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CASCADE

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Asset Diversification and Low Debt Are the Keys to Building and Maintaining Wealth*

By Ray Boshara, Director, Center for Household Financial Stability, Federal Reserve Bank of St. Louis, and William Emmons, Senior Economic Advisor, Center for Household Financial Stability, Federal Reserve Bank of St. Louis

In the mid-2000s, before the financial crisis, U.S. families set several records in their pursuit of the American dream of homeownership. These records include:

- The highest rate of homeownership ever recorded — slightly more than 69 percent of all households;[1]
- The highest concentration of assets in housing — 32 percent;[2]
- The lowest annual personal saving rate since 1934 — 2.6 percent;[3] and
- The highest personal debt-to-income ratio — 135 percent.[4]

Greatly expanded access to home mortgages during the 1980s, 1990s, and 2000s appeared to make the American dream a reality for millions of families. Homeownership was attainable by many who, for the first time, were able to take out a mortgage with an extremely low or no down payment — even if they had a blemished credit history or none at all. For those with access to their accumulated home equity through mortgage refinancing or other home-secured borrowing, as well as to other sources of credit, lack of available cash no longer meant that they had to delay making routine purchases, buying a new car, starting a home renovation project, or pursuing the dream of college for a family member.

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Asset diversification and reduced debt are recommended in light of the recession's impact on household finances.

* The views expressed here are those of the authors and do not necessarily represent the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.

[1] See U.S. Census Bureau, "Housing Vacancies and Homeownership," available at www.census.gov/housing/hvs/.

[2] See Board of Governors of the Federal Reserve System, "Financial Accounts of the United States," available at www.federalreserve.gov/releases/z1/.

[3] See Bureau of Economic Analysis, "Personal Income and Outlays," available at www.bea.gov/national/index.htm.

[4] See Bureau of Economic Analysis, "Personal Income and Outlays."

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Message from the Community Affairs Officer

Every day we make many decisions that have short-term or long-term implications. In their 2008 book, *Nudge: Improving Decisions About Health, Wealth, and Happiness*, Richard H. Thaler and Cass R. Sunstein maintain that the way in which choices are arranged can influence the decisions people make. The authors encourage the use of "nudges" to guide people to make more rational and beneficial decisions. This issue of *Cascade* explores several topics related to the financial decisions that people make and ways to encourage better decision-making.

For many years, homeownership was deemed the most effective way to build assets — particularly for low- and moderate-income (LMI) households. However, with the economic downturn, many households lost a significant amount of their housing equity and, consequently, a significant portion of their wealth. Ray Boshara and Bill Emmons make the case for greater diversification of assets and maintenance of low debt levels. Dan Hochberg's article highlights one potential model for asset diversification — tax-time savings programs.

Lisa Servon, a professor at the New School in New York City, recently spent several months working as a teller at a check casher in the South Bronx. Her experience sheds light on not only why low-income households rely on alternative financial services providers but also on the ways in which these institutions engage and serve the LMI population.

Theresa Y. Singleton, Ph.D., Vice President and Community Affairs Officer

After spending almost 30 years at the Federal Reserve, 10 of those as the director of the Federal Reserve Board's Division of Consumer and Community Affairs, Sandra Braunstein will be retiring early this year. We hope that you will join us in acknowledging her dedication to advancing consumer protection and community development, and we know that you will enjoy her reflections.

Finally, we are excited to open registration for the 2014 Reinventing Older Communities conference, which features leading research and practice. This year's conference theme is Bridging Growth & Opportunity. The conference will focus on ways to encourage inclusive growth and create more equitable communities. We look forward to seeing you at the conference in Philadelphia on May 12–14.

Theresa Y. Singleton

Register now for the 2014 Reinventing Older Communities conference. Go to www.philadelphiafed.org/ROC2014.

The Federal Reserve's Role in Community Development — An Interview with Sandra Braunstein*

After spending almost 30 years at the Board of Governors of the Federal Reserve System, 10 of those as director of the Federal Reserve Board's Division of Consumer and Community Affairs, Sandra Braunstein will retire early this year. As director, Braunstein is principally responsible for the development and administration of Federal Reserve policies and functions related to community development and consumer protection regarding financial services. She also oversees the community development departments, housed at the Federal Reserve Board and at the regional Reserve Banks and branch offices, which conduct community development activities and promote increased access to capital and credit in underserved markets.

In this interview, Cascade *staff wanted to take the opportunity to acknowledge Braunstein's contributions, discuss how she thinks the community development field has changed during her time at the Fed, and gain her insight into which opportunities are most promising for the field.*

Sandra Braunstein, Board of Governors of the Federal Reserve System

How has the Federal Reserve changed since you started working here? What are you most proud of during your time at the Fed?
Braunstein: Coming to the Federal Reserve was a culture shock. I went from leading a Washington, D.C., neighborhood nonprofit that participated with other community organizations in filing protests against bank merger applications to working for the Federal Reserve. At that time, the community development program at the Fed was small. It focused on providing information and education about the requirements of the Community Reinvestment Act to financial institutions and community organizations. The program has become increasingly sophisticated and employs survey methodology, data analysis, and empirical research to help us understand emerging trends in low- and moderate-income (LMI) communities.

Of the many projects and activities in which I participated over the years, I'm particularly proud to have helped establish a nationally recognized, Federal Reserve–branded biennial research conference that showcases and catalyzes research in the community development field. The conference has a dedicated audience of researchers, industry and community/consumer representatives, and policy professionals and features a community development–focused keynote address by our Chairman.

What have been the most significant changes in the community development field in recent years?
Braunstein: In many LMI communities, the recent financial crisis erased much of the progress that had been made during the past 30 years. Over the past five years, rebuilding communities has been a major focus of the Federal Reserve's community development work, which includes convening discussions and providing data and information that can be useful in stabilizing communities. Community development is difficult and painstaking work, and I'm very inspired by the people on the ground who continue to focus on creating sustainable communities.

The community development field has changed significantly over the years. Thirty years ago, there was a primary focus on housing issues, with some focus on small businesses and jobs. There is now a strong movement toward a much more holistic concept of community development. There is recognition that communities are sustainable only if all the pieces — affordable housing, jobs, access to transportation, good schools, safe streets, and access to health care and healthy foods — are in place. As a result, connections are being made between the sectors responsible for those various parts.

