

Curtailing Predatory Lending: Helping Families Grow Economic Assets

Policy Brief No. 10

By draining the economic assets of low-income families, predatory lending erodes their ability to raise children and become self-sufficient. This brief discusses the impact and cost of predatory lending on low-income families and identifies ways to increase affordable and fair credit alternatives.

Introduction

By draining the economic assets of low-income families, predatory lending erodes their ability to raise children and become self-sufficient. Unnecessarily high interest rates and abusive loan-fee structures divert family income from basic necessities and fuel repeat borrowing. In fact, nine in 10 payday loans are to repeat borrowers, who average 5-13 loans per year and often pay \$800 for a \$325 loan (McGill 2004; CRL 2005; Shirk 2005). Foreclosure, a common harm resulting from predatory lending, strips families of their most important asset—their home, which confers many protective benefits for children such as stability.

Low-income families with children are vulnerable to predatory lending. With limited education comes limited financial literacy, so many families have difficulty protecting their interests. Also, predatory lending thrives in neighborhoods lacking “mainstream” financial institutions that provide fair and appropriate financial services. Because

Policy Recommendations

Federal, state and local governments have an important role to play in curtailing predatory lending. Key policy opportunities include:

- **Adopt anti-predatory lending legislation.**
- **Improve enforcement of lending and consumer protection laws and regulations.**
- **Encourage mainstream financial institutions to expand services in underserved communities.**
- **Support consumer financial education and counseling.**

To be effective, a multi-faceted approach is needed. The full policy recommendation section begins on page 12.

traditional bank accounts are a “passport to the modern economy” according to former Treasury Secretary Lawrence Summers, unbanked families face many obstacles to growing their economic assets. Thus, *this brief examines both predatory lending and access to affordable mainstream financial services.*

To combat predatory lending, policy makers have an array of options. Some would help individual families be less vulnerable to predatory lending and foreclosure. Others would update policies that regulate financial services and increase support for regulation and monitoring. Research and practice indicate multiple strategies are necessary to effect change. Public/private partnerships should play a critical role in:

- Preventing and mitigating predatory lending.
- Expanding affordable mainstream financial services in low-income communities.

Research and positive results from the field make a strong case for policy action. In particular, when families avoid or escape predatory lending, they are better positioned to build assets and break the cycle of poverty. Children of homeowners are more likely to achieve higher levels of education, income and wealth than children of renters (Boehm et al. 2001).

Predatory Lending Endangers Families' Primary Assets

Predatory lending is a high-priority policy issue because it jeopardizes the primary assets of low-income families: their homes, cars and paychecks.

Homes: Predatory mortgages (and home equity loans) are overpriced because they charge high interest relative to the actual borrower risk. Other predatory elements include prepayment penalties,

What Is Predatory Lending?

Compared to conventional or mainstream credit services, predatory lending is characterized by:

- High interest rates and excessive fees do not correspond with actual risk (such as the borrower’s ability to repay or car/loan ratio).
- High and/or numerous penalties, such as large prepayment penalties, keep victims from refinancing with a more responsible lender or closing the abusive loan.
- Abusive or unjustified loan terms often include requiring single advance payments for credit insurance, balloon payments and mandatory arbitration requirements. These and other predatory terms encourage repeat borrowing or facilitate foreclosure or other loss of assets.
- Aggressive and/or deceptive behaviors may include pressuring vulnerable consumers into high-cost, high-risk products even though many could qualify for prime loans; offering loans knowing the borrower will be unable to repay it; not explaining or disclosing loan terms; abusive collection tactics; hidden fees and more.

Notably, not all subprime loans are considered predatory (Carr et al. 2001; Calhoun et al. 2005). (Subprime loans are made to borrowers with imperfect credit histories. They bear interest rates higher than the prime interest rate, which is available to borrowers with good credit histories.)

excessive or unjustified fees, unnecessary insurance and mandatory arbitration requirements. When predatory lenders unnecessarily refinance loans, borrowers pay twice (refinancing fees plus higher rates and fees on the new loan). Compared to conventional

loans, predatory mortgages are significantly more likely to end in foreclosure – taking away most or all of borrowers' wealth.

