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New FICO Model Changes Approaches to Consumer Credit

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Growing Consumer Reliance on Credit Cards

Banking Development Districts Offer Access to Services

Responding to an Aging Population

VOLUME 18, NUMBER 2, 2008

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VOLUME 18 • NUMBER 2 • 2008

COVER STORY

New FICO Model Changes Approaches to Consumer Credit

Shifts in FICO's assessment of credit-worthiness will rule out "piggy-backing" as a means of establishing credit, and some consumers may see modifications in their credit scores. The changes come in response to rising defaults on credit cards and auto loans.

FEATURES

PLANNING FOR LONG-TERM FINANCIAL SECURITY

Juan C. Sanchez
Vice President and
Community Affairs Officer

According to the Bureau of Economic Analysis, personal savings rates for Americans have fallen from approximately 9 percent of income in the 1980s to less than 1 percent over the past several years. Part of the reason may be that people have assumed real estate values would continue to appreciate and counted on equity in their homes as a primary form of retirement savings.

However, decreasing property values, especially in some markets, coupled with the decline in savings have led to significant deterioration in personal net worth for many Americans. Some are even facing negative net worth conditions. Financial independence could become a distinct challenge for many consumers as the "baby-boomer" generation approaches retirement age.

Studies indicate that only a small percentage of Americans feel confident that their current level of savings will support financial independence after retirement, and many adults close to retirement age have never started a retirement savings plan.

Research also reveals significant shortfalls in the average American's financial literacy and grasp of economic concepts. How closely does this knowledge gap correlate with the dismal savings rates?

Some experts believe that simply completing a financial education course will not significantly change a consumer's behavior about personal finances. Others believe that financial education programs, which inevitably bump against other priorities in school curriculums, don't begin early enough to have an impact.

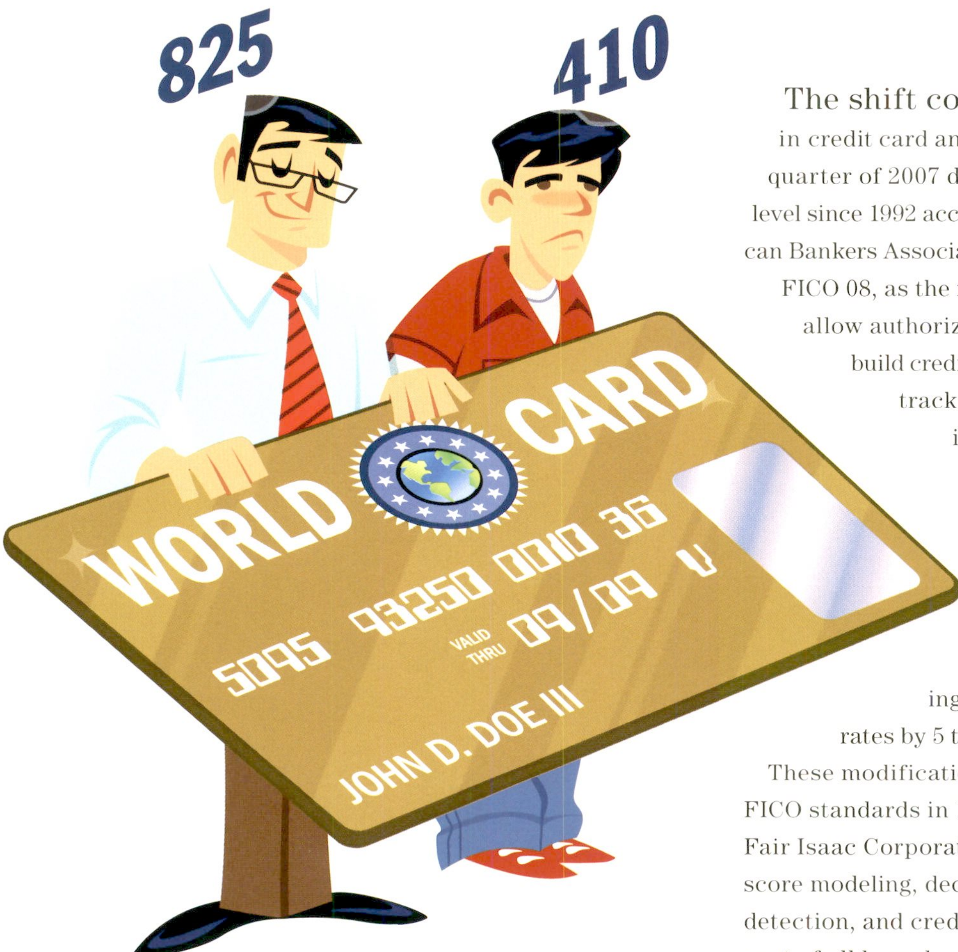
To learn more about the most effective way to educate people about finances, the Atlanta Fed will undertake two significant projects over the next several years. The first is development of an adult financial education program that focuses on long-term financial stability. In partnership with the FDIC, the Federal Reserve Bank of Atlanta is creating a series of modules in the Money Smart curriculum designed to provide life-long financial planning education.

Tailored for lower-income consumers who already have access to mainstream financial products and services, the new program will address issues well beyond maintaining checking and savings accounts. The six-course curriculum is scheduled for completion this fall.

The Atlanta Fed will also be observing the impact of financial education courses to see which features work best to promote wealth creation and personal financial fitness and which aspects aren't as effective. Over the next few years, we will collaborate with the St. Louis Fed to evaluate the impact of several frequently used financial and economic education programs. This initiative will help us identify best practices and allow us to modify financial and economic education programs to achieve the best results for participants, especially lower-income families.

I'm personally very proud of these two initiatives and their potential to help secure a stronger financial future for the next generation of Americans.

New FICO Model Changes Approaches to Consumer Credit



THE FAIR ISAAC CORPORATION IS MAKING CHANGES TO ITS FICO CREDIT SCORING MODEL THAT WILL AFFECT NOT ONLY CONSUMERS' CREDIT SCORES, BUT ALSO HOW PEOPLE GO ABOUT ESTABLISHING CREDIT.

The shift comes in response to recent jumps in credit card and auto loan defaults. In the fourth quarter of 2007 delinquencies rose to their highest level since 1992 according to a statistics from the American Bankers Association.

FICO 08, as the new model is called, will no longer allow authorized users of existing credit cards to build credit based on the original cardholder's track record. It will also recalibrate the impact of payment delinquencies on credit scores. The goal of the revision is to offer better predictions of the likelihood a customer will fail to repay consumer loans. Fair Isaac estimates that companies switching to the new system will cut default rates by 5 to 15 percent.

These modifications represent the first overhaul to FICO standards in 10 years. Established in 1956, the Fair Isaac Corporation is an industry leader in credit score modeling, decision management platforms, fraud detection, and credit scoring services. About 90 percent of all large lenders rely on FICO scoring models in addition to other scoring models when making decisions about credit applications.

No more credit boost for authorized users

Recent changes to the FICO scoring model will no longer recognize authorized user accounts in determining an individual's credit score. Previously if a parent, say, wanted to help a college student establish a good credit rating, the student could be added to the parent's account as an authorized user and benefit from the parent's good credit. The new model will prohibit an individual from receiving a boost in their credit score by being an authorized user on an account that maintains a good payment history.