In your opinion, what are the biggest challenges and opportunities facing the field today?
Braunstein: Housing and community development organizations are finding that some organizations have been working in the same

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Why Do the Unbanked Use Alternative Financial Services?*

By Lisa J. Servon, Ph.D., Professor and Former Dean, Milano School of International Affairs, Management, and Urban Policy, The New School, New York City

Lisa Servon lectures and conducts research on urban poverty, community development, economic development, and issues of gender and race. As part of her research, she worked for four months last year as a teller at RiteCheck, a check cashing business in the South Bronx; worked for two weeks in October 2013 as a teller and collections agent at Check Center, a check casher and payday lender in Oakland, CA; and staffed a hotline in Virginia for people having difficulties with payday loans.[1] She shares what she learned in these positions in the following interview.

Lisa J. Servon at RiteCheck

What are the trends regarding the use of alternative financial services (AFS) by the unbanked (people without bank accounts) and underbanked (those who have bank accounts but rely on AFS such as check cashing and payday lending)?

Servon: A Federal Deposit Insurance Corporation (FDIC) survey conducted in 2011 found that one-quarter of all households — including 65 percent of unbanked households — reported using at least one AFS product between June 2010 and June 2011.[2] The survey found that transaction AFS, such as nonbank money orders, nonbank check cashing, and nonbank remittances, have been used by 39.1 percent of all U.S. households.[3]

Policymakers, consumer advocates, and researchers have expanded their efforts to encourage the unbanked to open bank accounts and the underbanked to increase their use of such accounts. One such effort is the Bank On initiative, in which local governments work with banks and credit unions to try to remove barriers to financial access.[4] The efforts are based on several assumptions, such as banks are a better choice for people than AFS providers, people choose which institutions to use based on financial criteria alone, and low-income people must lack basic financial literacy skills if they choose AFS providers over banks.

What did you learn from your work at the check cashing businesses and the hotline?

Servon: Most of the customers I worked with and interviewed at RiteCheck made informed choices about how and where they got their financial needs met. I found that banks were not the best choice for most check casher customers, many of whom either currently had a bank account or had one in the past.

At check cashers, fees are more transparent than they are at banks, the hours and locations are convenient, the services provided are what customers need, and customer service is excellent. It's true that the fees on individual transactions at check cashers are high; this is one way in which it's expensive to be poor. But most of the RiteCheck customers I interviewed had done the math and found that it was less expensive to use RiteCheck than to use a bank. In their experience, required minimum balances and fees for everything from ATM usage to account maintenance were going up.

The customers I spoke with preferred to pay predictable flat fees that they understand rather than incur unexpected charges and overdraft fees. Customers found overdraft fees particularly hard to manage. The people who frequent check cashers tend to live from check to check and could not always predict when the checks they deposited would clear and when the checks they wrote would be cashed.

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[1] Servon has written articles about her experiences in Public Books, *The Atlantic Cities*, and *The New Yorker*. See www.publicbooks.org/nonfiction/ritecheck-12, http://ow.ly/tLa86, and http://ow.ly/tPMfj.

[2] The survey defines AFS products as nonbank money orders, nonbank check cashing, nonbank remittances, payday loans, pawnshop loans, rent-to-own agreements, and refund anticipation loans. See "Addendum to the 2011 FDIC National Survey of Unbanked and Underbanked Households: Use of Alternative Financial Services," June 2013, available at www.fdic.gov/householdsurvey/2013_AFSAddendum_web.pdf.

[3] The AFS industry, which generally uses the term *financial service centers*, conducts more than 350 million transactions each year, providing an estimated 30 million customers with an estimated $106 billion in products and services, according to the Financial Service Centers of America. For more details, see www.fisca.org/.

[4] For more information, see http://joinbankon.org/.

MAPPING OUR COMMUNITY

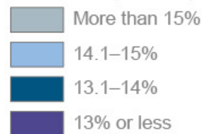
Third Federal Reserve District

KEITH WARDRIP, COMMUNITY DEVELOPMENT RESEARCH MANAGER

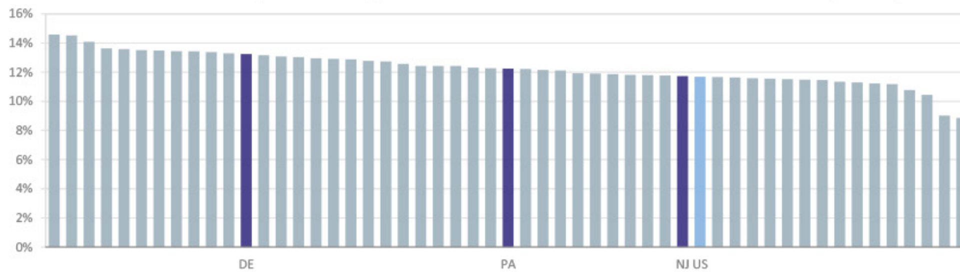
The Distribution of Household Income

One way to measure the level of equality in a community is to calculate the percentage of aggregate income accruing to its lowest-income households. For each county in the Third District, the map below illustrates the share of income reported by households in the lowest two-fifths of the income distribution — a group that is generally considered to represent a community's low- and moderate-income households. If income were evenly distributed, two-fifths of a county's households would claim 40 percent of its total income.

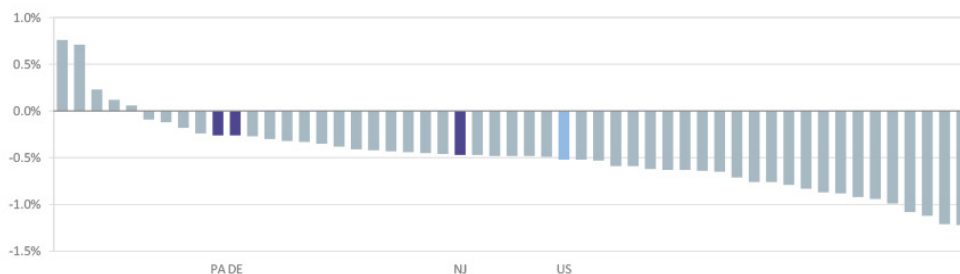
During the 2007–11 period, this share did not exceed 17 percent for any District county and was below 14 percent for six of the seven most populous counties. In all but two counties, a greater share of income accrued to the top 5 percent of households than to the lowest 40 percent. Relative to the national average, income distribution was slightly more equitable in Delaware, New Jersey, and Pennsylvania in 2011, and the percentage earned by households in the lowest two-fifths of the income distribution declined by less in these three states than in the entire U.S. between 2007 and 2011.



