5,000	5,500	1,500	3,108	2,600
INTEREST(%)	15.0	16.0	15.5	13.0	15.0	15.9	18.0
TERM (months)	948	24	12	36	36		
PURPOSE[29]	used auto	used auto	debt consol	busi ness	farm	credit card	used auto
AGE	31	36	39	38	43	36	41
SEX	F	F	F	M	M	M	F
INCOME/MONTH	1,000	1,260	1,920	2,500	1,096	2,349	1,577
JOB	emp'd	emp'd	emp'd	emp'd	emp'd	emp'd	emp'd
JOB YEARS	3	5	3	4	8	2	5
HOUSING	own	rent[30]	rent	rent	own	rent	rent
HOUSING YEARS	7	18	3	4		3	5
DEBT RATIO (%)	27	28	38		30	34	

The lowest borrower incomes were found in the three rural credit unions. Of these, the lowest was the Central Appalachian People's Federal Credit Union, with a median income of $1,000 per month and an average of $1,165 (the gap between the two measures indicates the extent to which the range of incomes above the median is greater than the range of incomes below). Half of the borrowers at CAPFCU earned less than $1,000 a month, and a significant portion actually earned less than $500. Only 4 percent of the borrowers earned more than $2,500.

At North East Jackson Area Federal Credit Union, the typical borrower incomes were just slightly above the CAPFCU incomes, and at First American, on the Navajo Reservation, the incomes were a bit higher still.

The four urban credit unions had higher borrower incomes. Watts United stood lowest, with an average income of $1,850, while Mission Area came next, with $2,149. Northeast Area and Santa Cruz Community had significantly higher borrower incomes.

Table 6 shows the median incomes of full time workers in the United States in 1989, by ethnic group. While these data are not directly comparable with the figures in Table 5, they show roughly how the incomes of the credit union borrowers compare with those of Americans generally. In five of the credit unions, the borrowers are poorer than workers in the country as a whole, while in Santa Cruz they are about the same and in Northeast Community they are somewhat better off. When compared to their respective ethnic groups, the borrowers at Appalachia, North East Jackson Area and Watts are worse off, at Santa Cruz they are about the same and at Mission Area they are better off.

A comparison of Tables 3 and 5 shows that there is only an imperfect correlation between overall neighborhood incomes and the incomes of the borrowers in the different credit unions. This leads to some interesting conclusions about the varying strategies of the credit unions.

Table 3 shows that the two poorest areas in the study are the Navajo reservation and Watts. These are not, however, the locations of the credit unions with the poorest borrowers. The incomes of borrowers at Central Appalachian People's and at NEJA are lower. This discrepancy reflects the fact that First American and Watts United do not actually seek borrowers from among the poorest people in their areas.

When it was founded in 1962, First American was called Navajo Tribal Employees Credit Union, and its field of membership was restricted to employees of the tribe. These people were the highest income group on the reservation. While the field of membership has been greatly expanded since that time, (now First American will accept as a member any Native American belonging to a tribe whose headquarters is in Arizona), still the leadership of the credit union tends to come from among the professional leaders on the reservation. Furthermore, the credit union will lend only to members who are on a payroll deduction plan with their employer. This policy has the effect of

Table 5
INCOME OF BORROWERS
(Percentage Distribution)

GROSS MONTHLY INCOME	APPAL	FIRST AMER	MISSION AREA	NORTH EAST	NEJA	SANTA CRUZ	WATTS UNITED
$0-499	8	3	1	1	8	0	1
500-999	42	23	7	2	33	5	13
1,000-1,499	29	37	16	13	26	9	30
1,500-1,999	10	21	27	22	18	19	24
2,000-2,499	8	9	16	8	5	20	13
2,500-2,999	2	3	17	16	5	13	6
3,000-3,499	1	1	7	8	0	12	8
3,500-3,999	0	1	2	11	3	7	1
4,000+	0	1	7	19	2	15	4
TOTAL	100	100	100	100	100	100	100
MEDIAN INCOME	$1,000	1,260	1,920	2,500	1,096	2,349	1,577
AVERAGE INCOME	1,165	1,426	2,149	3,084	1,318	2,842	1,850
MEDIAN/AVERAGE	.86	.88	.89	.81	.83	.83	.85

excluding from the borrower pool everyone who is unemployed, out of the labor force, or solely self-employed. As a consequence, while First American operates in an extraordinarily poor area of the country, its borrowers tend to be better off economically than the reservation population as a whole.

The lending policies at Watts United are not so clear. Nevertheless, it appears that the lowest income people in Watts do not have sufficient income to qualify for loans.

The opposite phenomenon is seen at the Central Appalachian and the NEJA credit unions. Madison County in Kentucky is not particularly prosperous, but neither is it as poor as some of the areas in the study. The borrowers at CAPFCU are the poorest in this sample however, for two reasons. First, while the credit union's office is located in Madison County, the field of membership extends over many counties and several states, in which there are a number of very poor areas. More importantly, however, the field of membership is restricted to employees (and in some cases clients) of certain local agencies, organizations and companies. In large measure, although not exclusively, these are social service agencies that deal largely with the poor as well as some companies that hire most of their work force at the minimum wage. It appears, therefore, that CAPFCU selects for the poorer segment in its area, and consequently the average income of the borrowers is quite low.

There is a similar story at NEJA. While Jackson County incomes are only moderately below those of the country as a whole, NEJA's field of membership does not extend to the entire county but is restricted to a small corner in the northeast, surrounding the village of Bascom. This is a rural area and the poorest part of the county, where the African-American population is concentrated. And while not everyone in the field of membership is black, still the credit union's membership is exclusively black. Thus the credit union selects for a relatively poor segment of the local population, and as a consequence the income of the borrowers is low.

This observation should be understood in context. The borrowers at First American and at Watts United are certainly not prosperous, by United States standards. They are quite poor, and in fact they are even poor in comparison to typical borrowers in some of the other CDCUs in the study. It is arguably the case that a private financial institution could not long survive if it restricted itself to the poorer segments of the Navajo reservation and of Watts. These latter are people so poor that they need expanded welfare programs and grants, not loans.

Table 6
MEDIAN MONTHLY INCOME OF FULL-TIME WORKERS UNITED STATES, 1989[31]

ETHNICITY	FEMALE	MALE
White	$1,656	$2,487
Black	1,492	1,726
Hispanic	1,334	1,548
Total	1,637	2,384

VIII
BORROWERS' INCOMES BY AGE AND SEX

The borrowers' incomes differ in systematic and interesting ways by age and by sex. Tables 7 through 13 show the patterns.

Several interesting features are revealed by these tables. First, the typical ages of the borrowers differ considerably from credit union to credit union. These age differences are not related to differences in the age composition of the different ethnic groups in the United States. In 1989, the median ages of blacks, Hispanics and whites were 27.7, 26.1 and 33.6 years respectively,[32] the differences being caused largely by the higher proportion of children in the non-white groups. In this study, in contrast, the highest borrower ages were found in the predominantly black and Hispanic credit unions.

The oldest borrowers are found in the North East Jackson Area Federal Credit Union, where the average

Table 7
BORROWERS' INCOME BY AGE AND SEX
CENTRAL APPALACHIAN PEOPLE'S FEDERAL CREDIT UNION

Age	Total		Women		Men	
	# in Sample	Ave Gross Income	# in Sample	Ave Gross Income	# in Sample	Ave Gross Income
-29	87	1,002.17	46	881.01	41	1,138.10
30-39	58	1,340.81	35	1,126.80	23	1,666.47
40-49	31	1,383.56	16	1,177.62	15	1,603.23
50+	17	929.67	12	869.78	5	1,073.40
TOTAL	193	1,158.81	109	1,002.24	84	1,361.98
Average Age		33		34		33
Median Age		31		31		30

age is 45 and the median 43. This is probably a reflection of the social conditions of this area of the black south; there is a reasonable living to be made by farmers who make a commitment to the area, but the young people typically choose to leave, because rural employment opportunities are so limited. The next oldest borrowers are found in the other African American credit union, Watts United (average age 40, median 41). Here the likely explanation is not that the young people leave the area, since the average age of the entire Watts area is actually quite young. It is more apt to be that young African American men and women have so few economic opportunities that they cannot qualify for loans.

The high average ages of borrowers in the two predominantly black credit unions, when taken together, probably reflect the desperate conditions in which many young black people find themselves today. Because of the absence of opportunities, they are leaving the rural south, as they have for generations. In the cities to which they migrate, however, they typically do not find much in the way of employment opportunities.

The youngest borrowers are found in the Central Appalachian People's Federal Credit Union, where the average age is 33 and the median 31. While Appalachia is certainly an area of the country that loses many of its young people, the relative youth of the borrowers in this credit union is probably a consequence of the membership of the particular organizations that make up the field of membership.

Gender has little to do with the age differences of the borrowers in the seven credit unions. In most credit unions, the age distribution of the women borrowers is quite close to that of the men. In five of the seven credit unions the men are somewhat older, on average, than

Table 8
BORROWERS' INCOME BY AGE AND SEX
FIRST AMERICAN CREDIT UNION

Age	Total		Women		Men	
	# in Sample	Ave Gross Income	# in Sample	Ave Gross Income	# in Sample	Ave Gross Income
-29	55	1,075.84	32	1,116.71	23	1,018.97
30-39	83	1,328.99	52	1,188.88	31	1,566.68
40-49	61	1,755.16	34	1,609.62	27	1,938.43
50+	16	1,874.65	7	1,634.89	9	2,061.13
TOTAL	215	1,426.13	125	1,309.82	90	1,587.68
Average Age		36		36		37
Median Age		36		36		36

Table 9
BORROWERS' INCOME BY AGE AND SEX
MISSION AREA FEDERAL CREDIT UNION

Age	Total		Women		Men	
	# in Sample	Ave Gross Income	# in Sample	Ave Gross Income	# in Sample	Ave Gross Income
-29	23	1,466.41	12	1,574.06	11	1,348.99
30-39	76	1,874.42	50	1,606.71	26	2,389.24
40-49	71	2,143.85	36	1,981.51	35	2,310.79
50+	23	1,540.59	13	1,330.42	9	1,867.51
TOTAL	193	1,885.13	112	1,689.16	81	2,156.10
Average Age		40		40		40
Median Age		39		38		40

Table 10
BORROWERS' INCOME BY AGE AND SEX
NORTHEAST COMMUNITY FEDERAL CREDIT UNION

Age	Total		Women		Men	
	# in Sample	Ave Gross Income	# in Sample	Ave Gross Income	# in Sample	Ave Gross Income
-29	25	3,062.79	6	2,675.00	19	3,185.25
30-39	37	3,104.62	13	2,415.08	24	3,478.12
40-49	28	3,403.28	10	2,243.29	18	4,047.72
50+	13	2,379.00	5	2,819.99	8	2,104.00
TOTAL	103	3,084.07	34	2,469.82	69	3,386.75
Average Age		39		38		39
Median Age		38		38		38

Table 11
BORROWERS' INCOME BY AGE AND SEX
NORTH EAST JACKSON AREA FEDERAL CREDIT UNION

Age	Total		Women		Men	
	# in Sample	Ave Gross Income	# in Sample	Ave Gross Income	# in Sample	Ave Gross Income
-29	14	931.14	6	841.83	8	998.12
30-39	24	1,387.89	13	1,373.38	11	1,405.04
40-49	41	1,474.50	14	1,053.00	27	1,693.06
50+	31	1,230.78	17	787.12	14	1,769.50
TOTAL	110	1,317.76	50	1,020.56	60	1,565.44
Average Age		45		45		45
Median Age		43		43		43

the women, but the differences are marginal.

Gender is, however, strongly associated with differences in the incomes of the borrowers. In each of the seven credit unions, the average income of the male borrowers significantly exceeds the average income of the female borrowers. Taking all seven credit unions together, males' incomes are 30 percent above females'.

The income difference by gender is consistent with the situation in the country as a whole. Table 6, for example, showed that among full-time workers in the United States in 1989, males' earnings exceeded females' by 45 percent. The economic literature on this phenomenon concludes that the male-female income gap is caused in part by the fact that women are more likely than men to move in and out of the labor force, in part by discrimination and in part by the lower educational attainment and hence the lower level of "human capital"[33] on the part of women.

Interesting patterns emerge in the age patterns of the borrowers' incomes. In each credit union, there is a general tendency of the borrowers' incomes to increase with age, except in the oldest group above 50, where incomes fall. One might conclude from these patterns that a typical credit union member can expect to enjoy an increasing income until middle age or later, and then a falling income. Gary Becker shows, however, that data such as these, generated from a cross section of people at different ages, may not be a good indicator of the expected age-earnings profile of a given cohort of people over time.[34] His analysis leads him to expect that for most groups of people, incomes rise steadily over time, at least until age 60. One reason that older people in a cross sectional panel have lower incomes may be that they were educated in an earlier period, and consequently have fewer skills, or human capital, than do younger people who had the advantage in their youth of more and better education and training. Consequently, while the income of 55 year old people today is less than the income of 45 year old people, still the incomes of 55 year old people today are greater than their own incomes were ten years ago.

Richard Freeman has added the insight that differences in the earnings of different age groups may be due at least in part to varying numbers of people in those age groups.[35] Workers born when birth rates were relatively low may be in short supply, and hence command higher earnings, than workers born when birth rates were relatively high. He finds that this effect is much more pronounced in the case of male workers and college graduates, where the age-earnings profile is relatively steep, and much less pronounced in the case of female workers and less educated groups, where earnings do not vary much with age.

In summary, the age differences in the earnings of the borrowers in these CDCUs may reflect a number of factors, among them different expected career patterns of earnings over their lifetimes, different levels of educational and skill attainments by people at different ages, and different sizes of age cohorts.