This shift came partly in response to a credit-repair strategy known as "piggy backing," which allows individuals with damaged credit to sign onto accounts of those with excellent credit. For a price, a consumer with a checkered credit history could use this strategy to improve his or her credit rating.

Loss of the authorized user strategy will make it harder for family members to help build a credit history for a child, spouse or others in the household who would benefit from this approach. The lack of a solid credit score typically influences the cost of credit, vehicle insurance rates, utility deposits and employer hiring decisions.

While the affected consumers are now faced with building their credit history from the ground up, having a joint account to build a credit file remains an option. However, joint accounts come with additional risk because both consumers are equally liable for the debt. Also, the only way to remove a joint holder from the account is to close it.

"Piggy Backing" makes rating credit harder

Authorized users on credit accounts traditionally have been family members assisting other family members to build or improve a credit file through leverage of their good payment history. However, in recent years, credit repair companies have turned the authorized user system into a loophole for those with poor credit ratings by selling the trade lines of a consumer with good credit history to a consumer with bad credit history. This practice, which involves individuals who don't know each other, is called "piggy backing."

To illustrate, a credit repair company would arrange a rental transaction in which a consumer purchases the right to become an authorized user on accounts with good credit, thereby artificially boosting their credit scores. In many cases, such a rental transaction would raise a credit score more than 100 points.

The individual who rents the trade line is paid based on the quality of their credit. The arrangement does not allow the authorized user to make purchases on the card nor does the authorized user have access to any of the personal information associated with the account. After a couple of months, the owner of the trade line removes the authorized user from the account and resells it to another individual with problem credit.

Credit repair companies have advertised that those with excellent credit can make as much as $10,000 per month for renting their trade lines for 90 days, according to a column by Kenneth R. Harney in the June 15, 2007 edition of *The Washington Post*.

The Fair Credit Reporting Act and privacy laws prohibit lenders from finding out additional information about authorized users on accounts, so it is difficult to distinguish legitimate authorized users from credit repair customers. FICO 08 will stop piggy-backing schemes from distorting credit ratings.

Figuring Your Credit Score

Fair Isaac is changing how it figures your FICO credit score. Here are some hypothetical examples of how the changes could affect scores:

Scenario 1

Alicia and Jose, higher risk consumers, each have 10 accounts and at least one major account delinquency. Their current FICO scores are 625.

FICO 08 Change:

Alicia's score rises to 650. Jose's drops to 600.

Why the different outcomes?

- More of Alicia's accounts are open and in good standing. She also has a mix of credit types.
- Jose has more accounts that have been closed, and a narrow mix of credit types.

Scenario 2

Isabel and Fred are active credit seekers, with as many as 20 accounts each. Their FICO scores are 725, considered prime.

FICO 08 Change:

Isabel's score rises to 745. Fred's drops to 705.

Why the different outcomes?

- Isabel uses less of her available credit and has nearly paid off an auto loan. She applied for credit more often, but FICO 08 penalizes her less for this.
- Fred carries higher card balances and hasn't made much progress in repaying an auto loan.

Delinquencies

Changes brought about by FICO 08 will also affect how the scoring agency accounts for delinquencies. Individuals who are late with their payments – especially those who are more than 90 days late in making a payment on an account—will see a change in how the credit scoring model views the associated credit risk.

FICO 08 will be more forgiving to those who are delinquent on one account but current on all their other accounts as opposed to those who show patterns of late payments in multiple accounts. According to Fair Isaac, consumers may experience a 20 to 25 point adjustment to their credit score.

Impact on Consumers

Besides the effect on children who would benefit from the help of a parent in building credit, women are likely to feel a disproportionately negative impact. According to a survey conducted by John Ulzheimer of credit.com, women are more likely than men to be designated as an authorized user. As noted, a joint account is a mitigating option. Also, secured credit cards and subprime (risk-priced) credit products can help consumers build credit history.

In addition to assessing delinquencies differently, FICO 08 will bring about other shifts in how the credit score is calculated. Applying for new credit accounts may hurt less. Having high balances on credit cards could hurt more. Actively using existing credit accounts may be important. Having both revolving and installment accounts may help credit scores because the new formula accounts for how borrowers manage various types of credit.

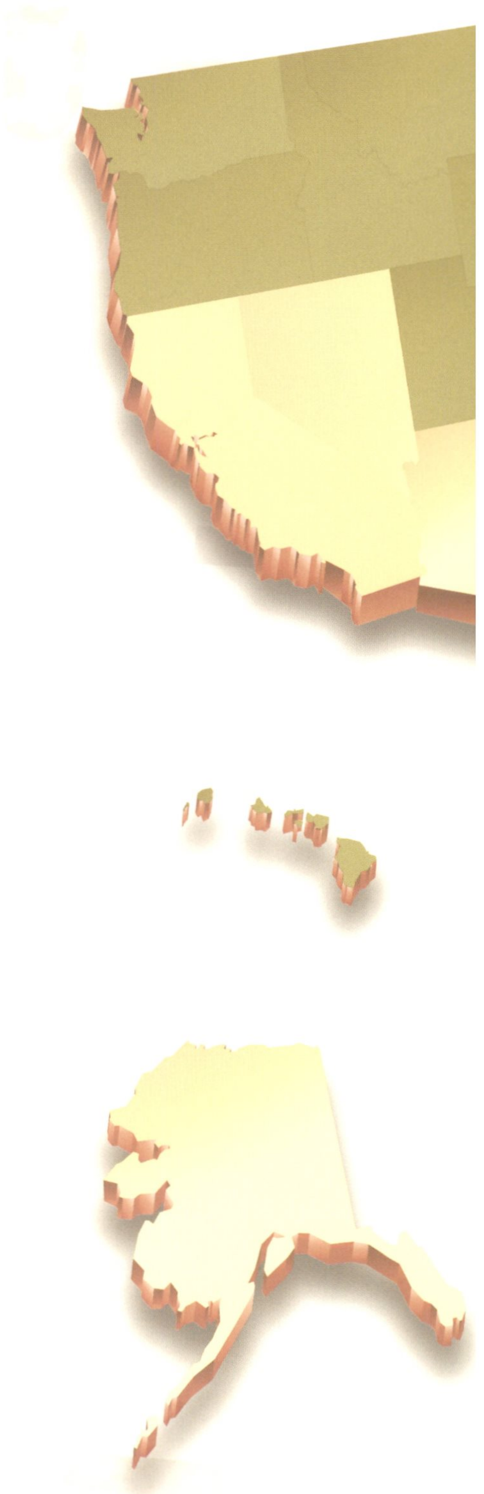
The new FICO formula is designed to distinguish the degree of risk among consumers with troubled or thin credit histories, those who are actively seeking credit, and "piggy backers." According to Tom Quinn, Vice President of Global Scoring Solutions for Fair Isaac, overall more consumers will see their FICO scores increase slightly than will see their scores decrease.