Share of income reported by lowest two-fifths of households (2011)



Percentage point change from 2007 to 2011



Sources: U.S. Census Bureau, American Community Survey Table B19082; ESRI, derived from Tele Atlas

Note: The views expressed here do not necessarily represent the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.

Using Tax-Time Savings Programs to Build Assets*

By Daniel Hochberg, Community Development Senior Research Assistant

The recent financial crisis and subsequent recession had a debilitating effect on the wealth of many American families. In a report produced by the Federal Reserve Bank of St. Louis, it was estimated that household wealth declined 26 percent from its peak in 2007 to the trough in 2009.[1] Not surprisingly, low- and moderate-income (LMI) families, who were already struggling financially prior to the crisis, were among the hardest hit. In 2008, nearly 30 percent of low-income families had zero or negative net worth.[2] Until recently, research on household balance sheets, or the savings, assets, and debts of households, focused primarily on family earnings.

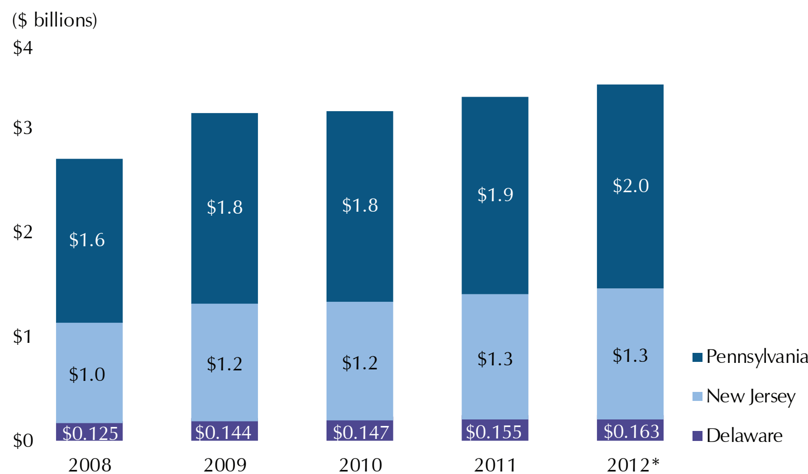
However, more attention is now being directed toward the role that assets play in providing financial stability for households. Families that are "liquid-asset poor" do not have the financial safety net to weather emergencies and, as a result, experience more hardship following negative financial shocks than those with assets. In addition, asset-poor families miss out on the financial benefits that are gained from having assets. Although balance sheets can be repaired by using a variety of asset-building strategies, this article focuses on programs that promote savings at tax time due to the inherent advantages of the tax preparation process.

Because tax time is both universal and recurring, many nonprofit and government agencies have found it valuable to structure savings programs around the moment of tax preparation. A federal refund can amount to as much as one-fifth of a tax filer's annual income, especially for those eligible for earned income tax credits (EITCs) and other credits, so tax time represents one of the few opportunities in which LMI individuals can realistically set aside savings for themselves and their families.

In the past decade, organizations across the country have launched innovative tax-time savings programs to motivate LMI families to save part of their lump-sum refund. Three notable programs are highlighted below.

The New York City Office of Financial Empowerment (OFE) launched the $aveNYC pilot program in 2008 to encourage saving at tax time and help LMI residents become more financially secure. Specifically, the program offered tax filers a 50 percent match on a portion of their tax refund to encourage them to set aside money for short-term goals, including paying down debt and building an emergency fund. To be eligible for the match, participants must have opened a risk-free, no-cost savings account at select Volunteer Income Tax Assistance (VITA)[3] sites in the city and maintained the initial deposit for one year. During the three-year pilot, approximately 2,200 tax filers saved

Total Earned Income Tax Credit Claim Amounts in Pennsylvania, New Jersey, and Delaware



*The average EITC claim amount in the 2012 tax year was $2,244 in Delaware, $2,196 in New Jersey, and $2,113 in Pennsylvania.
Source: http://www.eitc.irs.gov/EITC-Central/eitcstats/

* The views expressed here do not necessarily represent the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.
[1] The full report is available at www.stlouisfed.org/publications/re/articles/?id=2254.
[2] Signe-Mary McKernan and Caroline Ratcliff, "Enabling Families to Weather Emergencies and Develop: The Role of Assets," Urban Institute, 2008, available at www.urban.org/UploadedPDF/411734_enabling_families.pdf.
[3] VITA is an IRS-sponsored program that offers tax return preparation services to LMI individuals at no cost.

an average of $561, and 80 percent maintained their deposit for the full term.[4] The initial success of $aveNYC led to the expansion of the program in 2011 to Newark, NJ; San Antonio, TX; and Tulsa, OK.

Now known as SaveUSA, the program continued through the 2013 tax season, and its final match distribution was set for February 2014. To determine whether SaveUSA helped improve household financial stability and cultivate long-term saving habits for LMI families, the OFE has partnered with the Manpower Demonstration Research Corporation (MDRC)[5] to evaluate the program. Thus far, the preliminary results are encouraging: Despite having average annual incomes of less than $20,000, roughly two-thirds of the participants maintained their initial deposits for the full year.[6]

Another program that promotes tax-time savings is the SaveYourRefund sweepstakes, which was launched by the Boston-based nonprofit Doorway to Dreams (D2D) Fund in 2013. The national program encourages LMI tax filers to save a minimum of $50 using IRS Form 8888, which allows them to directly deposit a portion of their federal refund into a savings account or use their refund to purchase U.S. savings bonds. Registrants are entered into weekly drawings for cash prizes and are also eligible for a $25,000 grand prize. In the first year of the sweepstakes, 772 entrants saved an average of $896, representing approximately one-third of their total refund. A follow-up survey of both entrants and nonentrants also showed that SaveYourRefund raised awareness of Form 8888, as 74 percent of the program participants reported never having heard of the form prior to entering the sweepstakes.[7] D2D will continue the program in 2014 and hopes to enroll even more participants.

In 2005, the nonprofit Corporation for Enterprise Development (CFED) launched the Self-Employment Tax Initiative (SETI), which is aimed at assisting the 13 million self-employed individuals in the United States who are earning less than $50,000 annually.[8] The purpose of SETI is to help low-income self-employed individuals grow their businesses and take advantage of tax-based asset building opportunities. Specifically, the national initiative awards grants to VITA programs that provide free or reduced-cost tax preparation services to ensure that self-employed workers receive the maximum number of tax credits for which they are eligible. To date, SETI has partnered with more than 40 organizations across the country and has awarded more than $500,000 in grants. The initiative continues to conduct research to identify optimal ways to serve self-employed workers.