The data from these CDCUs confirm Freeman's finding that the association of age with income is much stronger for men than for women. This conclusion emerges from a casual inspection of the data in Tables 7 through 13.

The phenomenon was explored more closely using linear regression analysis. Table 14 shows the results of regressions in which the observations from all seven of the credit unions were pooled. The form of the regression is:

Table 12
BORROWERS' INCOME BY AGE AND SEX
SANTA CRUZ COMMUNITY CREDIT UNION

Age	Total # in Sample	Total Ave Gross Income	Women # in Sample	Women Ave Gross Income	Men # in Sample	Men Ave Gross Income
-29	78	1,892.85	36	1,723.67	42	2,037.86
30-39	147	2,807.84	68	2,696.38	79	2,903.77
40-49	81	3,575.47	35	2,677.48	46	4,258.72
50+	28	3,548.79	10	2,542.60	18	4,107.78
TOTAL	334	2,842.43	149	2,446.60	185	3,161.24
Average Age		37		36		38
Median Age		36		35		37

Table 13
BORROWERS' INCOME BY AGE AND SEX
WATTS UNITED CREDIT UNION

Age	Total # in Sample Income	Total Ave Gross Income	Women # in Sample Income	Women Ave Gross	Men # in Sample	Men Ave Gross
-29	38	1,520	26	1,384	12	1,814
30-39	60	1,876	37	1,790	23	2,015
40-49	73	2,131	47	1,912	26	2,526
50+	51	1,662	26	1,763	25	1,558
TOTAL	222	1,850	136	1,750	86	2,009
Average Age		42		40		44
Median Age		41		41		42

INCOME = CONSTANT + a.AGE + bapp.Dapp + ...+ bwat.Dwat,

where INCOME is the gross monthly income of the borrower

AGE	is the age of the borrower
Dapp	is a dummy variable, taking the value of 1 in the case of borrowers from the Appalachian credit union and zero in all other cases,
Dfir	is a dummy variable for First American credit union
Dmis	is a dummy variable for Mission Area credit union
Dnej	is a dummy variable for NEJA credit union
Dnor	is a dummy variable for Northeast Area credit union
Dwat	is a dummy variable for Watts United credit union,
and	
a	is a calculated coefficient showing the typical increase in borrower income for each year of age;
b	is a series of calculated coefficients showing the typical difference in income for each credit union, as compared to Santa Cruz Community Credit Union.

In the table, the "t values" for each coefficient are shown in parentheses under the coefficient. A t value of greater than 2 indicates a high probability that the "true" value of the coefficient differs from zero. R sq is the squared correlation coefficient, a measure of the proportion of the variation in the dependent variable, INCOME, that is associated with variation in the independent variables. N is the number of observations in each regression.

Table 14 shows a clear association of age with income, for the total sample and for men alone. For the full sample, each year of increase in age is associated with an increase in income of $14 a month. For men the association is stronger ($19) than it is for women ($7). Note also that the female age coefficient is not significantly different from zero at the 95 percent confidence level, while the male coefficient is strongly significant.

The coefficients on the dummy variables show that the incomes are lower in the credit unions shown than they are in Santa Cruz Community Credit Union,[36] and that the differences in incomes are significant, with the exception of the borrowers in Northeast Area and female borrowers in Mission Area.

The difference between men and women in terms of the association between age and income is explored further in Table 15. For each gender in each credit union, a separate simple regression was run, of the form:

INCOME = CONSTANT + a.AGE

In five of the seven credit unions in Table 15, the male age coefficient is greater than the female. In one, Northeast Community, the two are virtually identical and in one, Watts United, the female coefficient exceeds the male.

Taken together, Tables 14 and 15 demonstrate that age is more strongly associated with income in the case of male borrowers than it is with female borrowers. This raises interesting questions about the social and educational differences between men and women in this sample.

There is an extensive literature on the returns to education that explores the age profile of income.[37] As noted above, it shows that personal income is positively associated with age, that is to say, people can generally expect to earn higher incomes as they grow older. The association is stronger, however, the higher ones educational attainment. That is to say, highly educated

Table 14
REGRESSION OF BORROWER INCOME AGAINST AGE

INCOME = C + a.AGE + b(i).D(i)			
VARIABLE	**TOTAL**	**FEMALES**	**MALES**
CONSTANT	2112 (15.7)	2078 (11.3)	2183 (11.6)
AGE	14.4 (4.5)	6.9 (1.5)	19.1 (4.2)
D app	-1442 (-12.9)	-1301 (-8.7)	-1482 (-9.0)
D fir	-1210 (-11.3)	-1017 (-7.1)	-1302 (-8.1)
D mis	-424 (-3.7)	-250 (-1.6)	-475 (-2.7)
D nor	-216 (-1.5)	-386 (-1.7)	-215 (-1.2)
D nej	-1459 (-10.5)	-1376 (-6.8)	-1506 (-6.4)
D wat	-883 (-8.2)	-610 (-4.3)	-1063 (-6.4)
R sq	.18	.14	.21
N	1390	728	662

people can expect to enjoy steep increases in income as they age, while minimally educated people experience only modest increases in income over time. In fact, Becker's data show that there are only small differences in the incomes of people in their young twenties, regardless of their educational attainment, while there is a very large income differential, related to education, among older people. The point is not just that the highly educated earn more than the minimally educated, but that their age profile of earnings increases faster.

Why this should be the case is a matter of speculation. One plausible explanation has to do with typical career paths. Highly educated people tend to have professional careers, in which they move on to increasingly challenging tasks as they grow older, with greater and greater levels of responsibility. The increases in earnings that they reap reflect these increases in responsibility. Poorly educated people, on the other hand, tend to find themselves in blue collar or clerical occupations. The earnings levels in these occupations may seem quite attractive at the beginning, but the responsibilities tend not to increase very much over time, and the earnings stay fairly constant.

We do not have information in this study about the educational attainments of the borrowers. The age-earnings profiles suggest, however, that on average the men are more highly educated than the women, and

Table 15
REGRESSIONS OF INCOME AGAINST AGE FOR EACH CREDIT UNION

INCOME = CONSTANT + a.AGE

CREDIT UNION	FEMALE Coefficients C	FEMALE Coefficients Age	FEMALE R sq	MALE Coefficients C	MALE Coefficients Age	MALE R sq
APPALACHIAN	771 (4.8)	7.1 (1.6)	.02	932 (3.9)	12.0 (1.7)	.03
FIRST AMER	303 (1.4)	28.0 (4.9)	.16	258 (0.9)	35.9 (4.8)	.21
MISSION AREA	3477 (3.8)	-35.3 (-1.5)	.02	2116 (3.4)	8.8 (0.6)	.00
NORTHEAST	1563 (1.6)	10.3 (0.4)	.01	2304 (2.7)	10.1 (0.5)	.00
NEJA	1489 (6.9)	-10.7 (-2.3)	.10	1140 (2.5)	8.7 (0.9)	.01
SANTA CRUZ	862 (2.0)	41.5 (3.5)	.07	1021 (2.6)	49.6 (4.9)	.11
WATTS UNITED	1405 (5.2)	8.5 (1.3)	.01	2485 (5.6)	-11.9 (-1.2)	.02

that the men are closer to professional career paths, while the typical female borrowers are closer to working class occupations. This is shown not just by the higher average male incomes, but by the fact that males' incomes rise more steeply with age than do females' incomes.

With these hypotheses in mind, the calculated regression coefficients in Table 15 become particularly interesting:

Central Appalachian People's FCU: Here the male coefficient is higher than the female, but both are low, and in fact one cannot say with much confidence that there is any relation between borrowers' age and income. This is consistent with informal observations about the credit union members. They are relatively poor, with fairly low educational levels and for the most part non-professional occupations.

First American CU: In the case of both females and males, incomes rise with age, and the coefficients are statistically very significant. The male coefficient is somewhat higher than the female. This is consistent with the observation that the borrowers at First American, while poor, tend to come disproportionately from the upper-income group on the reservation, where professional job opportunities are more available.

Mission Area FCU: The association between age and income is very weak among the Mission Area borrowers. In fact the female coefficient is actually negative, although its statistical significance is questionable. This is consistent with the generally working class character of the membership.

Northeast Community FCU: The lack of a significant association between age and income here is somewhat surprising, in view of the comparatively high incomes in this credit union. It may indicate that the Becker effect noted above is particularly strong in this credit union, namely that the younger members are better educated than the elders, with access to more remunerative and professional jobs, and this almost completely counteracts the tendency of income to rise with age.

North East Jackson Area FCU: For men the association is weak, and for women it is actually negative. That is to say, the younger women borrowers have higher incomes than the older women. Again, this is consistent with a working class, rural membership.

Santa Cruz Community CU: There is a strong relationship between age and earnings for both men and women. For men, however, the coefficient is higher, and more statistically significant. This indicates a relatively well educated and professional membership.

Watts United Credit Union: In Watts, the association between age and income is weak, as one would expect among a poorer, less educated, more working class membership. This is the only credit union in which the male coefficient is less than the female, and in fact it is negative. This is likely another indicator of the poor prospects and generally negative economic conditions for African American men in central cities.

IX
AGE STANDARDIZED INCOME DIFFERENCES

The differences in the typical ages of the borrowers in the credit unions may have had an effect upon the average incomes that were calculated. That is to say, one reason why a credit union's borrowers have a low average borrower income may be that they are relatively young, concentrated in the age groups where one would expect comparatively low incomes. If this is the case, the low average income may not reflect fundamental social conditions among the membership so much as it does the age distribution of the borrowers.

To investigate this question, we have calculated the average income of borrowers in each credit union on an age-standardized basis. We used as our standard the proportion of borrowers that actually exist in the First American Credit Union sample. These are shown in Table 16.

To calculate age standardized average borrower incomes in each credit union (total, female and male), we weighted the average income in each age group by the proportion of borrowers in that age group found in First American Credit Union. This procedure will change the calculated average income if two conditions hold:

1. If incomes vary with age among the credit union's borrowers, and
2. If the age distribution of borrowers in the credit union differs from the age distribution of borrowers in First American Credit Union.

Table 17 shows an example of the calculation: use of the First American weights raises the average borrower income in

Central Appalachian People's Federal Credit Union from the raw figure of $1,159 to an age standardized figure of $1,236, an increase of 7 percent. Age standardization raises CAPFCU's calculated average borrower income, because at CAPFCU the borrowers are younger than at First American, and because at CAPFCU younger borrowers tend to have lower incomes than older borrowers.

Table 18 contains the age standardized average borrower incomes for each credit union—total, female and male—based upon the First American weights.

The largest positive adjustment as a result of age standardizing comes in the Appalachian credit union (7 percent), the credit union with the youngest borrower ages.

There are negative adjustments at Mission Area and at NEJA, because of the relatively old age of the borrowers there. Note that there is little adjustment at Watts because, although the age is relatively high there, income is not strongly correlated with age.[38]

The principal conclusion to follow from the exercise of age standardizing is that, after correction, the Appalachian borrower incomes are significantly closer to the incomes of the other two rural credit unions, NEJA and First American.

X
DIFFERENCES IN THE COST OF LIVING

Living costs differ significantly in different parts of the country. In this study, which compares four urban

Table 16
AGE DISTRIBUTION OF BORROWERS IN FIRST AMERICAN CREDIT UNION

Age	Proportion of Borrowers Total	Female	Male
-29	.256	.256	.256
30-39	.386	.416	.344
40-49	.284	.272	.300
50+	.074	.056	.100
Total	1.000	1.000	1.000

Table 17
CALCULATION OF AGE STANDARDIZED AVERAGE BORROWER INCOME CENTRAL APPALACHIAN PEOPLE'S FEDERAL CREDIT UNION

Age	Average Income	X	Weights	=	Calculated Income
-29	$1,002		.256		256.5
30-39	1,341		.386		517.6
40-49	1,384		.284		393.1
50+	930		.074		68.8
Unweighted Average Income					$1,159
Sum of column 4 = Weighted Average Income:					1,236

California credit unions with three rural credit unions in other parts of the country, these cost of living differences need to be taken into account, if meaningful comparisons are to be made.

Regional cost of living data are available from the United States Department of Commerce and from the American Chamber of Commerce. Unfortunately, however, there are no comparative price studies covering the exact areas served by these seven credit unions. Therefore some rough approximations were required.

According to the Chamber of Commerce statistics for 1990, based on an index number of 100 for the United States as a whole, prices in urban California metropolitan districts measured approximately 125, while prices in some non-metropolitan areas in the border and southern states measured approximately 90.[39] The biggest differences between these two areas were in the areas of housing and medical costs. Taking the ratio of these two indices, it was assumed that the cost of living in the areas of the urban credit unions is 40 percent greater than the cost of living in the rural areas.

Table 19 is similar to Table 18, except that the average incomes in the three rural credit unions—Appalachia, NEJA and First American—are raised by 40 percent. The first three columns show the unweighted average incomes, and the last three columns the age standardized average incomes. Thus the last three columns of Table 19 show the consequences of both adjustments taken together: age standardization and correction for the cost of living.