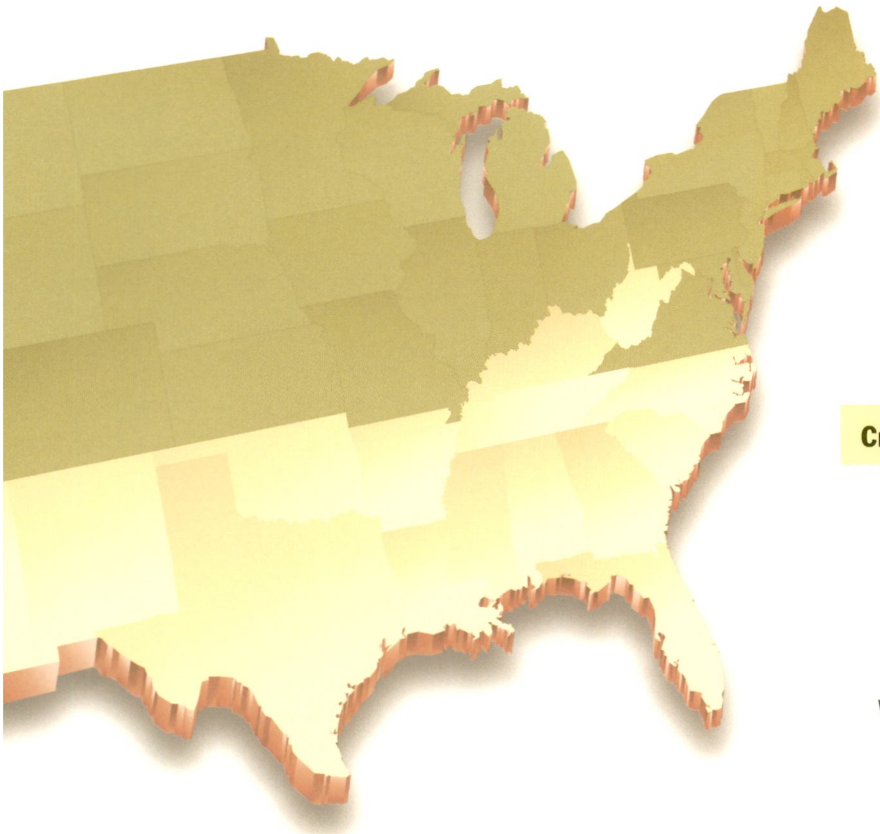
Implementing FICO 08

In 2006, VantageScore Solutions LLC, a joint venture between the three major credit reporting agencies, implemented VantageScore to compete with the FICO scoring system. Fair Isaac has a pending law suit against the three credit reporting agencies – Equifax, Experian, and TransUnion – accusing them of unfair and anticompetitive practices that could harm the FICO brand. Currently, Experian and TransUnion have started using the FICO 08 scoring model. Equifax has opted to wait until the pending lawsuit has been resolved.

Additionally, some lenders may take more time to test the system to see how it works with their business model and loan portfolios. In many cases, implementation can take 12 to 24 months. ■

This article was written by Sibyl Slade, regional community development manager at the Atlanta Fed.





National Average Credit Scores

Credit Scores Below the National Average

Texas	666	Mississippi	671
Louisiana	672	Nevada	672
New Mexico	676	Georgia	676
South Carolina	673	Alabama	678
North Carolina	680	Oklahoma	681
Arizona	682	Arkansas	682
Washington, DC	682	Florida	685
West Virginia	685	Kentucky	687
Tennessee	687	Alaska	688
California	691		

Credit Scores Above the National Average

Missouri	693	Michigan	694
Colorado	695	Delaware	695
Indiana	695	Ohio	696
Maryland	697	Illinois	698
New York	698	Kansas	699
Utah	699	Virginia	700
Oregon	703	Wyoming	703
Pennsylvania	704	Idaho	706
New Jersey	706	Rhode Island	706
Washington	706	Maine	707
Hawaii	708	Connecticut	709
Iowa	711	Nebraska	712
Wisconsin	712	Montana	713
New Hampshire	713	Vermont	713
Massachusetts	715	North Dakota	717
South Dakota	718	Minnesota	721

Source: Experian, Oct. 2007

According to Experian,

the national average credit score is 692. Only 13 percent of the nation's population boasts credit scores above 800, while 15 percent registers a credit score below 500. About 58 percent of the U.S. population has a credit score above 700.

Growing Consumer Reliance on Credit Cards

ARE MORE LOWER- AND MIDDLE-INCOME CONSUMERS RELYING ON THEIR CREDIT CARDS TO COPE WITH RISING ENERGY AND FOOD PRICES?

At one time consumers might have used the option of refinancing their homes or tapping a home equity line of credit to increase cash flow to temporarily make ends meet. But more stringent credit standards and falling home prices have locked many families out of that market. Some experts believe Americans are now turning increasingly to high-priced credit cards as an alternative.

A recent report by the Center for American Progress cites a *Boston Globe* article that states direct mail credit card offers aimed at subprime customers jumped 41 percent in the first half of 2008 compared to the first half of 2006. During the same time the April 2008 Senior Loan Officer Opinion Survey on Bank Lending Practices conducted by the Federal Reserve indicates that most mortgage lending became more stringent. About 60 percent of senior loan officers had tightened lending standards on prime mortgages and almost 77 percent had made subprime mortgage standards more rigorous.

Credit card balances climb

Credit cards, once seen as a convenient short-term loan or as a fallback for emergencies, are becoming increasingly a financial coping strategy. According to the 2007 Démos report entitled *Borrowing to Make Ends Meet: the Rapid Growth of Credit Card Debt in America*, credit card debt has risen 315 percent between 1989 and 2006.

As of 2006, approximately six out of every ten households using credit cards rolled forward their balances, and 35 million Americans made only minimum payments each month. The median household credit card debt was up from \$2,768 in 1989 to \$5,219 in 2004, an increase of 89 percent (shown in 2004 dollars). In this period, credit

card debt for lower-income households increased fourfold. These households use approximately 40 percent of their income to service debt compared with average credit card holders who use 21 percent.

According to the Démos study, African American and Hispanic households are also more likely to carry credit card debt. Compared to 54 percent of Non-Hispanic White households, 84 percent of African-American and 79 percent of Hispanic households carry credit card balances.

White households carry higher credit card debt overall, but African Americans and Latinos use more of their available credit balance. African Americans use 84 percent of their available balance and Latinos 79 percent compared with 53.7 percent for Whites. Higher balances across the board may reflect increases in late fees and cash-advance surcharges assessed on the cards: from 1989 to 2004 the number of accounts accruing late fees of 60 days past due or more rose from 4.8 percent to 8 percent of total cardholders.

American seniors are also racking up credit card debt. More than 35 percent of older adults are now managing credit card debt, and their average balances ballooned 194 percent from $1,169 in 1989 to $4,906 in 2004 (both shown in 2004 dollars). This debt appears more problematic in light of the fact that the 2004 median income of individuals 65 and older was $15,199. Nearly 40 percent of these seniors were living below the poverty line.

Fatal attraction

What factors are driving Americans to precariously high levels of credit card debt? Part of the explanation is that it's so much easier to get credit cards and use them.

The author of *Going Broke: Why Americans Can't Hold On to Their Money*, Connecticut College psychology professor Stuart Vyse, cites consumer behavior as part of the problem. "We have the ability to buy things at home, on the Internet, through television, through 800 numbers, and with cell phones and portable devices, it's much easier to do that. Thirty years ago if you wanted to buy something you had to go to town and you had to have the money," Vyse stated in an interview with ABC News.

Easier access to credit is another exacerbating factor. Whereas in the past banks only provided credit cards for customers with stable credit histories, the industry has now been able to broaden access through innovations in the underwriting of credit risk.