Although significant progress has been made in recent years to encourage LMI households to save at tax time, plenty of opportunities for growth still remain. More than 26 million tax filers received nearly $62 billion in EITCs for the 2012 tax year,[9] and innovative tax-time savings programs are the key to helping these individuals rebuild their balance sheets.

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[4] Department of Consumer Affairs, Office of Financial Empowerment, "The $aveNYC Account: Innovation in Asset Building," Research Update, December 2010, available at www.nyc.gov/html/ofe/downloads/pdf/savenyc_research_update_dec2010.pdf.
[5] The Manpower Demonstration Research Corporation (MDRC) is a nonprofit, nonpartisan education and social policy research organization that works to improve programs and policies that affect LMI households.
[6] Gilda Azurdia, Stephen Freedman, Gayle Hamilton, and Caroline Schultz, "Encouraging Savings for Low- and Moderate-Income Individuals: Preliminary Implementation Findings from the SaveUSA Evaluation," MDRC Policy Brief, April 2013, available at www.mdrc.org/sites/default/files/SaveUSA_brief14.pdf.
[7] Doorway to Dreams Fund, "SaveYourRefund 2013: Testing a National Infrastructure for Prize-Linked Tax-Time Savings," available at www.d2dfund.org/files/publications/D2D_SaveYourRefund_Web.pdf.
[8] See the Self-Employment Tax Initiative Fact Sheet, available at cfed.org/programs/seti/SETI_FactSheet.pdf.
[9] See Statistics for Tax Returns with EITC, available at www.eitc.irs.gov/EITC-Central/eitcstats.

Additional Information

New York City Office of Financial Empowerment
Phone: 212-487-2710
Website: www.nyc.gov/html/ofe/html/policy_and_programs/saveusa.shtml

D2D Fund
E-mail: info@d2dfund.org
Phone: 877-642-3167
Websites: www.d2dfund.org or www.saveyourrefund.com/

Corporation for Enterprise Development
E-mail: seti@cfed.org
Phone: 202-408-9788
Website: www.cfed.org/programs/seti

Student Loans: A Primer*

By Thomas Hylands, Community Development Research Analyst

On average, higher education is a great investment: The average person with a four-year degree earns substantially more than the average high school graduate,[1] and the cost of that degree is well below the financial benefits that are derived.[2] However, borrowing to pay for education has risen dramatically in recent years, with outstanding student debt recently passing $1 trillion, which is almost four times the debt incurred in 2004.[3] Today, an increasingly large number of borrowers are unable to make their student loan payments,[4] which raises concerns about what this means for individuals and for the economy as a whole.

How Do Student Loans Work?
Simply stated, student loans are a specific set of financial products that allow individuals to borrow money that will be used to pay for education. Because widespread access to higher education has been a long-standing policy goal in the United States, these loans have historically had low interest rates and have been widely available, with very little in the way of underwriting standards that are often used for other forms of credit, such as mortgages and credit cards. Today, an overwhelming majority of such loans are originated by the federal government;[5] however, until 2010, many loans were originated by private lenders and guaranteed by the federal government. Because student loans usually have a 10-year term, many such private loans, which typically have higher interest rates and less flexibility in repayment terms, are still outstanding today. In addition to these problems, student loans can be difficult to refinance and almost impossible to discharge, even in bankruptcy. Although student loans are typically associated with the young, and the problem is often highlighted in relation to recent college graduates struggling in a weak economy, only about 40 percent of student loan borrowers are under the age of 30.[6]

Why Are Student Loans Receiving So Much Attention?
Since the beginning of 2004, outstanding student loan debt almost quadrupled, from $0.26 trillion to $1.03 trillion,[7] which has led to speculation about a student loan bubble reminiscent of that seen in housing at the end of the last decade. The outstanding debt is increasing at least in part because of rising college costs, as shown in the figure. Between the 1990–91 and 2011–12 academic years, the average price of a year of college education had risen by more than $8,000 in constant 2012 dollars. Although this has been partially offset by increases in grant aid, much of the cost increase has been absorbed by student loans.

However, college remains a good investment, as long as students can pay off their loans. The challenge with student loans, therefore, is not in borrowing but in repayment. Students who start college but drop out are at particularly high risk because they incur costs without the full payoff of receiving a degree. Similarly, students who spend additional time completing their degrees are disadvantaged because they incur additional costs but with no greater future payoff than students who graduate on time. More students fall into these groups than many people realize: In 2011, the six-year graduation rate for full-time first-time undergraduate students seeking a four-year degree was just 59 percent.[8]

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[1] U.S. Department of Labor, Bureau of Labor Statistics, "Earnings and Unemployment Rates by Educational Attainment," 2013, available at www.bls.gov/emp/ep_chart_001.htm.

[2] Anthony P. Carnevale, Stephen J. Rose, and Ban Cheah, "The College Payoff: Education, Occupations, Lifetime Earnings," Georgetown University Center on Education and the Workforce, 2011, available at http://ow.ly/thlwi.

[3] Federal Reserve Bank of New York, "Household Debt and Credit Report," 2013, available at www.newyorkfed.org/householdcredit/2013-Q3/index.html.

[4] In the third quarter of 2013, 11.8 percent of outstanding student loan balances were delinquent, as compared with 6.3 percent in the first quarter of 2004. See Federal Reserve Bank of New York, "Quarterly Report on Household Debt and Credit," 2013, available at http://ow.ly/thlGA.

[5] In the 2012–13 academic year, 92 percent of all student loan debt originated came from the federal government. See College Board, "Trends in Student Aid 2013," available at http://ow.ly/th98R.

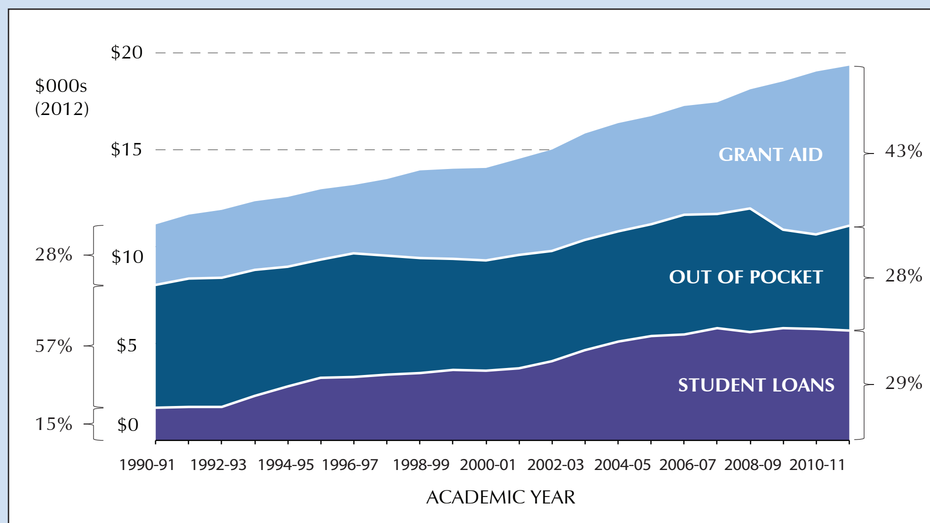
[6] Meta Brown, Andrew Haughwout, Donghoon Lee, et al., "Grading Student Loans," Federal Reserve Bank of New York *Liberty Street Economics*, 2012, available at http://ow.ly/uiVzi.