Car: Typical lenders of these so-called “small emergency loans” charge a triple-digit annual interest rate (even as much as 300% APR) on an amount that is far less than the car value, require loan repayment within a month and demand power of attorney for transferring the car title after default. Advanced without consideration of the borrower's ability to repay, most loans are extended or rolled-over, usually with additional charges. In time, lenders often repossess cars even if borrowers miss only one payment (McGill 2004; Quester et al. 2005).

Paycheck: Also marketed as small emergency loans, payday loans provide quick cash (and are sometimes called “cash advance” and “deferred deposit” loans). Borrowers who have a steady income write a post-dated check from their personal account to the lender and receive cash in exchange. Most payday loans:

- Bear a loan fee of \$45 (which is 15% of the typical \$300 loan).
- Charge 400% or more APR.
- Require full repayment in two weeks.

The payday loan structure results in repeat borrowing because few borrowers have the means to repay in two weeks. Not wanting a bounced check, borrowers continue paying \$45 fees to float or renew their loans for another two weeks. This cycle can continue for weeks, months, if not years; further, some borrowers obtain second and third loans from other lenders as their cycle-of-debt crisis deepens. Each year up to 15 million working families—and 26% of military households—have payday loans (McGill 2004; CRL 2005).

Low-Income Families Are Vulnerable to Predatory Lending

Why are low-income families with children vulnerable to predatory lending? According to the Fannie Mae Foundation and other experts, there are two primary reasons.

1. Many low-income families face a multitude of barriers in avoiding predatory lending situations. Common barriers are:

- Inadequate financial education means limited knowledge of the full range of available financial services and ways to access loans that are affordable and productive. Financial education is needed, too, to assess how loan terms would affect family economics.
- If they are unable to read loan documents, persons with low literacy skills may rely on claims made by predatory lenders and their agents.
- Recent immigrants from developing countries are accustomed to getting loans from family and friends and/or using informal financial services (such as a savings pool). They may also distrust mainstream financial institutions.
- Predatory lenders often aggressively market their products to racial and ethnic minorities and welfare-to-work mothers, who tend to earn less than men.
- Single-parent families, often headed by women, experience considerable financial

The ability to borrow well has become an essential component of wealth building.”

–Vermont Development Credit Union (Stewart et al 2005)

hardship. Desperation increases the likelihood of agreeing to predatory loans.

- Low-income families have little savings to handle work/life disruptions: car/home repairs, job loss, pay cuts, marital disruption and illness. So, they have repeated and sometimes urgent needs for extra money, which makes them prone.
- Limited or non-use of mainstream financial services means families lack a credit history, which is often key to accessing mainstream loans.

- Lending standards and terms are not uniform, which impedes comparison shopping.

2. Many low-income families are locked out of the mainstream financial services market. A General Accounting Office estimate indicates that 22+ million US households need access to basic bank accounts. Without adequate mainstream services, low-income families often have few options beyond fringe financial institutions. The table below describes how mainstream and fringe financial institutions differ.

Typical Characteristics of Mainstream and Fringe Financial Services

Mainstream Financial Services	Fringe Financial Services
<p>Asset-building. <i>Institution types:</i> banks, savings institutions and credit unions.</p>	<p>Asset-eroding. <i>Institution types:</i> subprime mortgage, car-title and payday lenders; check cashers; pawnshops; rent-to-own stores; debt consolidation services; among others.</p>
<p><i>Services:</i> broad array, competitive terms. Deposits are federally insured, safe from threat and often earn interest. Often require minimum balances that low-income families cannot meet.</p>	<p><i>Services:</i> more limited, no deposit or interest-bearing accounts, often charge three times more than mainstream institutions for basic services such as cash conversion and bill payment.</p>
<p>Highly regulated. <i>Location:</i> concentrated in middle- and upper-income neighborhoods; few sites in low-income and minority neighborhoods.</p>	<p>Limited or no regulatory oversight. <i>Location:</i> most are based in low-income and minority communities.</p>
<p><i>Marketing:</i> because of marketing practices targeting more affluent consumers, low-income consumers are often unaware of affordable accounts offered.</p>	<p><i>Marketing:</i> services are aggressively developed for and marketed to these communities.</p>
<p><i>Credit history impact:</i> contributing. Transactions are reported to and used by major credit-reporting agencies.</p>	<p><i>Credit history impact:</i> invisible. Transactions are not accepted by credit-reporting agencies.</p>
<p><i>Hours:</i> weekday, some with limited Saturday hours.</p>	<p><i>Hours:</i> weekday plus evenings and weekends.</p>

The scarcity of mainstream financial institutions that have sites in low-income and minority communities is a major barrier to use of their asset-building services.