Until recently, almost anyone could get a credit card. As of 2004, three out of every four households had a credit card. Now that the credit card market is over 20 years old, lenders (not brokers as in the housing industry) have become more sophisticated about how they securitize credit card debt.

In addition to easy access and an expansion of the occasions to use credit cards, many consumers are turning to credit cards to cope with the dual challenges of rising costs and diminishing buying power. Real wages in many areas have not kept pace with the combined increases in housing, transportation and health care costs.

A more fundamental problem?

In May 2008 National Public Radio featured a five-part series that examined Americans' relationships with

"Just as other disasters can foster awareness of the need to be prepared, the problems of excessive debt can serve as a wake-up call to take control of the future. The key is to learn more about managing finances and build reserves."

credit cards. According to economy.com analyst Mark Zandi, the rising debt taken on by consumers masks "a fundamental problem, particularly among those half of households that have lower incomes. They have been under a lot of pressure over the years. The jobs that they had in manufacturing have been lost, and they're competing against labor all across the world and suffering as a result. They used debt to try to supplement their incomes and now they can't."

Increases in credit card debt thus seem to hinge on more than just lifestyle choices and social pressure to consume. According to a 2005 national survey of low- and moderate-income households by Démos and the Center for Responsible Lending, 20 percent of respondents indicated that this was "the first time their credit card debt was this high."

Furthermore, 70 percent reported that they used their credit cards as a safety net to pay for car repairs, basic living expenses, medical bills and house maintenance. More than 30 percent used credit cards during four of the last 12 months to cover basic living expenses. Renters seem especially vulnerable: 45 percent of renters used credit cards for living expenses as opposed to 28 percent of homeowners.

Holes in the safety net

Loss of a job or major medical expenses were cited as primary reasons families relied on credit cards to get by. The social and financial systems that once buffered American families from hardship provide less protection than they once did. The table at the top of page 9 shows changes in some of these safety nets over the past 30 years.

The next generation may face even sharper cutbacks in their social investment and safety net as priorities shift to the senior population. Scholars Eugene Steuerle (a Senior Fellow at The Urban Institute, co-director of the Urban-Brookings Tax Policy Center) and Adam Carasso (Former Research Director, Fiscal Policy Program at the New America Foundation until April 2008, when he left to join the House Budget Committee as Chief Economist) found that between 1960 and 2005, federal spending

Changes in saftey nets over the past 30 years

	Then	Now
Unemployment Benefits-Maximum Duration	15 months (1975)	6 months (2004)
Percentage of workers covered by pensions	40% (1980)	20% (2004)
Federal budget for job training	$27 billion (1985)	$4.4 billion (2004)
Percent of workers with employer-provided health insurance	72% (1979)	60% (2004)

Source: Peter G. Gosselin, "The New Deal: If America is Richer, Why Are Its Families Much Less Secure?," *Los Angeles Times* (October 10, 2004); reprinted in "The Plastic Safety Net," published by Démos and the Center for Responsible Lending, October 2005

on children declined from 20.1 percent of the domestic budget to 15.4 percent, while non-child Social Security, Medicare, and Medicaid spending soared from 22.1 percent to 45.9 percent.

Trouble in the credit card market?

Looking at the rising cost of living in relation to incomes and consumer attitudes toward credit, some analysts predict that the next financial crisis will be in the credit card market.

Associated Press reporter Bob Porterfield says that October 2007 saw a 26 percent rise in the number of credit card holders making payments at least 30 days late. Porterfield co-wrote the article "Credit Card Crunch" with reporter Rachel Konrad after compiling statistics and reviewing spending patterns. He says defaults and delinquencies are surging, possibly an indication of more problems to come.

A recent *Smart Money* article by Aleksandra Todorova discusses troubling trends in credit card payments. The rate of delinquency at the country's 100 largest banks has risen in the last year as have charge-offs. However, the credit card outlook might not be as dire for lenders as the subprime mortgage market has been. For now delinquency rates are still lower than during the last recession of 2002 to early 2003, when they were close to 5 percent. Banks have managed credit card risk for several decades and know how to adjust their underwriting criteria and capital to weather a downturn.

Helping consumers adjust

Consumers are likely to feel the effects of burgeoning credit card defaults as many banks in response reduce credit lines, tighten access to new lines of credit, assess higher fees and rates for those who have been late in making payments, and initiate more aggressive collection efforts.

Several advocacy groups are seizing this opportunity to increase awareness about a whole range of asset-building and consumer protection initiatives. Démos, the Center for American Progress, the New America Foundation and many others have worked to create a platform of policy changes designed to increase financial literacy, savings and access to affordable banking services. They are also garnering financial support to mend the American safety net and foster responsible lending practices.

Just as other disasters can foster awareness of the need to be prepared, the problems of excessive debt can serve as a wake-up call to take control of the future. The key is to learn more about managing finances and build reserves. ■

For more information:

Refer to www.demos.org. Founded in 2000, Démos is a non-partisan public policy research and advisory organization headquartered in New York City. Other sources for the article include the Center for Responsible Lending (www.responsiblelending.org), the Center for American Progress (www.americanprogress.org), and New America Foundation (www.newamerica.net).

This article was written by Nancy Montoya, senior regional community development manager in the Atlanta Fed's New Orleans branch.

Banking Development Districts Offer Access to Services

BANKING SERVICES ARE CRITICAL FOR NEIGHBORHOOD REVITALIZATION, AND STATES ARE EXPLORING NEW TOOLS FOR ATTRACTING BANK BRANCHES TO UNDER-SERVED COMMUNITIES.

Incentives, which were initially offered to lure large industrial corporations, have also been successful for drawing businesses like hardware stores and grocery stores to developing neighborhoods. Now incentives are being used to recruit banks as well.

New York State's Banking Development District (BDD) program identifies areas without sufficient banking services and provides a variety of state and local benefits for banks that locate branches in these communities. The strategy seems to work, and several other states are now considering similar programs.

Meeting an important need

Adequate banking services are crucial for a community's economic development. Studies also suggest that establishing a bank account is an important first step for low-income individuals trying to achieve financial security. However, according to the 2004 Survey of Consumer Finances, more than 9 percent of U.S. families lack bank accounts. Many more households are considered underbanked: although they have bank accounts, they continue to rely on other financial service providers for basic transactions.

The costs for individuals without access to adequate banking services are significant. In addition to lacking a secure place to keep their money, those without accounts may be forced to rely on alternative financial service providers who charge high fees to conduct transactions.

One reason households do not establish bank accounts is that they cannot access banking services in their neighborhoods. Banks may hesitate to locate branches in low-income communities or in areas without a significant retail or service sector, citing a lack of profitability. They are concerned that building up the deposit base necessary for more profitable loans will be difficult in these communities.