[7] Federal Reserve Bank of New York, "Household Debt and Credit Report," 2013, available at http://ow.ly/thlQV.

[8] U.S. Department of Education, National Center for Education Statistics, "Fast Facts: Graduation Rates," 2013, available at http://nces.ed.gov/fastfacts/display.asp?id=40.

Financing the Average Cost for One Year of Undergraduate Education (constant 2012 dollars)

The chart is adapted from work by the Hamilton Project.[a] Cost data include tuition, fees, and room and board.[b] Grant aid includes federal grants, education tax benefits, Federal Work–Study income, state grants, institutional grants, and private and employer grants. Student loans include federal and nonfederal loans.[c] Out-of-pocket expenses are total costs minus grant aid minus student loans.[d]



[a] Michael Greenstone and Adam Looney, "Rising Student Debt Burdens: Factors Behind the Phenomenon," The Hamilton Project, 2013, available at http://ow.ly/thmiU.

[b] U.S. Department of Education, National Center for Education Statistics, "Digest of Education Statistics: 2012," available at http://ow.ly/thmtr.

[c] College Board, "Trends in Student Aid 2013," available at http://ow.ly/th98R.

[d] More information on the method is available from the original authors at http://ow.ly/thigg.

What Are the Implications of Inability to Repay Student Loan Debt?

For borrowers who fall behind on their loan payments, the consequences can be serious. Failure to make the required payments will damage a borrower's credit score and may limit his or her access to other forms of credit, such as mortgages or car loans. Even if borrowers stay current on their loans, the money used to make loan payments is not available for other uses, which limits their spending. For example, borrowers with student debt may not have the ability to pursue their desired career, start a business, or retire at an earlier age. Additionally, it is not always just the student who is affected. A student's family may take on loans to pay for the student's education (e.g., through the Federal PLUS Loan program[9]).

Are There Any Potential Solutions to These Problems?

Because of rising student loan delinquency rates, several potential strategies, including income-based repayment, longer repayment periods, loan forgiveness in exchange for working in certain key fields, and automatically withholding funds from paychecks, have been proposed. Some of these strategies have been introduced for certain federal loans, but efforts have been somewhat undermined by confusion over which loans are eligible. In addition, private lenders have been reluctant to make concessions.

Finally, entirely new products in education and finance have started to appear that may change the student loan landscape in the long term. Massive online open courses have proliferated in recent years, offering free or very low-cost college courses to anyone with an Internet connection. Also, new direct lending and investment models of financing that connect individual investors with students have been introduced by nontraditional financing companies such as CommonBond, SoFi, and Pave. CommonBond, founded by students at the University of Pennsylvania's Wharton School, and SoFi attract investors from a school's alumni base to lend money to the school's current students at a lower interest rate than the market provides, while Pave allows an investor to pay for a student's education in exchange for a portion of his income for a set period of time thereafter.

Conclusion

College remains a great investment when financed appropriately, but an increasing number of student loan borrowers are struggling with their debts. This has negative implications for the borrowers and for the wider economy, and potential solutions have had a limited impact to date.

[9] The Federal PLUS Loan program allows the parents of undergraduate students to cover any gap between the financing their child has available and the full cost of their child's program.

SPOTLIGHT ON RESEARCH

Cities for Financial Empowerment Effort*

During periods of economic hardship, virtually all segments of the population are adversely affected. While many individuals eventually make strides in recovering financially, some are not as fortunate. The less fortunate are not only unable to effectively improve their financial well-being but they also have difficulty contributing to the revitalization of their communities. In order to assist those in this sector, it is imperative to understand the factors that contribute to the difficulties they encounter in improving their plight, to pinpoint strategies to aid in their endeavor, and to identify the organizations/institutions best suited to help them become financially stable. The Corporation for Enterprise Development (CFED) confronts this challenge in a report that it compiled detailing the efforts of the Cities for Financial Empowerment (CFE) Coalition. The report chronicles the lessons learned by the local governments of the member cities (now 12, but 11 at the time) in addressing the struggles of financially vulnerable populations to restore their economic well-being after experiencing an economic setback.[1] The following is a summary of CFED's report.

Background

CFED maintains that city leaders should think more prospectively when contemplating assistance for the most vulnerable members of the population. More specifically, they should "think beyond reactive policies focused narrowly on crisis intervention and preservation of the safety net, to policies that aim to proactively help individuals out of poverty — in essence offering them a hand up instead of a hand out." Although CFED deems the efforts at the state and federal levels to be helpful, when it comes to "affordable housing, to transportation, to banking services, to consumer protection, cities are uniquely positioned to align their array of services to advance the common goal of building the prosperity of all its residents." The authors of the report stressed that municipal governments have devoted their efforts to assist individuals in achieving economic security by increasing their "income through job creation and job training strategies, and by proving subsidies for housing and other basic goods." But "what they have not traditionally focused on is parlaying that increased income into savings and durable assets — and then protecting that income, savings and assets from predatory financial practices."

The CFE Coalition consists of 12 member cities (Chicago; County of Hawai'i; Los Angeles; Louisville, KY; Miami; Newark, NJ; New York City; Providence, RI; San Antonio; San Francisco; Savannah, GA; and Seattle) that are piloting financial empowerment strategies "often in collaboration with partners from the private, nonprofit and philanthropic sectors." CFED worked in conjunction with member cities of CFE to document the program and strategies being implemented in the cities to "financially educate, empower and protect their residents."

Financial Empowerment Strategies

In its report, CFED focuses on five main strategies.