- A small study of banks and savings and loans in Los Angeles found the ratio of these mainstream institutions to residents was 1:36,000 in South Central Los Angeles and 1:1,250 in the affluent Pacific Palisades area. ATM locations followed a similar pattern.
- In contrast, fringe financial institutions abound in low-income and minority communities. For example, the nation's 22,000 payday loan outlets are primarily located by military bases and in African-American neighborhoods.

Beyond physical-distance barriers, low-income families face other obstacles in accessing mainstream financial services (see table above).

Sources: Barr 2001; Carr et al. 2001; Carr et al. 2001; Clevenger et al. 2002; GAO 2002; Murrell 2003; CRL 2004; CRL 2004; CRL 2004; McGill 2004; CRL 2005

The Facts: How Predatory Lending Undermines Family and Community Assets

Predatory Lending Harms Low-Income Families and Children

Predatory lending can:

- Reduce or liquidate home equity, which is often low-income families' only wealth and serves as a means to achieve upward mobility. Predatory lenders often target low-income homeowners who have considerable equity in their home.¹

¹ Marketing techniques include concentrating offices in low-income and minority neighborhoods, false or misleading advertising in neighborhood venues and papers and door-to-door sales.

- Shrink families' purchasing power by charging high interest rates, fees and loan penalties. This leaves less money for basic necessities, home or car repairs and keeps families from saving for college, homes, cars, new businesses and rainy days.
 - Predatory mortgage lending costs borrowers \$9 billion each year in unjustifiable fees and \$3 billion in excessive interest rates (CRL 2004).
 - Families that have payday loans pay \$3.4–6 billion annually in excessive fees and interest (CRL 2005).
- Create obstacles to employment, education, training and health care when car-title loans end in repossession. Lack of transportation ranks as a foremost barrier to obtaining and maintaining employment, especially when public transportation to worksites is not available, as is the case for many car-title borrowers.
- Prevent persons from developing credit histories, which are needed to qualify for affordable financial services. Many fringe financial services are not included in credit histories.
- Ruin credit histories when predatory mortgages result in foreclosure.
- Increase the risk of marital problems and family instability because being trapped in predatory loans heightens economic insecurity.

Car-Title Lending by the Numbers

Average Loan-to-Value Ratio

100%

used car purchase loan

33%

car-title loans

Typical Interest Rates (APR)

<10%

used car purchase

loans

100-300%

car-title loans

Source: Quester et al. 2005

- Take away the protective benefits that homeownership conveys to children. Children of homeowners tend to have more stability in their lives, and as adults they attain higher levels of education, income and wealth compared to children of non-homeowners.

Sources: Boehm et al. 2001; Page-Adams et al. 2001; Calhoun et al. 2005; Shirk 2005

Predatory Lending Harms Neighborhoods and the Community-at-Large

When predatory lending results in high foreclosure rates, neighborhood homeownership rates decline. Secondary effects often include:

- Reduced property values and home equity for homeowners and others.
- Lower property tax revenues, which pay for education and public safety.
- Weakened community stability and resident involvement.
- Increased crime.
- Added economical distress in low-income communities, which further dampens the market for mainstream financial services. Small businesses located in such neighborhoods may pass the high cost of fringe financial services to customers.

Sources: LISC Center for Home Ownership 2002; Murrell 2003; Quercia et al. 2004

Further, *municipal government services related to foreclosures are expensive*. In a single Chicago neighborhood block, 14 of 37 properties experienced separate foreclosures during a 10-year span. Some

homes underwent the foreclosure process several times. A Harvard University analysis estimated *each* foreclosure cost local government agencies more than \$34,000 (Apgar et al. 2005).

What Enables Predatory Lending?

Multiple factors (and their complex interplay) have created a troubled financial services environment in many low-income and minority communities.