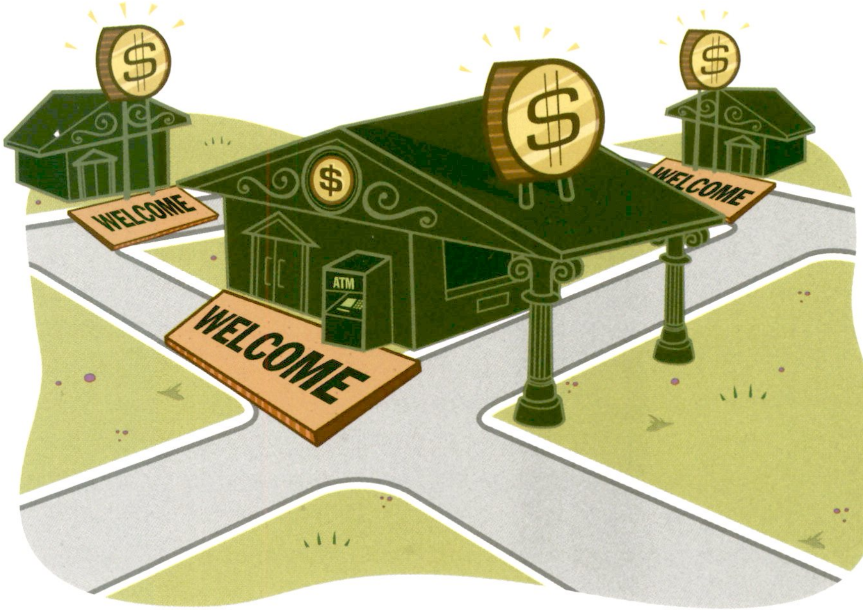
Banks, government agencies and community organizations realize the importance of making banking services accessible. They are now working with several states to explore banking development districts as a strategy to attract banks to under-served areas where lack of profitability may be an obstacle.

Banking Development Districts provide access to services

New York was the first state to institute banking development districts. Created in 1998, the BDD program encourages the establishment of bank branches in areas with a demonstrated need for banking services. The state recognized that although banks might see a market opportunity in under-served areas, it would take many years for the bank to attract sufficient deposits to make the branch viable.

To draw banks to banking development districts – areas that the state designates as underbanked – the state offers incentives such as access to below-market-rate public funds and municipal deposits to help banks increase their deposit base; real estate assistance for locating new branches; property tax incentives; CRA credit; help with workforce development; and financial education for customers.

In addition to increasing access to banking services, the BDD program in New York also aims to increase capital for businesses in under-served communities, create jobs, enhance community stability and foster economic development.



To qualify as a BDD in New York, a bank in partnership with the local government files an application seeking designation as a banking development district by the state. The application documents current and anticipated banking needs in the community and shows the needs are not being met by other institutions. Banks also outline their plans to meet these needs. Applicants document socio-economic conditions in a proposed BDD and project additional benefits to the community, including job creation and economic stimulus.

New York's success inspires Louisiana program

Since the launch of the banking development district program in New York, 38 BDDs have been created, primarily in New York City and Buffalo, and the program is meeting its objectives. In 2006, BDD bank branches opened 21,000 new accounts and in 2007, they loaned more than $126 million for mortgages, construction, personal loans and community development. In addition to providing direct benefits, banks in BDDs provide financial education and support community development efforts.

In the wake of New York's success creating banking development districts, other states are exploring similar programs. Illinois, California and Texas are considering the BDD strategy, and this year Louisiana is instituting its own version of the program to aid with storm recovery efforts and promote general economic development.

Louisiana's BDD program closely mirrors New York's. A bank applies with a local jurisdiction to request that the state designate an area as a banking development district. The state then reviews the need for more financial services in the proposed district and assesses the potential benefit for consumers and businesses. The state also looks at the socio-economic and demographic data for the proposed district and considers whether additional banks will encourage economic development.

Louisiana law allows local governments to waive property taxes for bank branches in BDDs and provides for the designation of these branches as "public body depositories," so they can hold government deposits at market or slightly-below-market rates. The law includes incentives not only to encourage new bank branches, but also to assist banks on the verge of closing so they can remain in the community.

According to John Fields, Deputy Chief Examiner for the Louisiana Office of Financial Institutions, the details of the law are still being clarified to determine how long a bank can receive the property tax break and hold government deposits. Although no applications have been filed for BDDs in Louisiana thus far, several banks have expressed an interest.

When the details are finalized, the state will market the program to municipalities and banks. However, banks often require several years lead time to plan for a new branch in a community, so the impact of this program in Louisiana may not be apparent for some time.

Conclusion

Bringing banks back into communities that lack banking services is a critical component of broader neighborhood revitalization and economic development efforts. While BDDs are a relatively new idea, the success of the New York program suggests this may be an effective strategy. Just as incentives have attracted other basic goods and services to communities, BDDs may eventually become an important tool to encourage banks to reconsider neighborhoods that have long been neglected. ■

For more information see:

New York Banking Development District Program: <http://www.banking.state.ny.us/bdd.htm> and Louisiana Banking Development District: <http://www.ofi.louisiana.gov/>.

This article was written by Jessica LeVeen Farr, senior regional community development manager in the Atlanta Fed's Nashville Branch.

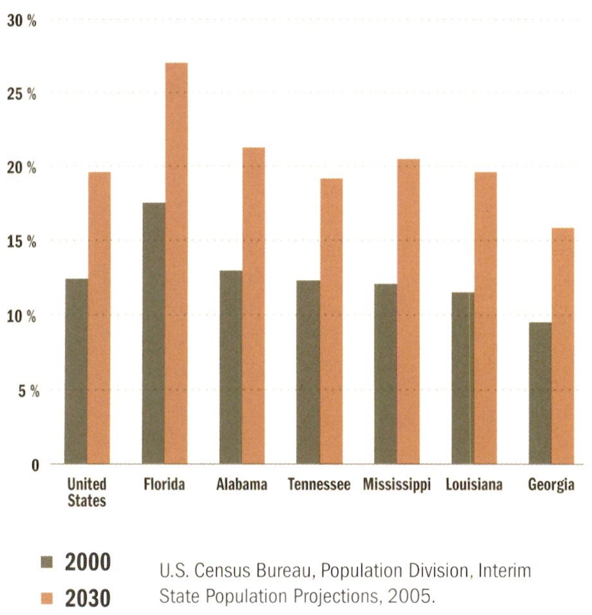
Responding to an Aging Population

TODAY, MORE THAN ONE IN EIGHT AMERICANS IS OVER THE AGE OF 65. THAT'S OVER 35 MILLION PEOPLE. BY 2030, IT WILL BE ALMOST ONE IN FIVE (OVER 71 MILLION PEOPLE).

This growing segment of the population will have tremendous implications for housing, transportation, social and financial services, and health care. The demographic shift will call for innovations to meet changing needs, especially at a time of diminishing resources and an uncertain economic future.

For example, many empty-nesters are considering downsizing their homes or may be considering home retrofits that enable them to maintain independence as some of their physical abilities diminish. In other cases, with expectations of more leisure time as they approach or enter retirement, some older adults are seeking communities with greater amenities.

Percentage of population age 65 & older in 2000 and 2030



U.S. Census Bureau, Population Division, Interim State Population Projections, 2005.

All of these preferences have implications for the communities where older adults currently reside or will reside. This includes the need to provide appropriate and affordable housing options that are supported by transportation systems and social services that recognize changing needs.

What does this mean for the Southeast?

The national demographic trends have serious implications for the Southeast. By 2030 more than 13.7 million older adults (age 65 and older) are projected to live in the Southeast (Alabama, Florida, Georgia, Louisiana, Mississippi, and Tennessee). That's up from 5.7 million in 2000. Honing in on just Florida, the U.S. Census Bureau projects the state's population over the age of 65 will grow from 17.6 percent of total residents in 2000 to 27.1 percent in 2030 (see graph below).

The needs that result from this shift will put additional stress on states and metropolitan areas already struggling with budget deficits, deteriorating infrastructure, housing affordability and increasing unemployment.

