VIEWPOINT

Reconsidering the Need for Personal Loans

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Low-income consumers lack access to equitable loans, so nonprofits need to fill the gap.

When I started Capital Good Fund in 2009, I was inspired by Grameen Bank founder Muhammad Yunus and his model for tackling poverty in Asia through microbusiness lending. The idea immediately struck a chord with me. Impoverished people with an entrepreneurial spirit could be helped toward self-sufficiency through microloans in the United States, too. So with the goal of reducing poverty in America, I set up shop with two others who also were affiliated with Brown University to offer loans of up to $3,000 for income-generating activities, such as home-repair services or catering.

Asking the End User

It didn't take long, however, for us to see that lower-income individuals and families had other, perhaps more urgent, needs. As we spoke with our clients and conducted our own research, we gained deeper knowledge of the $100 billion predatory financial-services industry—payday lenders, check cashers, rent-to-own stores, auto-title lenders, among others—which takes advantage of the vulnerability of the unbanked and underbanked. It also became clear to us that most mainstream financial-service providers were steering clear of some borrowers because of their low incomes, lack of collateral, high servicing costs, and in some cases, the real or perceived fear that regulators discourage serving this market.

Perhaps most intriguing was our discovery that many immigrants with low incomes couldn't afford the $680 cost of applying for U.S. citizenship. As a result, they either deferred their dream or sought out predatory lenders to finance the process.

At first, Capital Good Fund resisted the idea of making personal, or consumer, loans. Still, as the nonprofit's leader, I couldn't get my mind off the utter lack of access to equitable capital for disadvantaged populations. And with the financial collapse of 2008, it became impossible to ignore the need. We decided to take the step of making loans to cover the cost of the naturalization process, and pretty soon we were processing dozens of citizenship loan applications per month. Unlike banks and credit unions, we have low overhead costs, our credit standards are more flexible, and our ability to spend more time with each client is greater—factors that made it easier for us to enter the personal loan market.

For several years, our product offerings consisted of microbusiness and citizenship loans. Every once in a while, we got applications for other consumer needs—vehicle repairs, security deposits for renting apartments, computer purchases—and rejected them. They didn't fit our mental model for what nonprofits should do. In late 2012, however, Capital Good Fund became increasingly alarmed about payday lending in Rhode Island, where lenders were being allowed to charge rates of up to 260 percent annual percentage rate (APR), generating roughly $70 million in revenue for themselves every year. We could no longer ignore the need for consumer loans.

With reluctance, we began accepting applications to cover the cost of placing a security deposit on an apartment. We told ourselves that this was appropriate because the loans would have a meaningful impact on reducing debt and poverty. Several months later, though, we were underwriting a strong application for the purchase of a couch. The applicant, who had recently been homeless, indicated that he had just moved into an apartment, where he found himself sitting on the floor, unable to afford furniture. Absent our loan, he would go to a rent-to-own store, where a $500 couch might end up costing over $1,500.

"A couch loan?" we gasped. "Why would a nonprofit like ours make loans for couches?" And then one of our employees asked the question that changed everything: "Well, don't the poor need to sit somewhere, too?"

We listened.

A Good Business

Today, we offer personal loans of up to $2,000 for almost anything. We did get a lot of pushback about the decision from funders, staff members, and other stakeholders. We were asked about mission drift, our interest rates, and even if our clients really needed personal loans at all. But when we looked at our mission—to provide equitable financial services that create pathways out of poverty—it became clear that so long as our clients were weighed down by a crushing burden of debt, upward mobility would be out of reach. What's more, we wanted to be open to what they considered their needs. Perhaps they knew best. At the end of the day, we answered the criticism by pointing to the facts and channeling the voice of our customers.

Moreover, we saw an opportunity. Small personal loans are a phenomenal way to get folks in the door, yes, but that's just the beginning. Our borrowers save hundreds of dollars in interest, build their credit (thanks to the Credit Builders Alliance, we report to the credit bureaus), and gain access to our one-on-one financial coaching.[1]

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Few other community development financial institutions (CDFIs) focus on the small-dollar personal-loan market. Such lending does not often impress their funders, and colleagues in the industry sometimes question its impact. But given that the goal of the CDFI field is to meet the needs of underserved communities, it makes no sense to ignore such a significant issue. Today more policymakers, funders, and journalists are waking up to the damage that unscrupulous subprime lenders are imposing on the poor and are thinking of ways to combat them.[2]

See a video of author Andy Posner in a snowstorm explaining the Capital Good Fund's couch decision, here, at www.bostonfed.org/commdev/c&b.

Go into most low-income neighborhoods in America and you are surrounded by the attention-getting "instant cash" and "no credit required" signs that you rarely see in wealthy neighborhoods. The absence of banks and credit unions also looms large. As the United States recovers from the Great Recession, a game of financial whack-a-mole continues unabated. For every attempt to regulate one financial injustice, another one quickly pops up.

Capital Good Fund believes in policies that protect the poor from usury and is passionate about putting usurers out of business by competing on price, convenience, customer service, and impact. But we have to recognize that unscrupulous competitors are well funded and ubiquitous. They have an aggressive lobby and wield their influence effectively. As a case in point, a coalition of Rhode Island community organizations has been bested for the past four years by payday lenders in its effort to lower the interest rate cap from 260 percent APR to 36 percent, which is the maximum rate lenders may charge military men and women.

That is why in 2013, the United Way of Rhode Island (UWRI) gave the Capital Good Fund two substantial grants to launch a payday-loan alternative. Ranging from $300 to $500 and priced at a fixed 30 percent APR, with a 4 percent closing fee, our emergency loan is a competitive product. Unfortunately, getting the word out has been the bigger challenge. Our marketing budget, compared with that of payday lenders, is infinitesimal, and we lack their massive brick-and-mortar network of stores.

What nonprofits that do this work need most is for more funders to be as committed to ending the cycle of debt and poverty as are UWRI and several others, including the Rhode Island Foundation. We need grants for operations, low-interest loans to fund loan pools, and help with customer acquisition. And we need people to lobby for change. Microbusiness loans are, without a doubt, compelling and highly impactful, but we mustn't blind ourselves to what lower-income people say they need. Only by involving funders, policymakers, and community members in an honest dialogue can we help the poor chip away at the prevalence of financial injustice and free themselves from usury. It will take significant investments if we are to give payday lenders and their ilk a run for their money. We owe it to those we serve to give it our best shot.

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Endnotes

1 For more on Credit Builders Alliance, see Vikki Frank, "Helping Clients Build Credit," *Communities & Banking* 18, no. 4 (fall 2007), https://www.bostonfed.org/commdev/c&b/2007/fall/Vikki_Frank_Credit_Builders_Alliance.pdf; and Sarah Chenven, "Building Credit through Rent Reporting," 25, no. 1 (winter 2014), http://www.bostonfed.org/commdev/c&b/2014/winter/building-credit-through-rent-reporting.htm.

2 A good example is a September *New York Times* article, which exposed auto-title lenders' practice of using starter-interrupt devices to remotely disable the vehicles of borrowers who miss a payment. See Michael Corkery and Jessica Silver-Greenberg, "Miss a Payment? Good Luck Moving That Car," *New York Times*, September 24, 2014, http://dealbook.nytimes.com/2014/09/24/miss-a-payment-good-luck-moving-that-car/.