Table 19 shows that, when adjustments are made for the cost of living and for differences in the ages of the borrowers, the credit unions in this study fall fairly neatly into two income categories. There are five low-income credit unions, the three rural credit unions plus Mission Area and Watts United. In this group, average adjusted monthly borrower incomes range from $1,730 to $1,996, a difference of 15 percent. The second group consists of two moderate income credit unions, Santa

Table 18
AGE STANDARDIZED AVERAGE BORROWER INCOMES

Credit Union	Unweighted Average Income			Age Standardized Average Income		
	Total	Female	Male	Total	Female	Male
APPALACHIAN	1,159	1,002	1,362	1,236	1,063	1,453
FIRST AMERICAN	1,426	1,310	1,588	1,426	1,310	1,588
MISSION AREA	1,885	1,689	2,156	1,822	1,685	2,047
NORTHEAST COMM	3,084	2,470	3,387	3,125	2,485	3,437
NEJA	1,318	1,021	1,565	1,284	1,117	1,424
SANTA CRUZ	2,842	2,447	3,161	2,846	2,434	3,209
WATTS UNITED	1,850	1,750	2,009	1,842	1,718	2,071

Table 19
AGE STANDARDIZED AVERAGE BORROWER INCOMES
ADJUSTED FOR DIFFERENCES IN THE COST OF LIVING

Credit Union	Unweighted Average Income			Age Standardized Average Income		
	Total	Female	Male	Total	Female	Male
APPALACHIAN	1,622	1,403	1,907	1,730	1,488	2,034
FIRST AMERICAN	1,996	1,834	2,223	1,996	1,834	2,223
MISSION AREA	1,885	1,689	2,156	1,822	1,685	2,047
NORTHEAST COMM	3,084	2,470	3,387	3,125	2,485	3,437
NEJA	1,845	1,429	2,191	1,798	1,564	1,994
SANTA CRUZ	2,842	2,447	3,161	2,846	2,434	3,209
WATTS UNITED	1,850	1,750	2,009	1,842	1,718	2,071

Cruz Community and Northeast Community. In this group the average income range is $2,846 to $3,125, or 10 percent. The overall gap between the bottom of the first group and the top of the second is $1,395, or 81 percent.

XI
LOAN PURPOSE

Tables 20, 21, 22 and 23 analyze the loans in each credit union according to their purpose.[40] Table 20 shows the percentage distribution of the number of loans in each credit union. Table 21 shows the percentage distribution of the dollar amount of loans. Table 22 shows the average size of loans, and Table 23 shows the average monthly incomes of the borrowers, by purpose.

Tables 20 and 21 demonstrate that most CDCUs do a substantial amount of lending for automobiles, with CAPFCU and Watts United directing over half of their money to this purpose. It should be noted that the category "used auto" in these tables includes repairs as

Table 20
NUMBER OF LOANS BY LOAN PURPOSE

Percentage Distribution

PURPOSE	APPAL	FIRST AMER	MISSION AREA	NORTH EAST	NEJA	SANTA CRUZ	WATTS UNITED
New Auto	0.5	—	7.9	4.2	—	9.9	8.1
Used Auto	34.2	22.8	15.3	6.5	26.4	8.8	25.2
Home Impr	7.8	9.3	2.0	4.8	15.5	2.5	8.1
Debt Cons	11.4	16.3	28.7	9.5	4.5	4.2	6.8
Medical	0.5	1.4	1.0	—	2.7	0.9	2.7
Travel	5.2	6.0	9.4	4.8	—	1.1	11.3
Furniture	5.7	2.8	1.0	0.6	1.8	0.3	6.3
Christmas	14.0	4.2	1.0	—	0.9	—	—
Business	1.0	1.4	10.9	32.7	20.9	11.0	—
Real Est	2.6	4.7	3.5	6.5	8.2	0.2	—
Taxes	3.1	2.3	4.0	2.4	1.8	0.7	—
School	6.2	13.5	1.0	—	3.6	—	4.5
Credit Card	—	—	—	—	—	57.7	—
Other	7.8	15.3	14.4	28.0	13.6	2.8	27.0

Table 21
DOLLAR AMOUNT OF LOANS BY LOAN PURPOSE

Percentage Distribution

PURPOSE	APPAL	FIRST AMER	MISSION AREA	NORTH EAST	NEJA	SANTA CRUZ	WATTS UNITED
New Auto	3.5	—	13.7	3.9	—	15.8	27.2
Used Auto	50.0	22.9	13.5	2.1	20.9	7.1	25.7
Home Impr	6.1	13.2	2.2	8.8	8.2	10.2	6.2
Debt Cons	11.4	11.4	31.4	5.5	1.3	3.5	6.6
Medical	0.1	1.2	0.3	—	1.4	1.7	0.6
Travel	2.5	7.3	3.0	0.8	—	0.3	8.4
Furniture	2.6	2.3	0.2	0.0	0.6	0.1	4.2
Christmas	4.9	3.2	0.5	—	0.4	—	—
Business	0.4	1.6	16.8	48.0	44.2	28.1	—
Real Est	5.3	6.3	6.4	14.4	14.9	0.2	—
Taxes	1.8	2.5	2.4	2.3	0.2	0.3	—
School	4.6	14.6	0.4	—	4.1	—	3.6
Credit Card	—	—	—	—	—	30.7	—
Other	6.7	13.5	9.3	14.1	3.9	2.0	17.5

well as purchases. Other fairly large categories in some credit unions are business loans, debt consolidation and, in one case, credit cards.

Table 22 shows that in two of the credit unions, Central Appalachian and First American, the average size of a loan is considerably smaller than in typical United States credit unions of the same asset size.[41] In five of the credit unions, including the four that devote significant resources to business loans, the loans are on average larger than in other credit unions.

These tables present the opportunity to consider the lending experience of each credit union in some detail.

Central Appalachian People's Federal Credit Union.

At CAPFCU the typical loan size is very small (average $1,189, median $504). Only First American

Table 22
AVERAGE SIZE OF LOAN, BY LOAN PURPOSE

PURPOSE	APPAL	FIRST AMER	MISSION AREA	NORTH EAST	NEJA	SANTA CRUZ	WATTS UNITED
New Auto	7,977	—	10,401	12,783	—	10,995	12,145
Used Auto	1,738	483	5,333	4,229	2,328	5,535	3,695
Home Impr	938	683	15,400	24,938	1,564	28,539	2,790
Debt Cons	1,191	336	6,533	7,844	820	5,685	3,547
Medical	250	400	1,648	—	1,513	13,247	808
Travel	562	577	1,936	2,250	—	2,215	2,690
Furniture	542	394	950	1,000	900	2,654	2,429
Christmas	414	370	3,000	—	1,198	—	—
Business	502	538	4,969	19,782	6,213	22,669	—
Real Est	2,448	651	4,577	29,760	5,337	6,076	—
Taxes	682	527	3,587	12,875	300	2,723	—
School	889	522	2,450	—	3,275	—	2,870
Credit Card	—	—	—	—	—	1,819	—
Other	1,027	423	3,885	7,132	841	4,911	2,343
Average Size	1,189	481	5,568	13,486	2,936	7,992	3,623
Median Size	504	300	5,000	5,500	1,500		2,600
Industry Ave Size	3,581	4,214	3,164	3,581	2,618	4,054	3,164
Ave Term (mo)	15		43	44	17	48	40
Median Term	9		48	24	12	36	36

Table 23
AVERAGE MONTHLY BORROWER INCOME, BY LOAN PURPOSE

PURPOSE	APPAL	FIRST AMER	MISSION AREA	NORTH EAST	NEJA	SANTA CRUZ	WATTS UNITED
New Auto	1,857	—	2,206	3,279	—	3,166	2,228
Used Auto	1,125	1,371	1,857	2,228	983	2,573	1,939
Home Impr	1,123	1,361	2,182	5,544	1,299	6,831	1,921
Debt Cons	1,229	1,290	2,334	1,949	1,308	2,861	2,184
Medical	1,214	1,366	2,000	—	747	3,854	1,495
Travel	1,214	1,637	1,907	2,074	—	2,463	1,689
Furniture	957	1,337	1,803	1,888	1,292	2,974	1,946
Christmas	1,203	1,294	3,337	—	1,106	—	—
Business	1,023	1,798	2,801	3,685	1,788	—	—
Real Est	1,414	1,626	1,671	3,328	1,323	1,662	—
Taxes	947	1,470	2,110	2,383	1,650	3,445	—
School	1,110	1,624	1,500	—	1,581	—	1,783
Credit Card	—	—	—	—	—	2,370	—
Other	1,278	1,392	2,068	2,957	1,281	2,758	1,640
Overall	1,159	1,426	2,149	3,084	1,318	2,842	1,850

has smaller typical loans, and this is because of specific constraints that the latter's board of directors has placed on the lending policies in that credit union. At CAPFCU, the loans are small in most cases because the borrowers are poor, and cannot afford to go deeply into debt. Signature loans, without collateral, were available in 1990 for amounts up to $500 (plus loan fees), and the median loan was in fact for that amount.

Not only is the typical loan size small, but the term, or length of time for repayment, is unusually short; the usual loan is paid back in less than a year.

The loans are so small (and the borrowers so poor), that few if any of them would be attractive to commercial banks. And few of the members, we were told, qualify for credit cards at other financial institutions. So the only alternatives that CAPFCU members have for this sort of loan are finance companies, loan sharks and pawn shops, all of which charge much higher real interest rates than the credit union does.

The small size and short term of most loans impose a burden on the credit union. Each loan, no matter how small, requires staff time and attention, and those are not free commodities. A $500 loan for nine months at 15 percent annual interest generates about $25 income for the credit union, and that $25 may barely cover the staff time used to evaluate the loan, to say nothing of the credit union's other financial needs such as insurance, supplies, rent, reserves, etc. The CAPFCU board and manager are aware of this problem, and understand that since the credit union makes so many small loans it must find other ways to generate the income it needs to stay solvent.[42]

Over one third of the loans and one half of the loan money at CAPFCU are used for the purchase and repair of automobiles, and these are among the largest of the loans. This reflects the rural and isolated geography in the southern Appalachian mountains. Mountain people depend upon their vehicles for access to work, and much of their social interaction as well; for many people a working automobile is a necessity. The poverty of the area is reflected in the facts that almost none of the vehicles is new, and that the size of the auto loans, while large in comparison to most of the CAPFCU loans, is quite small when compared to the other credit unions.

Over 10 percent of the loans at CAPFCU are made for debt consolidation. As is the case at most of the other CDCUs, members find that they can turn to the credit union to organize and rationalize their debts, when they get in over their heads.

CAPFCU makes more Christmas loans than any of the other credit unions. These are normally small signature loans to pay for Christmas presents and celebrations. The board of directors has debated whether this is a proper use of credit union loan funds. There is certainly a high demand for loans for this purpose, and in fact in December 1990, Christmas loans represented more than half of the loan requests. The fact that so many people need to borrow several hundred dollars to get through the Christmas season is another indicator of the marginal economic conditions in the area, and of the response that the credit union can make to help people with their needs.

CAPFCU makes almost no business loans. However, as discussed in Section XIII, the HEAD Corporation, which is the credit union's sponsor, operates a Community Loan Fund that finances small businesses in the southern Appalachian mountain region.

Table 23 demonstrates little variation in borrower income according to loan purpose at CAPFCU (the high income figure for new autos is derived from just one loan).

First American Credit Union.

First American is the largest of the credit unions in this study, and yet the striking feature of its loans is how small they are. The average loan at First American in 1990 was just $481, and the median $300. This is a consequence of policy decisions made by the board of directors.

All loans at First American are "line of credit" loans. That is to say, a member is allocated a loan limit, after which he or she is able to borrow as often as desired, up to that limit. There is no set term on the loans; rather there is a minimum payment requirement of 3 percent of the loan balance each month, remitted through payroll deduction.

The loan limits are kept quite low. In no case do they exceed $2,500, and in the great majority of cases they are much lower. Some members have loan balances higher than this, but only if the excess over the loan limit is secured by their own savings in the credit union.

For the initial loan, and to establish the credit limit, a member at First American must fill out a standard loan application form, much the same as is found at other credit unions. Thereafter the member can request extensions over the phone or by dropping in at the office, and a staff person will fill out a very short, supplementary form. The funds are usually available the next day, if not immediately. In some respects, therefore, First American's lending program is similar to a credit card.

There are two principal reasons for this program. First is a decision made many years ago by the board that, since funds were limited, the credit union should try to spread them to as many members as possible, rather than concentrate them in just a few hands. The policy has been successful; approximately sixty percent of the members are borrowers, a very high proportion for any credit union. The board thought that, if the loan limits were kept quite low, members would use the money only for their most pressing needs, and would not be tempted to waste it or use it for low priority needs.

Secondly, the credit union finds it difficult to take collateral, and therefore judges it prudent to keep the loan limit to any one member quite low. Real estate is not privately owned on Indian reservations, and therefore the credit union cannot establish liens against real property.

Automobiles are privately owned, but the laws governing repossession on the Navajo reservation make it almost impossible for the credit union to lend against automobiles. Under the standard laws of most states, lenders can engage in what is sometimes called "self-help repossession." That is to say, if a borrower is in arrears on payments, the lender can simply collect the vehicle, provided that such collection does not provoke violence. On the reservation, in contrast, a lender can repossess only after a court hearing. Since the court process typically takes half a year, lenders understandably fear that not much will be left of the vehicle, once they have authorization to collect it. As a consequence, First American seldom lends to Navajos using automobiles as security.[43]

For these reasons, First American makes almost exclusively small, signature, line of credit loans. It does, however, make a large number of such loans. In June of 1991, for example, 2,500 new loans or extensions were made.

For First American, Tables 20 through 23 refer to extensions of existing loans as well as to completely new loans. In other words, when a member requests $150, to be added on to her existing loan balance of $900, the transaction is treated in the tables as a $150 loan.

The largest single category of loans at First American is for used autos. These are exclusively for auto repairs; as just explained, the credit union does not lend for the purchase of autos. Significant amounts are lent for home improvements and for debt consolidation. Included in the category of "other" is quite a large number of loans for religious ceremonial purposes.

School loans occupy a more important part of the loan portfolio at First American than at the other credit unions. These loans fall in three principal subcategories: tuition and supplies, school clothes, and graduation expenses.

At First American, as at CAPFCU, there is not a great deal of variation in borrower incomes according to loan purpose.