A strategy for communities

As people age, their activities, household composition, social networks and financial resources evolve. So too must their homes, communities and the services that support them. While some baby-boomers will gravitate to sunnier climates and amenity-laden cities, most will choose to stay where they are currently living. This means that every city, county and state will need to adapt to accommodate aging in place.

One innovative response can be found in the Atlanta Regional Commission's Lifelong Communities Initiative. The Atlanta Regional Commission (ARC) serves 10 counties and over 60 cities in the Atlanta metropolitan area. ARC's initiative works to achieve three major goals: promote housing and transportation options, encourage healthy lifestyles, and expand information and access to services. This three-pronged approach earned ARC the 2007 U.S. Environmental Protection Agency's Active Aging Award.

Through partnerships with local elected officials and government staff, business leaders and community groups, this initiative is transforming cities, counties and neighborhoods into places where individuals can live throughout their lifetime. Using a bottom-up approach, the initiative brings together professionals with a wide range of expertise, older adults and caregivers to form county-based partnerships that analyze the local data, challenges and opportunities to identify priorities and implement strategies.

The Initiative's focus on creating multi-generational communities where individuals from several age groups live in one neighborhood is consistent with consumer studies by Del Webb and Robert Charles Lesser and Company. Specifically, the studies suggest that the preferences of aging baby-boomers and Generations X and Y are converging to call for more compact and walkable neighborhoods.

Such preferences are driven in part by higher gas prices, increasing traffic congestion and a desire for more healthy lifestyles. The result is an increased demand for existing and new communities where residents can walk to stores or a transit stop, bike along neighborhood trails and mingle with their neighbors.

These model communities require partnerships among local governments, real estate developers, financial institutions, community groups and social service providers as well as a coordination of policies and infrastructure investments. With shared vision and purpose, these partners can create sustainable communities for people of any age. ■

For more about ARC's Lifelong Communities Initiative visit:

www.atlantaregional.com or contact Cathie Berger, Division Chief, Aging Services, Atlanta Regional Commission, cberger@atlantaregional.com or (404) 463-3235.

This article was written by Karen Leone de Nie, Community Affairs research manager at the Atlanta Fed.

Creating Multi-generational Communities for Healthy Aging Symposium: Innovations in Community Development and Housing

Sponsored by Federal Reserve Bank of Atlanta and Georgia Tech's Center for Healthy Aging in the Built Environment

What does the growing older adult population need in housing and community design? What does it take to make a successful "live, work, play" community for healthy aging? What are multi-generational communities? And what are the trends and innovations to help you be a stronger part of the team to support healthy aging and community development?

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Date: September 29-30, 2008

Location: Federal Reserve Bank Building, 1000 Peachtree Street NE, Atlanta, Georgia 30309

Fee: $245

Registration: www.pe.gatech.edu/conted/servlet/edu.gatech.conted.course.ViewCourseDetails?COURSE_ID=973 or contact Jennifer Freeman, Georgia Tech, at jennifer.freeman@innovate.gatech.edu or (404) 894-4904

More information: contact Karen Leone de Nie at the Atlanta Fed, (404) 498-7237 or karen.leonedenie@atl.frb.org

Peer-to-Peer Lending: A Tool for Community Finance?

MOST OF US WOULDN'T DREAM OF ASKING OUR NEIGHBORS FOR A LOAN TO CONSOLIDATE CREDIT CARD DEBT OR BUY NEW EQUIPMENT FOR OUR BUSINESS. BUT WHAT IF YOU KNEW YOUR NEIGHBORS WERE LOOKING FOR SOMEONE TO LEND MONEY TO?

This describes the concept of peer-to-peer (P2P) lending, which allows borrowers and lenders to transact business without traditional intermediaries such as banks. This approach, also known as "social lending," P2P is a growing trend both in the U.S. and around the world, and it could have important implications for financing community development.

Expanding niche draws lenders and borrowers

As global credit markets tighten to create bottlenecks in available bank lending, the social lending niche market is beginning to expand its structure and pick up participants. While P2P lending cannot eliminate the inherent risk of credit, the simplicity and ease of this system is attracting a growing market segment willing to experiment with a promising alternative to traditional loans and investments.

Social investment is also drawing donors who want to direct their donations personally to causes they believe in. Direct personal investment makes it possible to track the impact of projects on individual communities and lives. Harking back to the "character loan" of bygone days, this investment trend has at its heart social capital – what each of us uniquely brings to the table.

The Internet facilitates expansion of peer-to-peer financing by providing a medium that supports communication, analysis and accounting. Prosper.com based in San Francisco and Zopa.com in Britain are two services that match people who need to borrow money and people interested in lending money.

For a fee, the online services arrange person-to-person lending and provide safeguards and services on both sides of the transaction. These sites and others offer a variety of lending models and platforms, product structures and levels of communication between participants.

Who uses P2P?

Chris Larsen, CEO of Prosper.com, one of the internet companies that provides a peer-to-peer lending infrastructure, describes the company as an eBay for lending. "We view our role as that of the infrastructure that provides a tool for this marketplace," says Larsen. He says that many Prosper.com members who lend are looking for both a financial return on investment and the opportunity to do something good for their community.

In the marketplace model for peer-to-peer lending, organizations like Prosper.com connect borrowers and lenders through a competitive process: borrowers present loan opportunities and lenders bid interest rates and terms on the loans that interest them. The average Prosper.com transaction is an unsecured loan for $6,000 with a three-year term. Larsen says Prosper.com's original goal was to offer an alternative to high-priced unsecured credit cards.

The typical Prosper.com borrower tends to be 35 to 55 years old with an average income of $50,000. The borrowers are generally split evenly by gender and are geographically dispersed throughout the country. "Lenders tend to skew younger," says Larsen, "with an average income between $50,000 and $100,000."

Lenders are often motivated by more than just the higher returns offered for smaller investment commitments. The social benefit is also attractive to many who are willing to take risks with a relatively new and unproven process.

As individuals, the lenders are applying unique decision criteria to selecting potential borrowers for funding.

Larsen says that when the company started, roughly two years ago, subprime borrowers with less problematic credit histories accounted for nearly 25 percent of the organization's lending activity. Now, subprime borrowers make up only about 5 percent of the lending portfolio. Borrowers with strong credit are finding they can save about 3 to 5 percent on interest with a P2P debt consolidation loan. The company has generated over $125 million in loans and has a current default rate of 4.7 percent.

Lending circles could benefit community development

One interesting feature of the P2P industry is the potential to form lending circles or groups – both as borrowers and as lenders. The group can comprise individuals who interact closely or a broad membership that mirrors the structure of credit unions. Lending performance within groups can enhance credit references for individuals or can create references for members through group performance. One example of such a group would be an alumni association.

Larsen says that lending communities on Prosper.com can also improve the loan bids offered to borrowers when fellow group members personally vouch for a member or make bids on the loan requests. He says that loans to those who have received the endorsement of friends or have received part of the loan from friends or group members tend to have lower default rates.

Based on this experience, it seems possible that neighborhoods or nonprofits could establish lending groups to support community revitalization or help local businesses grow. A neighborhood revitalization lending group could attract financing from private citizens concerned with both financial return and the social impact of the group's activities. Requiring its members to complete a financial education program or provide a shared guarantee could improve repayment rates and hold down future interest costs.