1. Improve access to high-quality financial information, education, and counseling

The CFE's member cities are working to help households build their financial knowledge and develop positive financial behaviors by improving and making available quality education and counseling. Thus, the cities of Seattle, Savannah, and New York are incorporating these services into social services, welfare programs, and other federally funded programs targeted to low-income households. Moreover, the cities maintain that "providing dedicated funding streams for financial education, credit repair and asset-specific financial counseling would facilitate the expansion of these highly successful local initiatives."

2. Increase access to income-boosting supports and tax credits

Having adequate income is key to being able to afford basic needs and save for the future. Regrettably, many low-wage workers must rely on employment that is characterized by instability and unpredictable earnings.

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* The views expressed here are those of the author and do not necessarily represent the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System.

[1] Ida Rademacher, Jennifer Brooks, Kasey Wiedrich, et al., Building Economic Security in America's Cities: New Municipal Strategies for Asset Building and Financial Empowerment, CFED, January 2011, available at cfed.org/assets/pdfs/BuildingEconomicSecurityInAmericasCities.pdf.

While cities traditionally have had services and benefits to aid individuals during hard times, they "have begun to devise new ways to leverage existing services and benefits to reach the largest number of residents possible."

Fortunately, one program that enjoys a great deal of alignment among the different levels of government is the earned income tax credit (EITC). "The federal EITC is one of the largest and most effective wage support programs for low- and moderate-income families." Since the federal credit was enacted in 1975, it has been increased markedly — from $1.3 billion to $48.7 billion in 2007. According to a 2009 CFED publication, "since the federal credit was enacted, 23 states and the District of Columbia have enacted state-level EITCs, and several local jurisdictions — San Francisco, New York and Montgomery County, MD — have enacted local credits that piggy-back on the federal credit."[2] The authors of the CFED report noted that some cities are pursuing public awareness campaigns in regard to the EITC and are also encouraging residents to avail themselves of public benefits and work supports. Thus, "cities are using a range of technology platforms to link residents to city- and state-administered benefits."

3. Connect residents to safe, affordable financial products and services that reduce costs and facilitate savings
According to the CFED report's authors, "a household's ability to save depends on several factors: minimizing costs for basic goods and services, access to convenient, low-cost financial products and structures (transaction, saving, credit and insurance products as well as direct deposit, automatic enrollment, etc.), and financial capability related to money management, financial products and credit."

Unfortunately, many low-income people are unable to afford basic goods and services, let alone unanticipated contingencies. Thus, many rely on credit to make ends meet. But the high-cost credit products that some individuals use increase their debt — leaving even less for saving. The authors of the CFED report indicate that some cities are working with financial institutions to lower the cost of borrowing by developing "more affordable short-term credit products." Some of the products or activities include low-cost savings accounts, small-dollar loans, refund anticipation loans, auto refinance loans, and urging employers to use direct deposit.

4. Create opportunities to leverage savings into appreciable assets
When individuals are able to generate savings, they can cover emergency expenses in the short run and leverage their savings in the long run to obtain appreciable assets, such as education or marketable credentials, or to purchase a home or start a business. But many individuals with modest means find it difficult to amass a reasonable amount of liquid savings and tangible assets.

The authors of the report point out that some cities are embarking on efforts to assist individuals in their savings endeavors. Some of the undertakings include providing incentives for individuals to establish savings accounts that can be used for their own or their children's education or for purchasing a home or vehicle. Also, some cities "have forged strategic partnerships with not-for-profit microenterprise finance organizations to provide micro-loans to low- and moderate-income entrepreneurs who have difficulty securing financing through traditional institutions."

Marvin M. Smith, Ph.D.,
Senior Community Development Economic Advisor

5. Protect consumers in the financial marketplace
The final set of strategies by cities to assist the financial security and empowerment of consumers with limited incomes involves programs and policies to protect against loss of income or assets and the harmful consequences of predatory lending practices. In the report, the authors list several efforts being undertaken by cities that include "limiting or managing the proliferation of alternative, high-cost financial service providers through licensing and zoning powers, curbing predatory consumer lending through enforcement of disclosure laws or litigation, and foreclosure prevention strategies, including foreclosure counseling, forgivable emergency loans, encouraging lender workouts and assistance to tenants in foreclosed properties."

Concluding Observations
The authors of the CFED report noted that "the fundamental approach of each of the cities documented in [their] report is to embed and centralize financial empowerment and asset-building strategies within city administration." Thus, "no matter what door a person walks through, they can access the financial supports, products and services they need."

[2] Corporation for Enterprise Development, "The 2009–2010 Assets & Opportunity Scorecard," *Community Investments*, 21:3 (Winter 2009/2010), pp. 28–33, available at www.frbsf.org/community-development/files/cfed_scorecard.pdf.

In Memoriam: Frederick Heldring

Frederick Heldring, former chairman and CEO of Philadelphia National Bank (PNB) and a leader of affirmative lending, community development, and international trade initiatives, died October 12, 2013, at the age of 89 at his home.

Heldring, the son of a bank president, was born in 1924 in Amsterdam. During World War II, at age 19, he began working for a Dutch underground organization in Amsterdam that was dedicated to helping hide Jews among Dutch families.[1] Soon after, he became chief of a spy operation that smuggled reports of German troop movements to the Allied Forces.[2]

After the war ended, he served in the Dutch marines and studied economics. In 1950, he emigrated to the United States and enrolled at the University of Pennsylvania's Wharton School. While at Wharton, he worked part time evenings for PNB sorting checks. After graduating in 1951, he started a long career in the bank's overseas operations.

In 1959, Heldring was one of the first U.S. bankers who visited the former Union of Soviet Socialist Republics (USSR) to seek opportunities to finance imports and exports, and later he traveled extensively in Eastern Europe, Asia, and Latin America on similar trade financing missions. In 1974, he was appointed president of PNB and served as its chairman from 1986 until his retirement in 1989. He also served as vice chairman of CoreStates Financial Corporation.

As PNB's chairman, he instituted Upward Communication meetings, which gave employees an opportunity to sit down with members of senior management and discuss their concerns and questions. He said that he "wanted to have the ability for one hour a week to listen to employees in any part of the bank and see the bank through their eyes."

In the early 1970s, Heldring advocated bank lending in underserved neighborhoods in the Philadelphia area. In 1975, two years prior to the passage of the Community Reinvestment Act, Heldring and two other bank presidents[3] founded the Philadelphia Mortgage Plan (PMP), which became the Delaware Valley Mortgage Plan, in response to the concerns of area city officials, community organizations, and the media about urban disinvestment and "redlining."[4] According to a published report, from 1975 to 1998 the plan made $700 million in home mortgages available to more than 26,000 families throughout the Delaware Valley region.[5] In 1998, six financial institutions were participating in the plan, which received national attention.