Mission Area Federal Credit Union

Of the five lowest income credit unions in the study—CAPFCU, First American, Mission Area, NEJA and Watts United—Mission Area makes the largest loans, and for the longest term. The average loan amount at Mission Area is $5,568, and the median $5,000. The average period of repayment is 43 months and the median 48 (this latter being the longest of all of the credit unions, not just the lower income ones).

Table 22 shows that the typical loan amount is relatively high in almost all of the loan categories. An additional reason for the relatively high average size of loans at Mission Area is that lending is concentrated in several categories that tend to have high amounts, in particular automobiles and debt consolidation.

Almost a quarter of the loans by number, and over a quarter by dollar amount, are for the purchase of automobiles. Of these loans, half of the money goes for the purchase of new cars, which are of course more expensive than used cars.

The largest single category of lending at Mission Area is debt consolidation, and the average loan in this category is relatively high, $6,533. There is also substantial lending for business development.

Borrower incomes are higher for new cars than for used, and business borrowers tend to have higher than typical incomes.

The credit union prides itself on its financial counseling and advocacy services. These services are particularly concentrated in the loan categories of debt consolidation and automobiles, the categories in which most of the loans are made. When the manager, Raquel Castillo, provides a debt consolidation loan, she is often able to spend time talking with the member about how better to manage his or her affairs.

In the area of automobile loans, the manager frequently works with members, to help them understand the market better, and make more informed choices. She also works with automobile dealers in the neighborhood to get favorable deals for members, and is willing to go to bat for them when she thinks they have been cheated. One story she tells is of a member who requested a loan for a car she had agreed to purchase from a neighborhood lot. When Ms. Castillo looked at the papers, she discovered that the price exceeded the published Blue Book price by $3,000. She called the lot manager to complain, and he in turn explained, in some embarrassment, that the deal had been made by a new salesman who had not realized that this customer was a Mission Area member. The lot manager agreed immediately to a $3,000 rebate, and the deal went through. Poor people are susceptible to being cheated, Ms. Castillo believes, and through this sort of advocacy work, she tries to provide them some protection.

Northeast Community Federal Credit Union

Northeast Community has the highest borrower incomes of the credit unions in the study, and it makes the largest loans.

Northeast Community concentrates on business lending. One third of the loans, and almost one half of the loan money, goes to business loans. Again, this is considered more fully below.

An interesting feature of the Northeast Community loans is how little of the money is lent for automobiles. Just 11 percent of the loans, and 6 percent of the money, is used for this purpose. The reason for this is not that the members cannot afford autos, since credit unions that have much poorer borrowers concentrate more heavily in auto loans. The reason may be that the credit union's geographical area is such a highly congested urban neighborhood that members would find automobiles to be an expensive bother, not an asset.

A considerable amount of the loan money at Northeast Community is invested into homes. Table 21 shows that home improvement and real estate loans together account for almost one quarter of the funds lent. These are typically quite large loans; Table 22 shows the average home improvement loan to be almost $25,000, and the average real estate loan to be almost $30,000. It should be noted that for the most part the real estate loans are not first mortgages; rather they are second mortgages, or supplementary loans of some other kind to help a member buy real estate. Home improvement loans are also typically quite large in Santa Cruz, but note in contrast how small they tend to be in the three rural credit unions, CAPFCU, First American and NEJA. This difference is reflective of the large difference in housing costs between rural America and urban California, and it is also reflective of differences in member incomes.

At Northeast Community, the highest borrower incomes, in categories where a substantial amount of lending is done, are found in new autos, home improvement, business and real estate, while the lowest incomes are associated with debt consolidation.

North East Jackson Area Federal Credit Union

NEJA is the smallest of the credit unions in the study and, with the exception of CAPFCU, the one with the poorest borrowers.

The most distinctive feature of the lending at NEJA is the heavy concentration on business loans: 29 percent of the loans, amounting to 44 percent of the funds. These are crop loans to independent, African-American farmers. The farmer borrowers tend to have higher incomes than the other borrowers, although as noted in Section VI this may reflect at least in part a bias in the data since the farmers are self-employed. Business loans are taken up again in Section XIII.

The emphasis on crop loans helps to raise the typical loan size above that found in the other rural credit unions. It keeps the typical loan term fairly short, however, since crop loans are almost never extended for more than one year.

Aside from the farm loans, the largest single category of loans is for automobiles—26 percent of the loans, 21 percent of the money. It is noteworthy that these loans are exclusively for used cars. There appear to be two reasons for this: first, the low-income status of the members effectively precludes them from the market for new cars, and second, the limited size of the credit union, together with its commitment to relatively large agricultural loans, reduces its ability to lend in the amounts necessary to finance new cars.

Santa Cruz Community Credit Union

Santa Cruz is the only CDCU in the study that has a credit card program, and Tables 20 through 23 give an indication of how important it is. These tables count as a credit card loan not an individual purchase made with a VISA card, but rather the authorization of a new card or an increase in the credit limit on an existing card. The amount of the loan is taken to be the credit limit; since many members do not use their cards to the limit, this means that the tables somewhat overstate the amount of credit card lending in Santa Cruz.

Over half of the loans in 1990 were credit cards and, with the caveat noted above, almost one third of the loan money.

While a credit card program might seem, at first glance, to be a kind of "upscale" feature, appealing to higher income, professional members, in fact the function of the credit card program at SCCCU has been the opposite. The VISA card has been the vehicle by which the credit union has been able to make smaller loans, to lower income members, including a higher proportion of women. Table 24 compares conventional personal loans in Santa Cruz to VISA loans (business loans are excluded from this comparison).

The role of the credit card program in Santa Cruz, of permitting smaller loans to lower income people, did not occur by happenstance; it was an explicit goal of the credit union management when the program was instituted. The fact that credit cards do not necessarily perform this function in typical financial institutions is shown by comparing Table 24 with Table 25. Table 25 shows the relative incomes, and the gender ratio, of VISA and conventional loan borrowers at an occupational credit union in central California that we have named "Mainstream Credit Union." At Mainstream, the incomes of the VISA borrowers are no lower, and in terms of the median, are actually higher, than the incomes of the conventional borrowers. The VISA credit limits are somewhat less than the typical conventional loans, but not remarkably so. And the proportion of female borrowers is significantly smaller in the VISA program than in the conventional loans. By comparison, Santa Cruz has used its credit card program to target a lower-income stratum of its membership, including a higher proportion of women, and to make smaller sized loans.

Santa Cruz does a lot of small business lending. Approximately 20 percent of the lending is for automobiles and 10 percent (by dollar amount) is for home improvement. The average amount of a home improvement loan is quite large, again reflecting the high value of housing in urban, coastal California.

As at all credit unions, the incomes of new car buyers in Santa Cruz exceeds that of used car buyers. Interestingly, incomes of real estate borrowers in Santa Cruz tend to be quite low. This is because much of the real estate lending is done to help members purchase shares in low-income cooperative housing projects.

Watts United Credit Union

The typical size of a loan at Watts United falls roughly in the middle of the credit unions studied. The loan size is the lowest, however, of the urban credit unions, and this doubtless reflects the poverty of the area and the relatively low incomes of the members.

The most notable feature of the lending at Watts United is that over half of the money is used for automobiles (including repairs). This is consistent with the freeway culture of Los Angeles and the notoriously poor quality of public transportation in that city. Without a car, residents of Watts are almost as isolated as the mountain people of eastern Kentucky (the other area where automobile loans exceed 50 percent of the loan portfolio). By far the largest loans at Watts United are made for new autos.

There is not much variation in income by loan purpose, except for the by now familiar fact that new car buyers tend to have the highest incomes of all the borrowers.

XII
BUSINESS LOANS

Four of the seven CDCUs make a substantial commitment to business loans, and a fifth is associated

Table 24
COMPARISON OF CONVENTIONAL AND VISA LOANS

SANTA CRUZ COMMUNITY CREDIT UNION

	Conventional Loans	VISA Loans	Ratio of VISA to Conventional
AVERAGE BORROWER INCOME	$3,199	2,370	.74
MEDIAN BORROWER INCOME	2,520	2,076	.82
AVERAGE LOAN SIZE	8,989	1,767	.20
MEDIAN LOAN SIZE	5,906	1,500	.25
RATIO OF FEMALE TO TOTAL BORROWERS	.40	.51	

Table 25
COMPARISON OF CONVENTIONAL AND VISA LOANS

MAINSTREAM CREDIT UNION

	Conventional Loans	VISA Loans	Ratio of VISA to Conventional
AVERAGE BORROWER INCOME	$2,791	2,787	1.00
MEDIAN BORROWER INCOME	2,100	2,400	1.14
AVERAGE LOAN SIZE	7,106	5,493	.77
MEDIAN LOAN SIZE	5,824	5,000	.86
RATIO OF FEMALE TO TOTAL BORROWERS	.54	.44	

with a business lending institution.

Most American credit unions do little business lending. In the middle of 1991, member business loans accounted for just 5.4 percent of total lending by dollar amount in American credit unions as a whole, and even in the case of those credit unions whose common bond was residential, the proportion was only 9.4 percent.[44] Instead of making business loans, credit unions in the United States typically concentrate on consumer lending. In fact, credit unions are often thought of as being by definition consumer lending institutions.

The emphasis on consumer lending at the expense of business lending is ironic, in view of the antecedents of the credit union movement. The German cooperative credit associations of the mid-nineteenth century were formed for the exclusive purpose of making business loans. In the societies founded by Herman Schulze-Delitzsch, small urban craftsmen—including carpenters, tailors and shoemakers—pledged unlimited liability in support of loans taken by any of their members. Similarly in rural areas, Frederick William Raiffeisen's Village Banks were societies in which peasants and small farmers pledged their character in support of loans. The idea spread to Italy, where Leon Wollemborg founded cooperative credit societies for farmers.[45] When the cooperative credit movement migrated to North America at the beginning of the twentieth century, however, it abandoned its commitment to business lending. The American credit union pioneers were particularly concerned with the economic plight of wage earners who were enmeshed in retail store installment-credit plans, and they saw cooperative credit unions as a way of freeing workers from that kind of trap.

The NCUA strongly encourages consumer lending and discourages business lending. In its 1991 Annual Report, it referred to business lending as "speculative," and blamed most of the financial problems of credit unions upon an overdependence on business loans.[46] The agency adopted a restrictive rule governing business lending, effective on January 1, 1992. The rule restricts the size of business loans to one borrower to 15 percent of the credit union's reserves, or $75,000 (whichever is higher), and imposes rather onerous record and reporting requirements.

What worried the NCUA were some spectacular failures of credit unions in the late 1980's and early 1990's, where there was evidence of reckless speculation in commercial ventures. The agency did not, however, present evidence that business lending, properly carried out, was necessarily excessively risky. The President of the Credit Union National Association (CUNA), Ralph Swoboda, has criticized the NCUA's stance, questioning why a third automobile or a vacation is regarded by the regulators as a provident purpose, while capital for a small business is seen as speculative.[47]

The restrictive NCUA member business loan regulations will impinge particularly on small CDCUs, some of which have returned, at least in part, to the original German tradition of lending for productive purposes. These credit unions see business lending as an important component of community development, leading to both income and jobs in poor communities.

Table 26 outlines the business lending programs of Mission Area, NEJA, North East Community and Santa Cruz Community credit unions. The first two lines show the proportion of business to total loans in the four credit unions, by both number of loans and dollar volume. The latter proportion always exceeds the former, reflecting the fact that the typical business loan is greater in size than the typical consumer loan.

Of these four credit unions, the smallest commitment to business loans is made by Mission Area. Among the sample of loans studied were several to buy equipment or merchandise for a small business. Most of the business loans in this credit union, however, went to non-profit businesses and organizations, for purposes such as covering the time gap between grants or purchasing merchandise for a fund-raising sale.

North East Jackson Area FCU in Florida is organized principally for the purpose of making business loans to independent African-American farmers. Twenty-one percent of the loans, amounting to 44 percent of the dollar volume, is used for this purpose.

Table 26
BUSINESS LOANS IN FOUR CREDIT UNIONS

	MISSION AREA	NORTH EAST	NEJA	SANTA CRUZ
Proportion of Business Loans to Total Loans -by Number of Loans	.11	.33	.21	.11
-by Dollar Amount	.17	.48	.44	.28
Average Loan Amount	$4,969	19,782	6,213	22,668
Median Loan Amount	$5,000	20,000	6,870	10,000
Average Term (months)	14	54	16	25
Average Interest Rate	14.2	12.8	15.3	13.4
Average Borrower Income	$1,939	3,685	1,788	
Average Borrower Age	50	40	50	39
Proportion Female	.54	.25	.26	.31

The loans range in size from several hundred dollars to $10,000.

By the nature of their business, farmers are debtors. They incur costs at the beginning of the growing season, and must then wait a number of months to sell their product. They borrow to cover their costs of production, and not infrequently they also borrow to cover their living expenses in the period before they sell their crops.

Almost all of the agricultural loans at NEJA are made to peanut farmers. Usually they are used for purchasing fertilizer, seeds and chemicals, at the beginning of the growing season. They are sometimes also used to buy equipment, to repair equipment or to cover living expenses. The loans are usually quite short term: sometimes less than a year, and seldom more than a year and a half; they are intended to carry the farmer over until the revenue accrues from the next crop. The payment schedules are generally unconventional. Rather than make monthly payments of equal amounts, the farmers undertake to make just one or two payments, during the harvesting season.

In some cases the credit union takes farm machinery or vehicles as collateral. In most cases, however, it takes a lien on both the crop contract and the farmer's crop insurance. Thus the credit union has double protection, with security that is valuable whether or not the crop is successful.