Larsen agrees that the lending group model holds potential for community development because the lending platform allows for a free flow of captial and leaves the lending decisions in the hands of group members. By developing underwriting criteria not currently considered by traditional financial institutions, these alternative lenders may be able to provide valuable insight for conventional lenders.

Balancing risk and reward

The system is not without risks. Because the process leaves financial decisions to the discretion of borrowers and lenders, the success of loan transactions will depend on the participants' ability to anticipate risk. Recent mortgage performance seems to demonstrate that some consumers also lack fundamental understanding of financial products. Borrowers may benefit from guidance or increased disclosure to make sound decisions.

> **"While P2P lending cannot eliminate the inherent risk of credit, the simplicity and ease of this system is attracting a growing market segment willing to experiment with a promising alternative to traditional loans and investments."**

As intriguing as the peer-to-peer lending industry may be, it is in the early stages of its growth. How the industry develops will depend on user virtuosity in making the most of what the medium has to offer. The impact of a slowing economy on P2Ps' performance remains to be seen. Nevertheless this burgeoning trend could give community and economic development initiatives a new tool for private investment and thus reduce dependence on public financing. ■

This article was written by Ana Cruz-Taura, senior regional community development director at the Atlanta Fed's Miami Branch.

Covered Bond Framework Could Ease Mortgage Access

REMARKS BY FED GOVERNOR KEVIN WARSH

Excerpts from the U.S. Department of the Treasury Press Conference on Covered Bond Framework, Washington, D.C. July 28, 2008

Financial markets continue to show the ill effects of turmoil triggered by mortgage losses. The real economy is underperforming in terms of growth and job creation, a result in part of financial strains. And financial institutions themselves are affected by the generalized pullback in liquidity and deteriorating credit quality. Nearly one year after the onset of financial market distress, many financial institutions have retreated from certain business lines, limited their participation in markets for some financial products, delivered their balance sheets, and taken other actions aimed at balance sheet repair. These developments are both necessary and expected.

But the path to a new financial market architecture, however uneven and improvised, will not only be marked by the forces of retrenchment. The path should equally, in my view, be distinguished by the creative impulses that drive product and market innovation. It is perhaps too convenient to denigrate the attributes of dynamism and ingenuity, particularly late in economic cycles, when the forces of innovation can disappoint and weaken the real economy. Policymakers and market participants alike should recognize that innovation – in our product markets, labor markets, and yes, our financial markets – is likely to prove a necessary net contributor to economic growth in the coming period. We should also be reminded that financial innovation need not be equated with product complexity.

While some take comfort in the presumption that global economies have decoupled, I would note that our global financial markets are more integrated than ever. Financial products successfully developed in a single geography often can be readily exported to another; readily, that is, if the new product export befits investor preferences and policymakers remove barriers to their adoption. Today's introduction of the Treasury Covered Bond Framework may be illustrative of the benefits of product innovation in globally connected financial markets.

Treasury's discussions with market participants suggest that a covered bond framework may attract investor interest and facilitate greater access to mortgage credit. High-quality assets might be financed if banks are allowed to manage pools of loans, substituting new loans into the pool as others become delinquent. Newly issued covered bonds backed by high quality mortgage loans and issued by strong financial institutions may find a growing investor base in the United States.

The Federal Reserve has long accepted a broad range of high-quality collateral from depository institutions at its discount window. Highly rated, high-quality covered bonds would generally fall within that broad range as eligible collateral. Private lenders also are likely to find such bonds attractive as collateral for credit extensions.

Financial innovation, properly understood, can increase the diversity of funding sources, improve the distribution of risks, and provide incentives to monitor such risks—all helping to promote economic growth. The Federal Reserve seeks to encourage new and innovative sources of funding, and will continue to work with other policymakers and market participants to accomplish this important objective. ■

The full text of Fed Governor Warsh's press release is available at... http://www.federalreserve.gov/newsevents/speech/warsh20080728a.htm

Examining the Issues: Community Affairs Adds Research Function

THE FEDERAL RESERVE BANK OF ATLANTA HAS RECENTLY EXPANDED THE COMMUNITY AFFAIRS FUNCTION TO INCLUDE A NEW TEAM DEVOTED TO RESEARCH THAT FOCUSES ON SIGNIFICANT COMMUNITY AND ECONOMIC DEVELOPMENT ISSUES IN THE REGION.

Headed by AVP Todd Greene, the team will identify key community concerns and plan comprehensive research projects with the goal of improving the policy environment.

Grounded in the experiences of community development professionals throughout the southeast, the new research function is designed to inform policy and practice decisions to create more sustainable communities. Some potential areas of research include post-foreclosure consumer and neighborhood impacts, housing and the aging population, and green development and lending.

The research agenda will evolve to be responsive to the needs of local markets throughout the Federal Reserve's Sixth District, and the results will be widely shared through conferences, publications, articles and technical assistance.

Meet the Team

Todd Greene, assistant vice president for community and economic development research and policy, has held leadership roles with Southwestern Bell, the Metropolitan Atlanta Rapid Transit Authority and in management consulting before coming to the Atlanta Fed. Most recently, Greene served as director for Community, Policy and Research Services at Georgia Tech's Enterprise Innovation Institute with oversight of research and implementation efforts in applied economic development.

In addition to his Fed role, Todd is currently president of the Georgia Economic Developers Association. On the national level, Greene is a committee chair for the International Economic Development Council. In 2002, he obtained the Certified Economic Developer designation (CEcD).

Greene earned a bachelor's degree in English and American literature and language from Harvard University and master's degrees in human resources management from Washington University and in public administration from Georgia State University.

Dan Immergluck is a visiting scholar and a professor in Georgia Tech's City and Regional Planning Program. Immergluck has authored dozens of studies on community development, economic development, community reinvestment, fair housing and related topics. His most recent book is *Credit to the Community: Community Reinvestment and Fair Lending Policy in the U.S.* (M.E. Sharpe, 2004).

Before moving to Atlanta, Immergluck taught at Grand Valley State University in Grand Rapids, Michigan. Prior to teaching at Grand Valley State, he was Senior Vice President of the Woodstock Institute in Chicago, a policy research organization that works on community and economic development issues.

Immergluck has a master's degree in public policy from the University of Michigan and a Ph.D. in urban planning and policy from the University of Illinois at Chicago.

Karen Leone de Nie is research manager for community and economic development research and policy. Before coming to the Atlanta Fed, she was a researcher at

Pictured from left to right: (top) Dan Immergluck, Jessica LeVeen Farr, Todd Greene, (bottom) Jared Yarsevich, Karen Leone de Nie

Georgia Tech's Center for Quality Growth and Regional Development, where she managed studies and built partnerships related to housing, health and built environment, transportation, and land use. She has also worked in environmental resources management at the North Central Texas Council of Governments (Dallas/Fort Worth).

Leone de Nie earned a bachelor's degree in English from University of Wisconsin at Madison and a master's degree in city and regional planning from the Georgia Institute of Technology. In 2007 she obtained certification from the American Institute of Certified Planners.

Jessica LeVeen Farr is the senior regional community development manager working in the Fed's Nashville Branch. Prior to joining the section, Farr was an assistant vice president with Bank of America Community Development Corporation in Nashville, where she managed the single-family development program. Before that, she worked for a consulting firm in Berkeley, California, specializing in land use planning and real estate economics.