In the PMP, participating banks agreed to base home mortgage lending decisions on the structural soundness of the house and the creditworthiness of the applicant, not on conditions in the surrounding neighborhood. Before loan requests were declined, applications were reviewed, with identifying information omitted, by all PMP lending officers at regular weekly meetings.

Robert Palmer, PNB's president in 1987 and president and CEO from 1988 to 1992, said, "Heldring believed that the banks should be encouraged to take risks and lend to homebuyers in low-income Philadelphia neighborhoods who had jobs and exhibited character. Heldring was very sensitive to the needs of poor communities from his experience in Amsterdam and his international travel. He had a deep commitment to help Philadelphia's poorer neighborhoods and saw a similarity of problems, and possibly solutions, when confronting poverty locally and in the Third World."

Heldring was also a founder of the Philadelphia Rehabilitation Plan, which made loans for the rehabilitation of low-income housing. He helped develop PNB's Public Responsibility Department, which encompassed the bank's community development loan programs and bank foundation.

Upon his retirement from PNB, Heldring became chairman of the Philadelphia Development Partnership, later succeeded by Entrepreneur Works, which helps develop microenterprises in the Philadelphia area and Chester, PA, by providing loans, technical assistance, education, and networking opportunities.

Leslie Benoliel, executive director of Entrepreneur Works, said, "Fred was a remarkable human being whose efforts to help those less fortunate — those who were being persecuted, those living in poverty — spanned several decades and continents. He was a tireless champion of community development and social justice in Philadelphia."

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[1] This information was obtained from a detailed obituary written by his family.

[2] Heldring was interviewed about these experiences in 1998 by the USC Shoah Foundation's Institute of Visual History. See http://sfi.usc.edu/. Go to the institute's Visual History Archive and search for interview with Heldring. The interview is also available at www.youtube.com/watch?v=RiwOYDKvu3I.

[3] The other cofounders were the late M. Todd Cooke of the Philadelphia Savings Fund Society and the late James F. Bodine of First Pennsylvania Corporation.

[4] See "The Delaware Valley Mortgage Plan: Extending the Reach of Mortgage Lenders," *Journal of Housing Research*, 1993, available at www.knowledgeplex.org/showdoc.html?id=1159.

[5] See "Delaware Valley Mortgage Plan: Reaching Low-Income and Minority Borrowers," PRNewswire, available at http://ow.ly/rQKul.

The Federal Reserve's Role in Community Development — An Interview with Sandra Braunstein ...continued from page 3

neighborhoods all along, although they never collaborated. Communities are now leveraging expertise and finances across what were once independent sectors. A good example in several locations is the work being done between the community development sector and health policy experts. The Federal Reserve has been on the leading edge of this work, holding forums in various locations to bring the players together. Leveraging resources and working with nontraditional partners present a huge opportunity for community development and can result in more sustainable neighborhoods.

What are the lessons from the recent financial crisis for the Federal Reserve and the Third District?
Braunstein: The financial crisis taught us a lot about effectively understanding community challenges and communicating them to key stakeholders. One of the foremost lessons from the crisis is that the Federal Reserve needs to listen to outside voices to best understand the important issues for consumers and communities.

The Federal Reserve is a data-driven organization, which is a good thing. Unfortunately, data often lag the issues. By the time an issue becomes evident in the data, it may be too late for an effective policy response. While there continues to be a need for data, other qualitative information is important to help us stay on top of emerging issues. A real benefit can be gained from the polling work currently conducted by the community development staff at the 12 Reserve Banks. This information can help us gain "real-time" insight into community needs.

Additionally, the Federal Reserve should continue to use its convening power to bring stakeholders to the table to discuss important issues. Leveraging the institution's credible platform to make and solidify connections between the private and public sectors can facilitate conversations and, hopefully, foster innovative solutions to real problems.

Why Do the Unbanked Use Alternative Financial Services?

...continued from page 4

What were the typical financial needs of the customers who frequently visited check cashers?
Servon: At RiteCheck, a one-stop shop open 24/7, customers typically came in on paydays with a paycheck and a stack of bills. They cashed their paychecks and then divided up the cash among the bills they had to pay (sometimes not paying them all in full) and either purchased money orders in the amount of the payments or had us pay the bills electronically. They knew exactly what they had paid and how much money they had left until they received their next check.

The highest volume of transactions occurred at the beginning and end of the month when customers cashed their government benefit checks. Many customers paid $30 a year to have Supplemental Security Income checks sent electronically to the store, rather than by mail to their home address, to get access to the funds one or two days earlier.

How would you describe interactions between employees and customers?
Servon: When I asked customers what they got at the check casher that they did not get at a bank, the words "service," "trust," and "respect" came up repeatedly. At Check Center, I participated in an all-day customer service training session in which I was coached on how to learn customers' names and how to use the names at least three times during any transaction.

Tellers treated the customers as individuals and went the extra mile to assist them. They sometimes made policy exceptions for regular customers. We regularly got tips at RiteCheck, and frequent customers noticed if one of us was sick and asked about us.

Do you have any concluding thoughts based on your experience?
Servon: There's a large gap between the rhetoric of policymakers and the lived reality of the low-income people using check cashers. If we really want to help low-income people have better access to financial services, we have to listen to what they need instead of assuming that what we do is best for them.

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Asset Diversification and Low Debt Are the Keys to Building and Maintaining Wealth ...continued from page 1

Unfortunately, rapidly accruing household debts, especially mortgage debt, over many years resulted in highly leveraged — and extremely fragile — balance sheets for many families.[5] The result was that, when the financial crisis and ensuing Great Recession hit in 2007–08, millions of financially fragile families found themselves in dire financial straits. Mortgage foreclosures and consumer bankruptcies spiked, resulting in untold hardship for many families and a weak economic recovery.

How Did We Get Here? Family Balance Sheet Trends Before the Crisis

During the 25 years ending in 2007, Americans' per capita disposable personal income more than tripled, while total assets owned per capita increased about five-fold. The value of assets owned increased faster than incomes primarily because stock and house prices increased rapidly. Meanwhile, the amount of debt of all kinds owed per person increased by a factor of six, while mortgage debt owed per capita grew eight-fold.[6]

The rapid increase in the amount of debt owed in excess of income or asset growth meant that many families were highly leveraged; that is, their debt was unusually high relative to their asset holdings, and their wealth was very sensitive to changes in the value of their assets. Therefore, these families were highly vulnerable to falling house prices.