North East Community FCU and Santa Cruz Community CU both specialize in loans to small, primarily urban, locally owned businesses. Table 26 shows a higher concentration, in terms of both number of loans and dollar amount, at North East Community. This is in part a statistical artifact, however, resulting from the fact that Santa Cruz has a large credit card program, while North East Community does not. If credit cards are omitted from the Santa Cruz loans, then Santa Cruz makes 26 percent of its loans for business purposes (compared to 33 percent at North East Community), and it devotes 41 percent of its loan dollars to businesses (compared to 48 percent at North East Community). When this adjustment is made, the two credit unions are fairly comparable in terms of concentration on businesses.

The typical business loan at North East Community is relatively large, about $20,000, and it is made for a much longer term than is found at any of the other CDCUs, over four years. The sorts of businesses that the credit union deals with are mostly small retail establishments in the Chinatown and nearby downtown areas. They include a number of restaurants, laundries, bakeries, grocery stores and print shops. Some of the loans are for start ups, but most are for working capital, equipment and expansion of already existing firms.

While Santa Cruz directs a slightly smaller proportion of its loans to business borrowers than does Northeast Community, still the actual volume of business lending is considerably larger in Santa Cruz because the credit union is larger.

Business lending, or more broadly, community development lending, is the principal purpose of Santa Cruz Community CU. The credit union was founded in 1977 by a group of people who were dedicated to progressive social change in their community. Two years after opening their doors, they adopted what became the main identity of the credit union, the "60-40" policy. Under this policy, the goal was to allocate 60 percent of the loan money for community development purposes, and just 40 percent for personal loans. Community development loans included loans to consumer and worker cooperatives, non-profit organizations and small and locally owned businesses that were making a positive contribution to the life of the community. The thinking of the credit union leaders was that loans to encourage the creation and expansion of locally owned businesses, especially businesses that provided decent working conditions for employees, would make a more permanent contribution to the community than would strictly personal consumer loans. Personal loans were not to be excluded, but they were given a lower priority.

The 60-40 policy was adhered to by Santa Cruz Community throughout most of the 1980's, but by the time of this study in 1991 it had had to be abandoned. Business and community development loans were actually at an all time high in terms of dollar volume, but the credit union had grown so fast that community development lending could not keep up. So in 1990, community development lending represented 28 percent of total lending, or 41 percent of lending excluding credit cards.

The variety of business loans is considerably broader at Santa Cruz Community than at the other credit unions. As at Northeast Community, there are restaurants, grocery stores and print shops. Loans are also made to retail stores (toys, clothing, musical instruments and others), to professionals (attorneys, chiropractors and therapists), to small construction and trucking firms and to farmers. Among the less conventional borrowers are alternative weekly newspapers and non-profit associations in such fields as food and nutrition, public radio, nursing and peace. The credit union has put special emphasis on loans to low-income cooperative housing projects.

The three other CDCUs in this study—Central Appalachian People's, First American and Watts United—do not engage in business lending except very occasionally. In the case of First American, the reason is that the credit union has decided to restrict itself to small, personal, signature, line of credit loans. In the case of Watts United, the credit union manager does not believe that the institution has the expertise to evaluate potential business borrowers adequately, and that its cash flow is still too small to embark upon such a program. He is interested, however, in exploring the possibility of working with a state loan guarantee program, as a way of starting into the business loan field.

Central Appalachian People's stays away from business loans for a quite different reason. It works in partnership with an institution that is devoted solely to small business lending in the southern Appalachian mountains. The two groups divide the lending tasks, one specializing in business loans and the other in personal loans.

The cooperating business lender in Appalachia is the Human Economic Appalachian Development Corporation Community Loan Fund. As explained in Section IV, the HEAD Corporation was created by a task force on poverty in 1974. Since its founding, it has sponsored a variety of community development activities, including the Central Appalachian People's Federal Credit Union. In 1987, it began the Community Loan Fund. The Fund accepts deposits from "socially responsible investors" throughout the United States. These investors include individuals, corporations, churches, community organizations and foundations that have an interest in contributing to economic development in Appalachia. The deposits are made for a specific term and they receive interest; both the term and the interest rate are negotiated separately with each investor. Unlike deposits at a credit union, the deposits at the Community Loan Fund are not insured. As of mid 1991, the assets of the Fund stood at about $400,000.

Between 1987 and 1991, the Community Loan Fund provided technical assistance to 75 entrepreneurs, and made loans to 45 individuals or businesses, totalling over $600,000. These included loans aimed at revitalizing Appalachian culture, for example, Shaker crafts, pottery, quilting, rugs and homemade specialty foods. The Fund has lent to small businesses in monuments, printing, motor repair, landscaping, video and T-shirt design. Loans have also been made to non-profit organizations in housing, childcare and other social services.

The HEAD Community Loan Fund works closely with the credit union. The two organizations share the same building and the same reception area, and the small staffs interact with each other on a daily basis. A low-income housing agency (initially sponsored by HEAD, but now operated independently) is located in the same building. So while in a formal sense the Central Appalachian People's FCU does not make business loans, it is part of a broader organization that does put considerable emphasis on economic and housing development in the area.

In short, while community development credit unions are by no means uniform in this respect, many of them devote a considerable portion of their resources to business loans. They are rightfully concerned, therefore, that the NCUA's business loan regulation may restrict them unduly from achieving some of their principal goals.

XIII
INTEREST RATES AND ALTERNATIVE LOAN SOURCES

Table 27 shows the average loan interest rates, classified according to to loan purpose, for each credit union.

A number of interesting patterns are revealed by these interest rates. First, rates in the CDCUs were higher than rates in the credit union industry generally in the middle of 1991. For comparison, Table 28 shows some average rates on loans in American credit unions of various categories in the last week of June 1991. The highest rates were set on unsecured loans, while loans secured by automobiles and real estate carried lower rates. A comparison of the last row of Table 27 with the first column of Table 28 shows that interest rates on all loans in the CDCUs were close to or above the highest priced, unsecured, loans in the industry as a whole. All of the new auto rates in the CDCUs exceeded the average new auto rates in the industry, as did all of the used auto rates. Similarly, real estate rates in the CDCUs were significantly above the rates for both first and second mortgages in the industry.[49]

Second, Table 27 shows substantial differences between the CDCUs themselves. The lowest average rates are at Northeast Community, 13.9 percent, and the highest are at Watts United, 17.3 percent. Just as low-income credit unions on average have higher interest rates on loans than do typical credit unions, so also among the CDCUs themselves, interest rates are inversely correlated with borrower incomes. One way to show this is to compare the rankings of the credit unions in terms of average interest rates on the one hand, and average borrower incomes on the other, as is done in Table 29. The relationship between the two rankings is not exact, but it is suggestive. The credit union with the highest income, Northeast Community, has the lowest interest rates. Dividing the credit unions in two groups, the three with the highest incomes have the three lowest interest rates, and the four with the lowest incomes have the four highest interest rates.

Third, Table 27 shows interesting variations in interest rates within most of the CDCUs. New car loans invariably carry the lowest rates. Rates are generally below average on business loans, and higher than average on debt consolidation loans.

While there is doubtless some random variation in interest rates, there are a number of possible systematic explanations for these differences.

1. Interest rates may be higher on loans deemed by the lender to be riskier. The higher rate compensates for the higher expected rate of default.
2. Interest rates may be higher on loans on which the cost of lending is higher. For example, loans requiring expensive appraisals of collateral, or small loans in which the staff expense is high relative to the size of the loan, could be expected to carry a higher than average rate.
3. Credit unions with low overall expenses, relative to their income, may be able to set lower average interest rates on loans than do credit unions with higher expenses. That is to say, since credit unions are non-profit cooperatives, they may pass on savings in their own costs to their members in the form of cheaper loans.[50]
4. Market competition influences rates. In a geographical region in which other lenders are offering relatively low rates, or in a sector of lending (such as new autos) in which credit union members have access to inexpensive loans elsewhere, a credit union will have to offer low rates if it is to attract business.
5. Credit unions may set some interest rates as a matter of social policy, with lower rates on types of loans they are particularly trying to encourage.

This set of influences on interest rates is somewhat more complex than might be found in a typical bank or savings and loan association. One can assume that these latter financial institutions attempt to maximize net income on behalf of the shareholders, and set interest rates with that goal in mind. Credit unions, in contrast, are non-profit cooperatives. They do have to pay attention to income and expenses; otherwise they are in danger of stagnating and disappearing. But they are established for a communal purpose, to be of help to all of their members. Hence they face conflicting

Table 27
AVERAGE 1990 INTEREST RATES, BY LOAN PURPOSE

PURPOSE	APPAL	FIRST AMER	MISSION AREA	NORTH EAST	NEJA	SANTA CRUZ	WATTS UNITED
New Auto	11.0	—	12.2	11.9	—	11.2	13.0
Used Auto	14.7	16.0	13.6	13.4	16.2	13.9	16.9
Home Impr	14.9	16.0	14.5	13.7	16.8	13.0	18.0
Debt Cons	14.9	16.0	14.8	15.5	16.8	14.4	17.8
Medical	15.0	16.0	16.0	—	17.0	15.2	18.0
Travel	15.0	16.0	14.4	18.0	—	13.7	18.0
Furniture	15.0	16.0	12.0	18.0	16.5	16.3	18.0
Christmas	14.6	16.0	16.5	—	15.0	—	—
Business	15.0	16.0	14.2	12.8	15.3	13.4	—
Real Est	14.6	16.0	12.8	13.1	15.3	18.5	—
Taxes	15.0	16.0	15.1	15.6	18.0	15.3	—
School	14.3	16.0	9.8	—	15.8	—	18.0
Credit Card	—	—	—	—	—	15.9	—
Other	14.5	16.0	13.3	14.1	17.2	15.8	18.0
OVERALL	14.7	16.0	14.0	13.9	16.2	14.4	17.3

pressures in setting all of their policies, including interest rates.

It is not possible to distinguish definitively between the different influences on interest rates, but the tables in this section are suggestive.

The finding that CDCU interest rates are inversely related to borrower incomes—between CDCUs and typical credit unions on the one hand, and among the CDCUs themselves on the other—may be discouraging to people concerned with the phenomenon that "the poor pay more." It is certainly a hope that CDCUs, established for the purpose of serving low and moderate income people, could offer loans at the same rates paid by middle class Americans. The reality, however, is that the poor indeed pay more.

At least when considering the institutions in this study, one cannot explain the phenomenon by an intent to exploit poor communities, since the CDCUs are controlled by representatives of their own communities. Rather, the explanation probably has to do with differences in risk, expenses and competition.

Certainly the risks connected with lending are greater in low-income communities than in the country generally. As explained below in Section XV, each of the CDCUs in this study has experienced a period of very high loan delinquencies, far higher than in typical credit unions.

Expenses are higher in CDCU's than in average credit unions. The first row of Table 30 contains the ratios of operating expenses (excluding dividends) to income in each of the CDCUs, the second row contains the industry-wide average expense ratios in credit unions of the same asset size category as each of the CDCUs, and the third row is the ratio of the first two rows. The finding is unmistakable that CDCUs have higher expenses than do ordinary credit unions.[51]

There are a number of reasons for the relatively high expense ratios of CDCUs. They typically have to spend more staff time dealing with members, because fewer of their transactions occur in computerized payroll deduction form than in other credit unions. In some cases CDCUs find it more expensive to determine the credit-worthiness of their borrowers and to process their loans. The most fundamental reason, however, is that their members are poor, with relatively low savings balances. To understand the consequence of this, one can envision the financial effect of a member upon a credit union. The credit union generates net income from the "spread," that is, the difference between the interest earned on loans or investments and the dividends paid on savings. The contribution of the member to this net income is proportional to the member's savings, since it is the savings that generate the resources to be relent. The expenses imposed upon the credit union are for the most part independent of the member's savings. The expenses are created by transactions (that is to say, deposits, withdrawals, loans, inquiries, etc.) The number of transactions does not appear to be related to the level of savings; a member with low savings makes just as many deposits and withdrawals as does a member with high savings. Consequently a low-income member, with a small savings account, is likely to represent a financial loss for the credit union, while a high-income member with substantial savings is likely to generate a profit or a surplus. Financial institutions therefore have difficulty thriving among a low-income clientele.

Competition from other lenders probably also influences interest differences among credit unions. Middle income people generally have access to other conventional lending institutions, and if the credit

Table 28
INTEREST RATES IN US CREDIT UNIONS JUNE 1991[48]

Credit Union Category	Unsecured Loan, 2 yr Maturity	New Auto, 4 yr Maturity	Used Auto, 3 yr Maturity	First Mortgage Fixed Rate	Second Mortgage Fixed Rate
Asset Size $1 - $2 Million	14.8%	10.8%	12.7%	11.4%	11.9%
Asset Size $10 - 20 Million	14.9	10.3	12.0	10.6	11.6
Residential	15.1	10.3	11.9	10.1	11.5
All Credit Unions	14.8	10.2	11.6	10.0	11.5

Table 29
RANKINGS BY AVERAGE INTEREST RATE AND BORROWER INCOME

CREDIT UNION	RANK BY INTEREST RATE (lowest interest rate has lowest rank)	RANK BY BORROWER INCOME (highest income has lowest rank)
APPALACHIAN	4	7
FIRST AMERICAN	5	5
MISSION AREA	2	3
NORTHEAST COMM	1	1
NEJA	6	6
SANTA CRUZ	3	2
WATTS UNITED	7	4

unions want to attract their business, they have to offer rates that are competitive with those institutions. At Santa Cruz Community, Northeast Community and Mission Area, members can "shop" for loans at other conventional financial institutions in the neighborhood. In some of the poorer communities however, the only alternative to the credit union is a pawn shop, a loan shark or a finance company, where the real interest rate is far higher than at the credit union.