Market forces are a major factor. Mainstream financial institutions cite insufficient demand as the reason they place few outlets in low-income and minority neighborhoods. Yet innovative efforts by some mainstream institutions demonstrate that the market in underserved communities can be developed. In addition, partnerships between non-profit community-development financial institutions (CDFIs, which include community-development credit unions) both enable mainstream commercial banks to meet their Community Reinvestment Act obligations and help bring affordable and reliable financial services to lower income consumers.

Discriminatory practices in the financial services and housing industries have also contributed to the development of economically distressed communities. Despite improvements, a recent Federal Reserve Board analysis comparing borrowers with similar risk profiles found a very small percentage of lenders may push more racial/ethnic minorities into subprime products than non-minority applicants. Many predatory lenders specifically target their services to racial/ethnic minority groups, according to a joint task force of the US Departments of Treasury and of Housing and Urban Development (HUD). For example, the task force cited evidence that:

- Some subprime lenders require minority borrowers to pay higher fees even though they have similar credit histories as white borrowers.
- Subprime refinancing loans are five times more common in predominantly black than in white neighborhoods and three times more common among low-income than high-income borrowers.

Public policy governing (and related enforcement) of the financial services industry has also enabled predatory lending. For example:

- Safe-harbor laws in 33 states and the District of Columbia permit lenders to provide cash advances by accepting post-dated checks and to be exempt from state laws regarding exorbitant interest rates.
- Some predatory lenders partner with out-of-state banks to sidestep state restrictions. Such “rent-a-charter” or “rent-a-bank” models enable payday

lending to thrive even in North Carolina, one state where payday lending is illegal. The Federal Deposit Insurance Corporation has not acted to prevent such activities.²

- Loopholes enable lenders to dodge regulation by renaming their loans as other products (such as “internet access rebates” or “phone card promotions”).
- Some state laws require title loans to be fully repaid in 30 days, a requirement that lenders use to entrap borrowers in a debt cycle.

Notably, there are many challenges to effectively developing and enforcing policy to improve the financial environment in low-income neighborhoods and to curb predatory lending.

² For an overview of the federal regulatory system, see the 2005 Congressional Research Service Report RL 33036, Federal Financial Services Regulatory Consolidation: An Overview, which is available at <http://www.opencrs.com>.

Subprime and Predatory Lending Are on the Rise

- In just three years, the size of the *payday lending* industry quadrupled (McGill 2004). Today an estimated 22,000 outlets provide payday loans, compared to 300 in the mid-1990s (Carr et al. 2001).
- *Car-title lending* is rapidly growing in states where the product is legal and poorly regulated. In 2004, one Tennessee county had more than 110 title-loan offices (Quester et al. 2005).
- *Subprime lending* boomed in the past decade, going from a nearly nonexistent market in 1994 to a \$500 billion industry. While some subprime lenders offer reasonable products, limited regulatory oversight has enabled questionable lenders to flourish (Clevenger et al. 2002).
- *Subprime mortgages* rose six-fold from \$34 billion in 1994 to \$210+ billion in 2002 (GAO 2004).
- The number of *fringe financial institutions* is growing exponentially in lower income and minority neighborhoods. Because many of these institutions are unregulated and unlicensed, national estimates are often unavailable, but regional studies (see the Predatory Lending Solutions Project case study) have documented this growth (Carr et al. 2001; Austin Turner et al. 2002).

- First, lending occurs on a continuum. Not all subprime lending is predatory; moreover, it helps millions of American families with poor credit histories to access mortgages and build assets. Over-regulation can reduce access to fair subprime lending and stifle innovative approaches to helping low-income communities obtain credit. Yet, low-income and minority families need greater protection from fraudulent or abusive practices, unjustifiable loan terms, excessive fees and other predatory practices.
- Second, financial services is a rapidly evolving industry. Policies, regulations and enforcement require continuous updating as predatory lenders find alternate paths to exploit consumers.
- Third, fringe services are largely un-regulated, — examined and—licensed. As a result, data are limited on which policy makers can base decisions.