Recovery of Wealth: Unfinished and Uneven

The Board of Governors of the Federal Reserve System recently reported that total household wealth once again exceeded the peak it had reached before the Great Recession and that household deleveraging — that is, steady declines in the balance of debt outstanding — apparently had come to an end.[7] However, closer examination reveals that household balance sheet recovery is far from complete and is proceeding at an uneven pace depending on the individual family.[8] The kind of assets a household owned going into the crisis and how much debt it owed significantly influence how well it is rebounding.

A family's financial recovery is likely to be complete if the family happens to be among the one-quarter of American families headed by someone who (1) is 40 years of age or older, (2) has a college degree, and (3) is white or Asian. This is because demographic factors such as age, educational attainment, and race or ethnicity tend to be closely associated with certain balance sheet choices; therefore, groups of families defined by their demographic characteristics tend to experience similar wealth gains and losses.[9] If, on the other hand, a family is among the three-quarters of U.S. families headed by someone who is under 40 years of age, does not have a college degree, or is black or Hispanic, financial recovery is likely to be far from complete.

An important reason why many younger, less educated, and historically disadvantaged minority families are struggling financially today is that many of them entered the recession with balance sheets that were not liquid or well diversified and were highly leveraged. That is, families who were already vulnerable to an economic downturn through job market risk had assumed more financial risk with their balance sheets, not less.[10]

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[5] A family's balance sheet is the financial statement that summarizes at a point in time what the family owns (assets) and what it owes (liabilities, or debts). The difference — assets minus liabilities — is the family's net worth, or wealth. Major asset categories include automobiles, other durable goods, residential real estate, cash, deposits, mutual funds, retirement accounts, the cash value of life insurance policies, stocks, bonds, investment real estate, and other business assets. Major debt categories include credit card, automobile, student loan, mortgage (including closed-end second liens and revolving lines of credit secured by a residence), and other installment debt; taxes payable; and a variety of other liabilities.

[6] See Bureau of Economic Analysis, "Personal Income and Outlays," available at www.bea.gov/national/index.htm; Board of Governors of the Federal Reserve System, "Financial Accounts of the United States," available at www.federalreserve.gov/releases/z1/.

[7] See Board of Governors of the Federal Reserve System, "Financial Accounts of the United States — Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts," available at www.federalreserve.gov/releases/z1/Current/z1r-1.pdf.

[8] William R. Emmons and Bryan J. Noeth, "Wealth Recovery Still Not Complete, Remains Uneven Across Families and Locations," Federal Reserve Bank of St. Louis *In the Balance*, 6, 2013, available at www.stlouisfed.org/publications/itb/articles/?id=2445.

[9] Ray Boshara and William Emmons, "After the Fall: Rebuilding Family Balance Sheets, Rebuilding the Economy," Federal Reserve Bank of St. Louis Annual Report 2012, available at www.stlouisfed.org/publications/ar/2012/pages/ar12_2a.cfm.

[10] William R. Emmons and Bryan J. Noeth, "Economic Vulnerability and Financial Fragility," Federal Reserve Bank of St. Louis *Review*, 95:5, September/October 2013, available at research.stlouisfed.org/publications/review/article/9961.

Among all families, declines in the value of the average home accounted for 58 percent of the total loss of household wealth suffered during the financial crisis.[11] But that number rises to 75 percent among families headed by someone who is under the age of 40; to 79 percent when the head of the household does not have a high school diploma; and to 88 percent for families headed by someone who is black or Hispanic.[12]

Two Keys to a Healthy Balance Sheet: Asset Diversification and Low Debt

How can a family that is headed by someone who is young, does not have a college degree, or is a minority break the historical link between economic vulnerability and financial fragility? The first crucial strategy is to diversify the family's balance sheet while building wealth; the second is to maintain low debt. Neither is easy, but recent experience suggests these steps are necessary.

Asset diversification means owning several different kinds of assets, including safe and liquid bank accounts to handle emergencies; long-term saving vehicles such as mutual funds to accomplish long-term goals like education, homeownership, and retirement; and an appropriate amount of durable goods and real estate. Given the large upfront cost of buying a house, maintaining a diversified asset portfolio means homeownership generally will not be the first step on the road to financial stability; instead, it is more likely to be the final piece of the puzzle.[13]

Throughout the slow and steady process of building a diversified base of assets, a prudent family focused on financial stability will minimize or, if possible, eliminate its debt. In addition to being risky, borrowing generally is expensive for economically vulnerable families who might be required to pay relatively high interest rates and fees and who usually gain little if any tax benefit from deductible mortgage interest. Even middle-income families typically realize very little benefit from deducting mortgage interest. Virtually all low-income families are excluded from the tax benefit associated with paying mortgage interest.

The Bottom Line: Keep It Simple, Diversified, and Debt-Free If Possible

The bottom line for economically vulnerable families seeking financial stability is to maintain a diversified balance sheet with low or no debt. This means that homeownership may well be the final, crowning achievement signifying the attainment of financial success rather than an early strategy to pursue it. We have only to look at the tragic outcome of millions of foreclosed homes and shattered dreams to see the dangers of economically vulnerable families holding illiquid, undiversified, and overleveraged balance sheets.

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[11] See Table 1, p. 4, in William R. Emmons and Bryan J. Noeth, "Why Did Young Families Lose So Much Wealth During the Crisis? The Role of Homeownership," Federal Reserve Bank of St. Louis *Review*, 95:1, January/February 2013, available at research.stlouisfed.org/publications/review/article/9600.

[12] For more information, see Emmons and Noeth (2013), Table 2, p. 13. The previously unpublished estimates for families headed by someone with less than a high school education and for minority families were computed analogously to those in Tables 1 and 2, based on data in the Federal Reserve's Survey of Consumer Finances.

[13] It is possible to obtain investment exposure to real estate without becoming a homeowner by purchasing shares in a real estate mutual fund. The scale of the investment can grow as a family's assets grow.

Additional Resources

Several presentations given by the Center for Household Financial Stability's staff members provide additional information about topics discussed in this article. "Financial Inclusion and Economic Recovery" lists studies on household wealth, shows a connection between youth savings and college graduation rates, and highlights the importance of short-term savings. "Why Did So Many Economically Vulnerable Families Enter the Crisis with Risky Balance Sheets?" and "Financial Sustainability and Strength (Assets)" also provide relevant information. To view these presentations, go to www.stlouisfed.org/household-financial-stability/presentations/.

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