The managers of each of the credit unions studied were asked their impressions of the alternatives available to members. In Appalachia, Watts and on the Navajo Reservation the principal alternatives were thought to be pawn shops and finance companies. Pawn shops on the reservation are restricted to 48 percent annual interest, but in adjoining off-reservation areas the rates may rise above 100 percent. In Watts, the only conventional lenders in the neighborhood are the credit union and one branch bank, so for the most part members have to turn to the informal, high interest sector for loans. At NEJA, farmers may get crop loans from their suppliers, but here also the rates are often quite high.

None of the CDCUs in this study is completely secure financially. All of them, therefore, have a motive to keep their loan rates relatively high, in order to maintain a significant spread between the cost of funds and their income. The constraint they face in doing this is from the market; if they set their rates too high, they will not be able to attract borrowers. The data in this study suggest that this constraint is felt more severely by credit unions with more middle class members who can turn to conventional financial institutions outside the credit union for loans. Poor people lack these alternatives, and therefore find themselves paying higher rates, even at CDCUs that are designed specifically to be of help to a low-income community.

It is no secret that poor people lack ready access to conventional loans; this after all is the principal reason for the existence of many CDCUs. Banks frequently take the position that they cannot afford to operate in poor communities, where the risks and expenses are seen to be high, and so they leave the field open to less formal lenders, who charge relatively high rates.[53]

Differences in risk and in competition are probably the most important determinants of variations in interest rates within credit unions. The low rate on new cars reflects the good quality of the collateral (and hence lower risk), the relatively high incomes of the borrowers (see Table 23) and the competition from other lending institutions and automobile dealers for new car loans. Rates are generally below average for business loans also. Since this is unlikely to be a consequence of relative risklessness, one can surmise that it is a result of market competition. It may also reflect the values of CDCUs which are strongly committed to member businesses and the generation of local employment, and which may therefore attempt to encourage this type of borrowing by offering lower rates.

Table 30
EXPENSE TO INCOME RATIOS
First Half of 1991

	APPAL	FIRST AMER	MISSION AREA	NORTH EAST	NEJA	SANTA CRUZ	WATTS UNITED
Expense to Income Ratio	.49	.41	.53	.39	.58	.64	.54
Industry Ave Ratio for Same Asset Category[52]	.37	.34	.39	.37	.42	.35	.39
Ratio of First Two Rows	1.3	1.2	1.4	1.1	1.4	1.9	1.4

XIV
REPAYMENTS

Lending institutions in poor communities face two substantial obstacles to commercial success, high expenses (considered in Section XIV above) and high risks.

Risk of repayment default is the essence of banking; no lender can avoid it. Risk is substantially greater in poor communities, however, where people's discretionary incomes are relatively low and where disastrous changes in people's circumstances are relatively frequent.

Each of the credit unions in this study has had to struggle with the problems of delinquencies in loan repayments and defaults. For the most part they have handled them successfully.

Credit union regulations require each loan that is two months or more in repayment arrears to be listed as delinquent. The delinquency rate is the ratio of the balance of these loans to the total balance of the credit union's outstanding loans. Federal and state examiners require credit unions to accumulate a a reserve for loan losses, which is listed as a negative asset on the balance sheet, and which can be drawn down only to offset loans that go into default. The examiners normally require credit unions to set aside a portion of their monthly gross income for this purpose, and they may also require specific allocations to the loan loss reserve to cover particular loans that seem to be especially risky.

In mid 1991, the average delinquency rate in the credit union industry was 1.6 percent. It was 5.4 percent in the smallest credit unions, and fell continuously with the size of credit union, reaching 1.3 percent in the largest.[54] Rates such as these do not normally put credit unions at undue risk, for two reasons. First is the reserves that have been built up to compensate for the possibility of losses. Second is the fact that the charge-off rate is significantly lower than the delinquency rate. In other words, most people who fall behind in their loans eventually make good on them. For all credit unions in 1991, the charge-off rate was 0.7 percent of outstanding loans.[55] This was considerably lower than the corresponding rate for commercial banks, which stood at about 1.5 percent.[56]

Credit unions that serve the poor normally have higher delinquency rates than average credit unions. In 1991, the rate in limited income credit unions was 5.5 percent.[57]

Interestingly, delinquent borrowers in limited-income credit unions go into default less frequently than do delinquent borrowers in all credit unions. The charge-off rate in the poor credit unions (1.6 percent of loans) was 29 percent of the delinquency rate in 1991, while in all credit unions the charge-off rate was 44 percent of the delinquency rate.[58]

While delinquency and charge-off rates in these general ranges do not threaten the viability of a credit union, rates significantly above industry standards are a danger sign, and in some cases can lead federal or state examiners to liquidate or merge a credit union.

A number of CDCUs have in fact been liquidated or merged. Most of those that remain, however, are quite sound.

Central Appalachian People's FCU faced serious repayment problems in the quite recent past. The delinquency rate rose at one point to 20 percent, far higher than could be safely sustained. Once it understood the seriousness of the situation, the board of directors took the prudent action of hiring an experienced bank manager, Marcus Bordelon[59], to conduct its affairs. Bordelon instituted tighter procedures than were in effect previously, in terms both of screening loan applications and of working with already delinquent borrowers to encourage them to resume payments. Under his direction, the delinquency rate fell by mid 1991 to 11 percent, and seemed to be heading safely on a downward trajectory. Nevertheless, the delinquencies still represented a drain on the credit union's resources, and had a significant impact on the net income.

First American CU suffered from a high delinquency rate in the early years of its existence; in 1974 the rate was over 10 percent. In the last decade and a half it has been able to keep delinquencies relatively low. In mid 1991, the rate stood at 4.1 percent. This was true in spite of the fact that fully 10.5 percent of the loans, by count, were in a delinquent status. This implies that the delinquent loans were considerably smaller than the average loans in the credit union. This occurs because a high proportion of the loans have a large share secured component. A characteristic borrower may have a loan balance of $8,000, of which $6,000 is secured by his savings account, and just $2,000 is unsecured on his personal signature. If this member stops making payments, the required amounts are transferred automatically each month from his savings account, and this can go on for many months, even years. Only when the member's savings are completely exhausted does the loan officially become delinquent. By this time, of course, it is a $2,000 loan, not an $8,000 loan. Thus through the mechanism of encouraging share secured loans, the credit union manages to keep a relatively low delinquency rate in spite of the fact that economic conditions on the reservation lead to a high proportion of members being unable to make their contractual payments.

Mission Area FCU has experienced a remarkable improvement in its delinquency rate. As noted earlier, in the mid 1970's the loan balance was very small and the delinquency rate was close to 100 percent, as a result of continued neglect of the credit union. In mid 1991, the rate was approximately two thirds of one percent, with just two loans in arrears of over two months. One of the reasons for the low rate is the constraints that the credit union puts on lending. A person must be a member for three months before being eligible for a loan, since the credit union does not want people to join just in order to get a loan. For a long time there was another rule that the first loan could not exceed 10 times the member's average share balance over the last 12 months. While that rule has now been dropped, still the credit union is careful about the size of first loans, keeping the amount relatively small until the member has established a record of repayment.

Northeast Community FCU has seen a dramatic decline in its delinquency rate on loans. In 1986 the rate was as high as 18 percent, but by 1991 it had fallen to between 2 and 3 percent. The high rate in the earlier period was probably due to a certain degree of inexperience and even naivete on the part of the credit union board and staff. Loan applicants were not screened very carefully, and there were few systems in place to deal with loans that were in arrears. In some cases a group of people would take out a number of loans at the same time, and then cease making payments as a group. Once the credit union board and staff realized they were in a situation in which the very existence of their institution was in danger, they took appropriate action to correct the problem. For a period of time they hired an outside person to do collections work with delinquent borrowers. That person not only dealt with individual borrowers, but also helped the credit union to establish systematic methods for working with delinquent borrowers in the future. Under this system, as soon as a payment is late, the borrower receives a letter. If the payment is not made, the letter is followed by a phone call, and then further actions, on a specified schedule. At the same time, the credit union is more careful about checking credit references and in other ways trying to insure that new borrowers are credit worthy. These new policies have worked; the delinquency rate has fallen steadily.

North East Jackson Area FCU has also struggled with loan delinquencies. In 1980 the rate reached 30 percent, and then again in 1986 it was over 10 percent. Each time, the federal examiners threatened to liquidate the credit union, and only intense negotiation averted that fate. At NEJA, as at other CDCUs, the picture completely reversed. In 1991, the rate stood at just 2.2 percent, with only six loans in delinquent status. Credit union leaders attribute the turnaround to better screening of loans and counseling of borrowers, more secure collateral, and the institution of a coherent system for keeping in touch with borrowers who have fallen behind in their payments.

Santa Cruz Community CU had a relatively low delinquency rate on loans, fluctuating between 1 and 2 percent during 1991. The rate on community development or business loans was somewhat higher, at about 5 percent, than the rate on personal loans of about 1 percent. The repayment picture was not always so positive. The credit union opened its doors to savers in the middle of 1977 and began lending at the beginning of 1978. A year later, at the beginning of 1979, the delinquency rate on its loans was approximately 20 percent. The people authorizing the loans had not made good judgments, and they had not communicated clearly to the borrowers what their obligations were. Some of the borrowers, on their part, had thought that since this was a cooperative community organization and not a formal bank, they would not really have to make repayments. In fact some of the delinquent borrowers felt quite betrayed and angry when they were later pressed by credit union representatives for repayment. In response to the crisis in delinquencies, the credit union closed its doors to lending for four months in 1979 while the board rethought its lending policies. When lending was resumed there were new loan officers in place and a new set of lending policies. Borrowers received clear information, at the time of the loan, about their responsibilities, and systems were established to make contact with borrowers just as soon as a payment was late. In mid 1979, the state regulatory agency summoned the board of directors to an emergency meeting in San Francisco, to discuss the crisis in repayments and whether the credit union should be closed. By that time, however, the board had clearly understood the problem and was taking appropriate action to correct it, so the examiners agreed to give the credit union time to reduce the delinquency rate. The rate did come down steadily; within a few years it was within the 3 to 4 percent range, and then later it fell even lower.

Watts United CU had a loan delinquency rate of approximately 5 percent in 1991. Delinquencies were a continuing problem for the credit union, with its low-income membership located in an economically depressed neighborhood. The problems were compounded in a period of economic recession. The delinquency rate actually approached 10 percent in 1986 and 1987, when three companies that were on a payroll deduction plan laid off many of their workers. These were plants that offered their employees the service of making their loan payments automatically. One went into Chapter 11 bankruptcy, one was closed by the Internal Revenue Service because of failure to withhold taxes, and one laid off a significant proportion of its work force. Many of the newly unemployed workers walked away from their credit union loans. They lacked the resources to pay, and in addition many of them apparently believed that the loans were related to their employment, and when their employment was terminated their debt obligations ceased. In the face of such threats to its continued well being, the credit union adopted policies to help protect the safety of its loans. For about ten years, it has required borrowers to freeze a proportion of their loan in their share account. As of 1991 the proportion was 20 percent for first time borrowers, and 15 percent for repeat borrowers. Funds equal to this amount must be left untouched in the member's account for the life of the loan, and can be used only for making the final payment if the member wishes.[60]

There is a common pattern to the loan delinquency experience of these CDCUs. All of them experienced high delinquency rates in the past, so high as to threaten the continued existence of the credit union. The particular reasons differed from credit union to credit union, but the common thread, in all cases but one, was a certain degree of naivete. The exception is Watts United CU, where the high delinquency rate was caused by unexpected layoffs by three large employers with payroll deduction plans. In all of the other cases the basic problem was that the credit union managers did not expect members of a community-based, cooperative organization to be remiss in their obligations. They were therefore insufficiently careful in screening loan applicants, and they also neglected to have systems in place to deal with borrowers immediately when they were late with their payments.

In each case the credit union learned through hard experience that good will is not enough. It learned that the credit union cannot make a loan to a member simply because the member needs the money; the member must also demonstrate the ability to repay. As one of the staff members at Central Appalachian People's FCU said, "Sometimes these applicants don't need a loan; they need a grant. We don't give grants, but we can help them find an agency that does." The credit union also had to establish a systematic routine for contacting borrowers just as soon as their loan payment was late. If the problem was identified early, there was a good chance that it could be averted; later, the problem was often too large to be reversed.

All of the CDCUs in this study successfully learned these lessons. They demonstrate that while delinquencies are always apt to be a problem in a low-income community, nevertheless through carefully thought out policies and systems, the credit unions can keep repayment problems down to an acceptable level. Of course, the credit unions in this study are representative of the survivors; over the years, some CDCUs were unable to solve the delinquency problem, and disappeared.

XV
POOR PEOPLE'S CREDIT UNIONS: STRATEGIES FOR SURVIVAL

Each one of the seven CDCUs in this study serves the financial needs of a low-income community, as do all CDCUs. The question arises of how they are able to do this and survive, when banks and savings and loan institutions often find it unprofitable to operate in such areas. The very existence of CDCUs is a reflection of the fact that other conventional financial institutions are not operating in this niche; if they were, there would be much less need for CDCUs. Is there something special about at least some CDCUs that allows them to serve poor people successfully, when other financial institutions cannot?

A fully satisfactory answer to this question would require an examination of the entire business operations of the CDCUs, a task which is beyond the scope of this study which focusses particularly on lending. Some tentative answers can be advanced, however.

The success of these seven credit unions conveys some hints about productive strategies. All seven have had strong management, and their board members have been willing to educate themselves in the basic principles of credit unions. In addition, they have found ways of bringing outside funds into partnership with the resources of their own low-income communities.

There are at least three ways of bringing outside resources into a low-income credit union: non-member deposits, grants and a broad field of membership that includes middle-income people.