Farr earned a bachelor's degree from the University of California at San Diego in urban studies and planning and a master's degree in regional planning from University of North Carolina at Chapel Hill. While building her specialty experience with the Federal Reserve, Farr gained her credential as a commissioned examiner.

Jared Yarsevich is an intern with community and economic development research and policy. He is currently pursuing a master's degree in city and regional planning at Georgia Tech with a focus on housing policy. Yarsevich has worked as an economist researching tobacco control policy and anti-tobacco marketing campaigns with RTI International, and has lectured in philosophy at Georgia State University and Clayton State University.

Yarsevich earned a bachelor's degree in economics from North Carolina State University and a master's degree in philosophy from the London School of Economics. ▪

This article was written by Karen Leone de Nie, Community Affairs research manager at the Atlanta Fed.

Mississippi

YAZOO CLAY, A COSTLY CHALLENGE TO CONSTRUCTION

When driving through the many beautiful old neighborhoods and new residential subdivisions of Jackson, Mississippi, it's not unusual to see substantial cracks in the sidewalks and streets. Those who aren't from the area might attribute the damage to tree roots or subpar concrete work. However, Jackson natives will probably know that the culprit is a geological phenomenon called Yazoo clay.

Yazoo clay, which causes cracked home foundations, cracked walls, sticking doors, popping windows, crumbling bricks and plumbing leaks, has been an expensive nightmare for contractors and homeowners who are often faced with costly repairs. Foundation cracks can also harbor molds that cause serious health problems.

Deriving its name from the Yazoo River, yazoo clay is a mineral-filled mud with elastic properties—it can shrink and swell dramatically, causing sometimes severe structural damage to anything constructed on it. This peculiar kind of earth is located mainly in Mississippi in a geographic area approximately 40 miles wide and 120 miles long. The swath of Yazoo clay extends from Yazoo County to Scott County, stretches on to Madison and Hinds counties and crosses the Pearl River. A total of 11 counties in central and eastern Mississippi are affected by Yazoo clay.

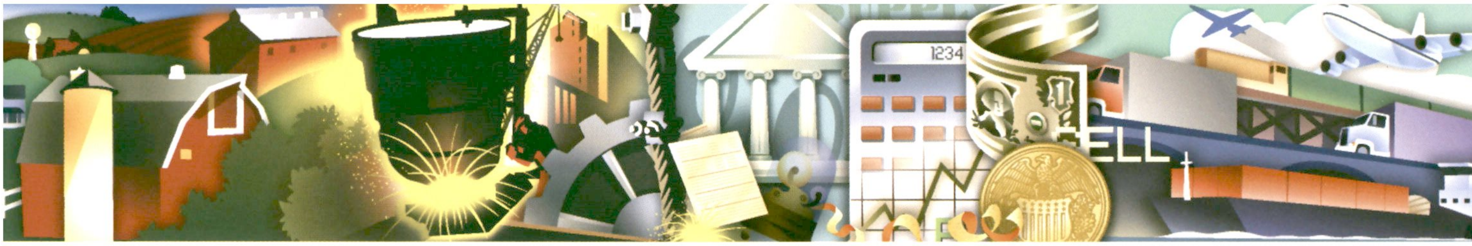
Industry reports estimate that up to 65 percent of homes in the metro Jackson area have been damaged to some extent by the movement of this clay. The severity of the damage depends on how far below the surface it lies. The depth can range from 6 inches to 15 feet. When preparing for new construction, the clay can be removed or, in some cases, a special concrete "floating slab" can be constructed on top of the clay. If these measures fail to control the problem, tedious repair work and costly foundation adjustments may be required. When large commercial buildings are affected, repairs may involve digging 25 to 30 feet below the surface to construct concrete pilings.

Although builders have some effective remedies for the Yazoo clay dilemma, problems persist. Part of the reason is that costs associated with offsetting the clay's effects can be significant. Unscrupulous builders looking to cut costs too often fail to remove the clay or prepare the foundation inadequately before building the home. Owners of older homes may not be able to afford the necessary repairs when these problems occur.

New homes come with a six-year implied warranty, according to the Rundlett Law Firm in Jackson, which specializes in personal injury claims. These warranties transfer to subsequent owners when a house is sold. In addition, a homebuyer who has purchased an older home with foundation problems that have not been disclosed may be entitled to recover damages for home defects.

Considering the additional costs to developers of new construction and the millions of dollars paid annually by homeowners to make repairs to their homes, the economic impact of the Yazoo clay phenomenon is substantial. However, home buyers can save money if they are aware of the problem of Yazoo clay, require soil tests prior to purchase, and make sure the developers prepare the home's foundation carefully. When purchasing an existing home, the buyer should require the seller to make any necessary repairs. ■

This article was written by Michael Milner, senior regional community development manager at the Atlanta Fed's Birmingham Branch. We wish to acknowledge work by Lynne Wilbanks Jeter which appeared in *The Mississippi Business Journal*.



South Florida

MIAMI ADVOCATES FIND OPPORTUNITY IN RISK

The Human Services Coalition (HSC), was born in 1995 in response to welfare reform initiatives that were gaining momentum in Congress. While welfare reform promised to deliver job training, placement, work supports and educational access in an era of low unemployment, advocates worried that dismantling the social safety net system would leave low-income families with inadequate access to basic services.

Risk, however, was paired with a corresponding opportunity. HSC's founders believed the promise of welfare reform could only be realized through a combination of service and advocacy. They envisioned an organization that would not only connect people to economic support programs and financial counseling, but also create avenues for active engagement in democratic civic life. The goal was to encourage those directly affected by the programs to work along with other concerned citizens.

After several years piloting new approaches, HSC developed two innovative and effective programs: the Prosperity Campaign and Civic Life Academy. Both address the need to provide economic opportunity as well as a means to participate in policymaking.

A third program, Imagine Miami, is emerging to create opportunities for "civic networking." The HSC program bears the working title Center for Social Innovation and is designed to develop sustainable social enterprises to address community and civic concerns.

The Prosperity Campaign links low- and moderate-income households with income supports (such as the Earned Income Tax Credit) and other services that bolster income. In addition, it invites clients to become engaged in community and civic life.

HSC found that activating and sustaining civic involvement calls for a variety of approaches to meet individual needs, interests and preferences. The Civic Life Academy answers this need by providing multiple pathways for individuals to get involved in their own advocacy and sustain this involvement.

Participants in the Civic Life Academy move from basic to more advanced skills as they engage in positive actions that help sustain their involvement in the program. Individuals seeking prosperity services are encouraged to tell their stories as a vehicle for personal expression, validation and empowerment. Many of these powerful "stories of truth and hope" are featured on websites and other media and are offered as public testimony to policy makers.

> "They envisioned an organization that would ... create avenues for active engagement in democratic civic life.."

Those involved in the Academy then join leadership programs such as the Neighborhood Leadership Program, Parent Leadership Training Institute and Public Allies, which provides leadership training for young people. Additional skills and policy are taught through Advocacy Corps Training and Project Development and Management programs.

HSC is proud to be a pioneer in creating an integrated service-advocacy approach that teaches individuals to be effectively involved in both our economy and democracy. The organization, which began as a committee of the Miami Dade League of Women Voters, is now an independent nonprofit. ▪

This article was written by Daniella Levine, Executive Director, Human Services Coalition.

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