Normally, credit unions can accept deposits only from members. However, an act of Congress in 1974 established the category of limited income credit unions, and allowed the credit unions so designated to accept deposits from non-members. This proved to be an important provision, as it allowed CDCUs to solicit deposits from foundations, religious organizations and other socially responsible investors. In recent years, the National Federation of Community Development Credit Unions has served as a conduit between some outside investors and member credit unions.

Non-member deposits help a limited-income credit union in two ways. First, they allow the credit union to increase lending within its community, in cases in which loan demand is outstripping member savings. Second, they can improve the financial condition and profitability of the credit union; the credit union benefits from the spread between what it pays the investor on the deposit and what it can earn by lending or investing the money. Little or none of this income is consumed in credit union expenses related to the deposit, since there are typically few transactions on a non-member deposit.

In December 1988 the NCUA significantly reduced the value of non-member deposits to limited income credit unions, by restricting the amount of such deposits to 20 percent of shares. It did this as a response to extraordinary fraud in a CDCU in Omaha, Nebraska, in spite of the fact that there was no evidence that non-member deposits caused the malfeasance in that credit union. In response to protests from credit unions, the agency did make provision for exceptions to the 20 percent rule.[61]

In 1990, the NCUA resumed its program of making $200,000, five year, low interest loans to some limited-income credit unions. While these resemble non-member deposits, they are not subject to the 20 percent limitation.

The second way of bringing outside resources into a CDCU is through grants. In some cases the grants consist of subsidies from a sponsoring agency, for example a community action program, and in other cases they come from foundations and other agencies.

The third principal way in which a CDCU can bring outside resources into partnership with poor people is to combine middle-and low-income people in the same field of membership. If the credit union can attract sufficient middle-income members, their savings can help to support the more expensive work that the credit union does with poor members.

These strategies have been adopted by some of the credit unions in this study.

Central Appalachian People's FCU has brought both deposit and grant money from the outside, to help mould a successful credit union for Appalachian people. In 1991, about half of the credit union's deposits came from its members, and about half from outside non-members, roughly $900,000 in each category. The non-member deposits came from religious organizations including the Campaign for Human Development, and also from the National Federation of Community Development Credit Unions. The credit union also qualified for a revolving loan of $200,000 from the NCUA. The credit union actually has experienced no difficulty in attracting non-member deposits. The only limit is the cap imposed by the NCUA; while the agency has relaxed its usual 20 percent limit on non-member deposits, it has not been willing to allow CAPFCU to increase these funds beyond the current level.

CAPFCU also depends upon outside support for some of its expenses. The staff salaries are partially paid by the parent HEAD Corporation. Without these kinds of outside support, it is doubtful if CAPFCU could provide the sort of service it does, and perhaps even survive.

First American CU is less dependent upon outside resources. It has often sought non-member deposits, but the reason has been not so much to generate the income needed for survival, as to permit continued lending when loan demand has outstripped savings. In 1991 its loan demand was relatively low, and so it did not need to solicit outside funds.

Mission Area FCU depends in important ways upon outside resources. It was virtually rescued, early on in 1979, by an NCUA $200,000 loan. At that time, the assets of the credit union stood at just $100,000, so the outside loan tripled the size of the credit union and transformed it. In the same year, 1979, Mission Area received a small grant from the Vanguard Foundation, enabling it to hire an employee. The grant was for a limited period, and when it ran out, the credit union had to resort to a purely volunteer basis once again. Regular staffing was not possible until 1988, when the San Francisco Foundation provided another grant, this one permitting a part time manager to move to full time status and a second and later a third full position to be created. The San Francisco Foundation grant was to run for three years, but the credit union turned down the third year of support, in part because it could be self-sufficient without the grant, and in part because of a contradiction between the Foundation's requirements and those of the NCUA examiners. The former wanted the credit union to demonstrate a financial loss, in order to justify the grant, while the latter insisted that the credit union generate a profit. In any case, the grants permitted the credit union to hire the staff who in turn helped the credit union to grow to a point that it could survive independently of grants.

Mission Area has also made extensive use of non-member deposits. In 1991, it had deposits from the Campaign for Human Development, the Fund for the Common Good, the Gerbodi Foundation, the Presbyterian Church, the Calvert Fund and the National Federation of Community Development Credit Unions. In order to accept these deposits, it had to obtain a waiver from the NCUA, to allow it to exceed the 20 percent limit by $350,000.

Northeast Community FCU has two strategies for thriving in a low-income community: soliciting of non-member deposits, grants and loan guarantees; and attracting middle income members to balance the low-income members. The credit union accepts non-member deposits from private foundations and non-profit investment funds, and also from other credit unions. In 1991 these amounted to approximately 20 percent of total assets, although the credit union received a waiver from the NCUA to exceed that limit. It also had two substantial loan guarantee programs that were financed by outside agencies. The Center for Southeast Asian Refugee Resettlement (CSEARR) used a grant from the Ford Foundation to establish a Refugee Revolving Loan Fund in the credit union; the fund provided partial guarantees to Southeast Asian immigrants starting new businesses. This was not actually a non-member deposit, since CSEARR is located within the field of membership. In another program, the credit union had a grant of $160,000 from the Office of Community Services, a federal government agency, which guaranteed loans to garment, printing and import-export businesses for the purpose of creating jobs.

The second part of Northeast Community's strategy is to solicit participation from a range of people within its field of membership, not just the poor. As Table 5 shows, the median and average incomes of borrowers are higher at Northeast Community than at the other credit unions studied. The partnership of different income groups in the credit union relieves the institution from having to make ends meet purely out of its business relationships with the poor.

Of the seven CDCUs studied, North East Jackson Area FCU has had the least help from the outside. Most southern black credit unions founded in the 1960's were sponsored by a community action program that covered at least some of the expenses, but NEJA was on its own from the beginning, without CAP sponsorship. There have been some non-member deposits, most notably from the Presbyterian church. In 1991, NEJA succeeded in being included in the NCUA Revolving Loan Fund program. The most important feature of the credit union's success, however, has been the stability of its membership, in particular the core group of independent farmers.

Santa Cruz Community CU depended upon outside grants during its earliest years, most importantly a three year grant from the John Hay Whitney Foundation that paid for staff salaries at a time when the earned income was relatively low. A 1979 loan from the NCUA Revolving Loan Fund also helped to increase the credit union's income. By the early 1980's, the grants and subsidies were exhausted, and the credit union had to survive on its own. There have been few non-member deposits; most came after the earthquake of October 1989, when several credit unions around the country, including First American, made deposits to try to help the Santa Cruz credit union cope with that natural disaster. The more important reason for Santa Cruz' commercial success has been the partnership between middle- and low-income people. The mission of the credit union—community economic development and economic democracy—has attracted sympathetic middle-income and even a few high-income people. The greater part of the deposits come from these people. They are often interested in borrowing money for themselves, but what keeps them attached to this particular credit union is the social commitment of the institution to improve living conditions for the poor. Like Northeast Community, therefore, Santa Cruz has been able to forge a partnership of people in quite different economic circumstances, to the benefit of all.

Watts United Credit Union has become completely self-sufficient. It was founded, however, with outside money, in response to the riots of 1965, and for the first years many of its expenses were paid by its sponsor, the Westminster Association. Over the years since then, it has attracted few non-member deposits, and its subsidy has disappeared. Its members are for the most part poor; while the credit union has a few professional and middle income members, they constitute a small portion of the membership. Faced with a lack of outside resources, Watts United has fought for survival by using the pricing mechanisms available to it. As shown in Section XIV, Watts United charges the highest interest rates on loans of all the credit unions in this study, and pays the lowest dividend rate on savings. This might seem disadvantageous to the members, but the reverse is really the truth. The members at Watts United have few alternatives to the credit union except pawn shops and loan sharks, which charge much higher interest rates. So by setting rates sufficient to generate a spread that allows the credit union to survive commercially, the leaders of the credit union provide for a source of comparatively low interest loans for the members. If Watts United attempted to match the rates of other CDCUs, while at the same time lacking the outside support that many of them have, it might fail as a business entity.

In sum, financial participation by the non-poor, while not absolutely necessary in every case, seems to be an important feature of CDCU success. Even when it is not required for the survival of the institution, it permits the CDCU to make a greater impact on the economic development of its low-income community.

It must be recognized that there are constraints on the use of each of these strategies. In the case of non-member deposits, a serious restriction is created by the NCUA's 20 percent cap, even though exceptions are granted in some cases. The NCUA takes the position that these deposits are likely to be unstable, and that a credit union is in danger losing its asset base if it depends upon them. None of the credit unions in this study has experienced this problem, however, and it appears that the NCUA concern may be misplaced. Of course non-member deposits may be withdrawn, but they are generally done so with considerable prior warning and even negotiation, so that the credit union can plan adequately for any liquidity problem that the withdrawal might create. Non-member deposits in CDCUs can be a powerful tool for bringing private outside resources into poor communities, and one would think that a public agency would want to encourage the prudent use of this tool, not discourage it.

The constraints on grant support are not only that grants are limited in availability, but that a credit union needs to invest resources, and develop sophistication, in order to approach granting agencies.

Several constraints may impede the creation of a mixed-income membership. Some credit unions—for example, First American and Watts United—are located in areas in which there are few higher-income people to begin with. Yet even where higher-income people are nearby, the CDCU may not be able to structure itself in such a way as to attract them. Sections XIV and XV showed that low-income credit unions tend to have higher expenses and higher delinquency rates on loan repayments than do average credit unions, and that as a consequence, they must charge higher interest rates on their loans. Middle class people have access to other financial institutions that are able to charge lower rates, and so they may be reluctant to join a credit union with a significant number of poor borrowers.[62]

Santa Cruz and Northeast Community, the two credit unions under review that have attracted significant middle-income members, have kept their interest rates on loans at a moderate level. There is more to their success than just interest rates, however; in both credit unions, middle-income people have had non-economic reasons for joining. In Santa Cruz, the appeal of the credit union could be called political or social, or even ideological. The credit union is connected to the strong local progressive movement, and many middle class people are members precisely because the institution's purposes are to serve low-income people and to promote community development. At Northeast Community, some more affluent members have developed a strong loyalty over the years to an institution that is dedicated to serving Asian immigrants. Absent these common purposes, it is very difficult to bring the different income groups together in a single credit union, as the experiences of Central Appalachian People's, NEJA and Mission Area show.

XVI
POLICY RECOMMENDATIONS

This study shows that CDCUs can be successful at directing capital towards low-income people in impoverished communities. In view of this success, and in view of the pressing need for economic development in poor areas of the country, it would behoove government regulatory agencies to search for ways to encourage the creation and expansion of CDCUs. They are, after all, a private sector initiative in poor communities, and they require not massive public funding, but just a little public encouragement.

Throughout the 1980's and early 1990's, however, the thrust of federal government policy has been the opposite. There have been a few positive signals, such as the renewal, after a hiatus of a decade, of the NCUA Revolving Loan Fund for limited-income credit unions. For the most part, however, government policy towards credit unions has been driven by the debacle in the savings and loan industry and the dangerous condition of the banks. Federal regulators have been concerned, as they should have been, to insulate the credit union sector from these financial catastrophes. At times, though, their concerns have translated into policies that have stifled the development of CDCUs. There seems to have arisen an attitude, among at least some of the regulators, that credit unions of the poor are by definition a threat to the stability of the credit union system.

It should not be so difficult to develop regulatory policies that protect the safety and soundness of credit unions and their share insurance fund on the one hand, and that promote the growth of credit union services to the poor on the other. The CDCUs share the goal, after all, of promoting their own stability and survival.

Changes in three specific areas of regulation could enhance credit union services to the poor: business lending, non-member deposits and the chartering of new credit unions.

It is appropriate for the NCUA to regulate member business lending, in the interest of protecting the share insurance fund, because commercial lending can be risky. The regulators should specify criteria for judging the soundness of business loans and for securing them. What they actually did in 1992, however, was to lower considerably the maximum size of a business loan, and to impose onerous record-keeping requirements on all business loans of even the smallest size. These two changes have the effect not of improving the quality of business lending but of reducing the quantity. They therefore inhibit the ability of CDCUs to promote economic development in their communities. The experience of the credit unions examined in this study is that they are capable of making sound business loans if they choose to develop expertise in this area. The goal of regulatory policy should therefore be to improve the soundness of business loans, not to move credit unions away from them.

Non-member deposits are the principal way in which CDCUs can bring outside resources into partnership with funds from their own communities. As shown in Section XVI, non-member deposits can expand the ability of a CDCU to lend to its members, and they can even be critical to the financial success of the institution. Federal regulations do not allow non-member deposits in most credit unions, however; in low-income credit unions non-member deposits are restricted to 20 percent of member shares.

In most low-income credit unions, the 20 percent rule has not been unduly restrictive. According to NCUA data, only 57 of 156 limited-income credit unions accepted non-member deposits in 1991, and non-member deposits were less than 10 percent of shares in 19 of these credit unions.[63] But some credit unions pressed the regulatory limits, and even when exceptions to the 20 percent rule were granted, the regulations probably reduced non-member deposits below what they would otherwise have been. Furthermore, the existence of the limit inhibits low-income credit unions from searching aggressively for outside support.

The concern of the regulators is that relatively large non-member deposits are likely to be an unstable resource for credit unions, and that therefore undue reliance upon them can put the credit union at risk of illiquidity and insolvency. To date, however, this is just an assertion; the NCUA has presented no systematic evidence that non-member deposits increase the riskiness of a credit union. In any case, the agency could certainly develop regulations designed to reduce the risk of non-member deposits, rather than constrain their amount. For example, non-member deposits beyond a certain level could be allowed only if withdrawals were preceded by several months' notice, or if withdrawals could only be made in small increments. A creative, imaginative response by the NCUA could both encourage the flow of financial resources into poor communities and reduce the risk of those flows.

Finally, the NCUA should reverse its policy of chartering only a few new credit unions. The number of new charters has fallen steadily since the 1960's, reaching a low of 14 in 1991. In that same year, the NCUA cancelled 291 charters, for a net loss of 277 federal credit unions. The number of federal credit unions fell from a high of 13,555 in 1970 to 8,352 in 1991. The NCUA is not alarmed by this trend, since membership in credit unions continues to increase each year.[64] It states that members of liquidated or merged credit unions can be and in fact are being served by larger credit unions. While this may be so in middle-income communities, it is not the case among many of the poor. In fact, the poor often lack access to any conventional financial institution. The decline in the number of credit unions is occurring at the same time that many bank branches in poor neighborhoods have been closed.

Voices in the credit union movement have called for a dramatic reversal in chartering policy. CUNA has developed a program named Moonshot to expand credit union membership from approximately 60 million Americans to 100 million by 2000. It recognizes that many of the new members will have to come from among the relatively poor, and that this in turn will require the creation of new credit unions. The National Federation of Community Development Credit Unions has made a more modest proposal to the NCUA, that it charter 10 new CDCUs each year for three years, for a total of 30 new poor people's credit unions.

At present, the number of limited-income or community development credit unions is fairly small. As this study demonstrates, they can be an effective instrument for bringing financial services at moderate cost to the poor, and for encouraging economic development where it is most needed. There is every reason for public policy to promote the expansion of these institutions.

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FOOTNOTES

[1] Isbister is Professor of Economics and Provost of Merrill College in the University of California at Santa Cruz. Thompson is a graduate student in Sociology at UC Santa Cruz. Both are on the Board of Directors of the Santa Cruz Community Credit Union.

[2] Federally chartered credit unions have the word "Federal" in their name.

[3] Credit Union National Association. *Credit Union Operating Ratios and Spreads, Mid-Year 1991.* Madison, Wisconsin: CUNA Economics and Research Department, 1991: Table 25b.

[4] National Credit Union Administration. *1991 Annual Report.* Washington DC, 1992.

[5] Lawrence J. White. *The S & L Debacle, Public Policy Lessons for Bank and Thrift Regulation.* New York: Oxford University Press, 1991: 15.

[6] Lindsay L. Neunlist. "Limited Income Credit Unions," an unpublished report presented to the National Credit Union Administration Board. Chicago: May 7, 1992.

[7] Kathryn Tholin and Jean Pogge. *Banking Services for the Poor, Community Development Credit Unions.* Chicago: Woodstock Institute, 1991.

[8] John Earnest Johnson. "Low-income Credit Unions: Failures that Lead to Success." A Master's Thesis Submitted to Antioch University, Yellow Springs, Ohio: 1991.

[9] Linda Hoke. "Community Development Credit Unions—A Powerful New Vehicle for Southern Economic Development?" *Southern Growth Reports* 2 (March 1991): Southern Growth Policies Board, Research Triangle Park, North Carolina.

[10] Neunlist. "Limited Income Credit Unions," op.cit.

[11] Clifford N. Rosenthal and Joseph Schoder. "People's Credit, A Study of the Lending of the Lower East Side People's Federal Credit Union," New York: National Federation of Community Development Credit Unions, 1990.

[12] After the study was completed, the delinquency rate at LESP FCU increased; in December 1991 it stood at 8.7 percent.

[13] At least one other CDCU has studied the income and other characteristics of its borrowers. An in-house study of the loan applicants from October 1989 to September 1991 at Vermont Development Credit Union in Burlington, Vermont revealed that the median annual income was between $10,000 and $15,000. Private communication from Caryl J. Stewart, President of the Vermont Development CU, May 15, 1992.

[14] It is an imperfect indicator. Assets per member can be increased by the acceptance of large institutional deposits, and the ratio can be reduced if members choose to keep some of their assets in other financial institutions.

[15] Neunlist. "Limited Income Credit Unions," op. cit.

[16] Calculated from data in CUNA. *Credit Union Operating Ratios and Spreads*, op. cit.

[17] *CAPFCU Annual Report.* 1990: 15.

[18] Quoted in Hoke, "Community Development Credit Unions," op. cit.

[19] First American Credit Union. *A History of First American Credit Union.* Window Rock, Arizona: 1983.

[20] That is to say, the credit union does not have its own ATM, but members can conduct transactions on ATMs operated by certain other institutions. It is quite unusual for a credit union of such a small size to have access to an ATM service.

[21] Some of the information on NEJA FCU comes from Johnson. "Low Income Credit Unions," op. cit.

[22] On the OEO credit unions, see Peter Livingston. "The Crisis in Limited Income Credit Unions." Madison, Wisconsin: Credit Union National Association, 1973.

[23] The Woodstock Institute in Chicago, which is investigating the history of the OEO credit unions, is having some difficulty identifying the ones that have survived.

[24] Low income credit unions in California generally report that they have received consistent support from the state League, the trade association of all credit unions in the state. In some other states, however, credit unions serving the poor report indifference and in some cases even hostility from their leagues.

[25] At the time of writing, the poverty rates by county were available only from the 1980 Census. However, the overall poverty rate in the country changed hardly at all over the succeeding decade. See United States, Bureau of the Census, *Statistical Abstract of the United States, 1991*. Washington DC: 1991, Table 748.

[26] The effect of differences in the cost of living is explored below in section XI.

[27] Sources:

1. Navajo Nation, Fax 88 Technical Support Department. Commission for Accelerating Navajo Development Opportunities. Window Rock AZ: September 1988.

2. *1980 Census of Population*, Vol. 1, Chapter B, General Population Characteristics, Part 4: Arizona PC80-1-B4.

3. *1980 Census of Population*, Vol. 2, Subject Reports, American Indians, Eskimos and Aleuts on Identified Reservations and in the Historic Areas of Oklahoma (Excluding Urbanized Areas): PHC80-2-1D.

4. *County and City Data Book, 1988: States, Counties, Cities of 25,000 or More, Places of 2,500 or More.*

5. Census Tracts, Los Angeles, Long Beach, California. Standard Metropolitan Statistical Area, Section 2 of 4, Census of Population and Housing. U.S. Department of Commerce, Bureau of the Census: PHC80-2-226.

6. Census Tracts, San Francisco, Oakland, California. Standard Metropolitan Statistical Area, Section 1 of 2, Census of Population and Housing. US Department of Commerce. Bureau of the Census: PHC80-2-321.

[28] Per capita income for 1985 is interpolated.

[29] The loan purpose shown is not the median, but rather the most frequently cited purpose. The rows labelled "jobs" and "housing" show the employment status and the housing status respectively of the majority of the borrowers.

[30] Real estate is not privately owned on Indian reservations.

[31] *Statistical Abstract of the United States, 1991*, op. cit.: Table 736.

[32] *Statistical Abstract of the United States, 1991*, op. cit.: Table 12.

[33] "Human capital," as the term is used by economists, is accumulated skills resulting from education and on-the-job training that allow a person to be a productive member of the labor force. The seminal presentation of the theory of human capital is Gary S. Becker. *Human Capital, A Theoretical and Empirical Analysis, With Special Reference to Education*. 2nd. Edition. Chicago: The University of Chicago Press, 1975.

[34] ibid., Chapter VII.

[35] Richard B. Freeman. "The Effect of Demographic Factors on Age-Earnings Profiles." Chapter 4 in *Labor Markets in Action, Essays in Empirical Economics*. Cambridge: Harvard University Press, 1989: 74-102.

[36] Since dummy variables were used for each credit union except Santa Cruz, the dummy coefficients can be interpreted as the typical difference in borrowers' incomes between the credit union in question and Santa Cruz.

[37] Again, the seminal work is Becker's *Human Capital*, op. cit.

[38] Note the statistical curiosity, that in those cases in which age is negatively associated with income, the age standardized adjustments do not follow the normal patterns. Thus among female borrowers at Mission Area the relatively high age does not lead to a negative adjustment, while at NEJA (females) and at Watts United (males), standardization to a younger age distribution actually increases average income.

[39] American Chamber of Commerce Researchers Association. *Cost of Living Index, Comparative Data for 246 Urban Areas* 23. Louisville, Kentucky: Fourth Quarter, 1990.

[40] These tables are not directly comparable with the data on loan purpose compiled by NCUA and CUNA. The latter really classify loans by collateral type, not by the purpose for which the proceeds will be used. Thus, for example, an unsecured, personal loan which a borrower expects to use to purchase or repair an automobile will be classified by the NCUA as "unsecured" but in Tables 20 through 23 as "automobile." Note also that the loan purpose is stated in the borrower's own words on each application. Construction of Tables 20 through 23 therefore required some interpretation in borderline cases, particularly when more than one purpose was given.

[41] The data on industry-wide averages come from CUNA, *Operating Ratios and Spreads*, op. cit.

[42] In 1992, the CAPFCU board of directors instituted a $15 loan application fee, to help recover some of the costs of making small loans.

[43] We were told that Navajos usually finance their vehicles from dealers and finance companies that are located off the reservation, for example in nearby Gallup, New Mexico. These dealers are of course subject to Navajo law when they come on to the reservation. So in order to repossess, they typically wait until the borrower drives off the reservation, for example to go to a grocery store in Gallup, and repossess the car there. There are stories of Indian women walking out of a store to find their car vanished. It was because First American was unwilling to engage in this sort of practice that it decided not to lend against vehicles on the Navajo reservation. In 1992, it did begin making a few automobile-secured loans to members living on other reservations in Arizona where the Navajo repossession law does not apply.

[44] CUNA, *Operating Rations and Spreads*, op. cit. In contrast, see Table 20 above, where in four of the CDCUs, business lending ranged from 17 to 48 percent of total lending.

[45] The European origins of modern credit unions are described in Jack Dublin. *Credit Unions, Theory and Practice*. Detroit: Wayne State University Press, 1979.

[46] National Credit Union Administration, *1991 Annual Report*, Washington DC, 1992, p. 7.

[47] Speech at the annual meeting of the National Federation of Community Development Credit Unions, Chicago, May 8, 1992.

[48] Source, CUNA, *Operating Ratios and Spreads*, op. cit.

[49] The finding that CDCU interest rates exceed industry-wide interest rates is confirmed in Neunlist, "Limited Income Credit Unions," op. cit., Table 8.

[50] Under credit union regulations, surplus earnings may be returned to borrowers at the end of an accounting period in the form of an interest rebate (much like a patronage refund in a consumer cooperative). This has never occurred in the seven CDCUs in this study, and seldom occurs in any credit union. Instead, the surplus is divided between dividend payments (that is to say, interest payments to members on their savings) and the accumulation of reserves. It is quite possible, however, that the surplus earnings are "spent" in advance, by charging reduced interest rates on loans in the first place.

[51] Again, this finding is confirmed by data presented in Neunlist. "Limited Income Credit Unions," op. cit.: Table 13.

[52] Source: CUNA, *Operating Ratios and Spreads*, op. cit.

[53] Recent evidence indicates, however, that these informal, sometimes exploitative, lenders in poor neighborhoods often receive their financing from the very banks that refuse to do business directly with poor people. See John R. Wilke. "Some Banks' Money Flows Into Poor Areas—And Causes Anguish." *The Wall Street Journal*: October 21, 1991.

[54] CUNA. *Operating Ratios and Spreads*, op. cit.

[55] Neunlist. "Limited Income Credit Unions," op. cit.

[56] We are grateful to Bill Hampel, Vice President and Chief Economist for CUNA, who has suggested a reason for this disparity. Bank managers are encouraged to take risks, because if the risky venture succeeds, all of the gains accrue to the stockholders who will likely compensate the managers generously. If the venture fails to such an extent that the bank collapses, the federal insurance fund covers a high proportion of the losses. This is known as the "moral hazard" problem in economics, and it is held to skew decision making. Credit union managers are protected from losses by an insurance fund, similar to the one that protects banks, but they do not stand to gain particularly from unusually successful ventures. Since the credit union is a non-profit cooperative, surplus income accrues to all of the members, not to the decision makers in the institution. Hampel argues that, since credit union managers will not benefit from big successes, they are reluctant to undertake big risks, and that this is the cause of the relatively low charge off rate in credit unions. He further argues that credit unions take fewer risks than they should, if they were to make an optimal social contribution to their membership.

[57] Neunlist. "Limited Income Credit Unions," op. cit.

[58] ibid.

[59] Bordelon had been the chief executive officer of a bank in rural northern Louisiana, and then for a period of years had been a VISTA volunteer, working with Vietnamese immigrants in Louisiana, before taking his position at CAPFCU in 1990.

[60] Note that this practice has the effect of raising the "real" interest rate, that is to say, the interest paid (net of dividends earned) as a proportion of the usable loan proceeds. Formally the entire loan is available to the borrower, and the frozen savings come from a different source. One could interpret this, however, as being a situation in which only 85 percent of the borrowed funds are available to the borrower, and 15 percent are frozen. The frozen shares earn a dividend for the member, but the dividend rate received on the savings is invariably less than the interest rate paid on the loan (about 3.5 percent vs. 17 percent in 1991). Therefore the borrower is paying net interest on funds that he or she cannot use. Consequently the average loan interest rate at Watts United, shown in Table 26, which is the highest of all the credit unions studied, is actually an underestimate of the "real" interest rate.

[61] See Tholin and Pogge. *Banking Services for the Poor*, op. cit.

[62] The NCUA study of limited income credit unions is pessimistic about the possibility of combining upper and lower income members in the same institution: "Setting interest rates commensurate with a certain credit risk level selects a part of the market. It appears unlikely that one institution can serve both middle- and upper-income households with good credit at the same time it meets the needs of lower income households who are more likely to have had credit problems." Neunlist. "Limited Income Credit Unions," op. cit.

[63] Neunlist. "Limited Income Credit Unions," op. cit.

[64] NCUA. *1991 Annual Report*, op. cit.: 28-9.

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