Sources: Carr et al. 2001; HUD-Treasury Task Force on Predatory Lending 2001; ACORN 2002; Austin Turner et al. 2002; Clevenger et al. 2002; GAO 2004; McGill 2004; Neighborhood Housing Services of Chicago 2004; Andrews 2005; Bowdler 2005; CRL 2005; Shirk 2005; Stewart et al. 2005

Fighting Back: Highlights of Efforts to Combat Predatory Lending

This section features a few of the many ways to curtail predatory lending and help low-income families pursue economic self-sufficiency. Some of the outcomes are captured in the table on the effectiveness of predatory lending interventions, • which begins page 11.

Center(s) for Working Families (CWF) Mary Rigg Neighborhood Center

Indianapolis, IN

<http://www.aecf.org/initiatives/fes/center/>

<http://www.maryrigg.org>

Centers for Working Families (CWF) are a new approach to strengthening families. Conveniently located in low-income neighborhoods, each CWF offers a supportive and resource-rich environment where families can access financial services and assistance, income and work supports, community referrals and more. Human service agencies and financial institutions “staff” the centers and bundle their services to deepen impact while expanding their client base. With seed funding from the Annie E. Casey Foundation, four CWFs are developing three integrated core services.

- *Workforce services* help families achieve stable jobs and career advancement opportunities.
- *Income supports* enable families to access the wide array of cash and non-cash benefit programs offered by all levels of government.
- *Financial services and asset-building* bring more families into the financial mainstream through fair, appropriate financial services and financial education and counseling (AECF 2005).

One of these CWFs is at George Washington Community School, a nationally recognized “center of community” in west Indianapolis. The CWF receives support from Casey, BankOne/Chase, Indiana University-Purdue University Indianapolis Office of Neighborhood Partnerships, the Purdue Extension Service, the Mary Rigg Neighborhood Center, Christamore House and Hawthorne Community Center. Through the center, local families —many of whom earn less than \$19,000 per year—are able to access existing community

resources they need to build a strong financial foundation, including:

- *Financial literacy:* A five-week program teaches participants how to budget, save, build a strong credit history and break habits that keep them from getting ahead. As an incentive, participants receive grocery coupons, gift certificates and \$100 to start a checking or savings account.
- *Financial counseling:* The center offers one-on-one financial resource counseling by trained professionals.
- *Family resource referrals:* The center helps families connect with the services they need in their neighborhood, such as food pantries and individual development accounts. Before coming to the center, many clients were unaware of resources that could help them make ends meet and get ahead.

CWF participants have purchased homes, cleaned up credit, completed job training, secured employment, advanced careers and enrolled in GED programs and college. This fall, the center is partnering with the Central Indiana Community Foundation to provide intensive support to 30 families with the goal of significantly enhancing their economic foundation. Over the next three years, participating families will receive in-depth financial counseling, goal-setting and job-advancement assistance and open individual development account-style savings plans.

Homeownership Preservation Initiative (HOPI)

Chicago, IL

<http://www.nhschicago.org>

To help distressed borrowers keep their homes whenever possible, Neighborhood Housing Services

(NHS) of Chicago joined with the City of Chicago and responsible lenders to create the Homeownership Preservation Initiative (HOPI). The public/private partnership's goals are twofold.

- *Foreclosure avoidance:* Each year the partnership aims to help 500 homeowners at-risk of foreclosure through a multi-faceted set of strategies.
 - *Community outreach* through mailings and neighborhood institutions educates homeowners about getting help at the first sign of trouble.
 - *3-1-1 campaign* encourages at-risk homeowners to call Chicago's non-emergency 3-1-1 assistance line for referrals to qualified credit counselors. Through a free one-hour session, counselors help homeowners assess their financial situations and develop action plans. Counseling agencies also help clients communicate with lenders.
 - *Financial education* by NHS in foreclosure "hot spots" proactively helps homeowners learn about refinancing, paying for home repairs and avoiding foreclosure. The Chicago Department of Housing also offers a post-purchase education course.
 - *Intensive counseling and assistance* by NHS helps homeowners develop repayment plans, work with lenders, obtain loan modifications and refinance. Small loans and grants are used to become current on payments. NHS also refers clients to local resources (such as job training, tax assistance).
- *Reclaiming foreclosed properties for affordable housing:* Each year NHS, with assistance from the city and lending partners, seeks to acquire 100 foreclosed, vacant single-family homes. After making the houses safe and habitable, NHS sells them to low- and moderate-income

families. HUD and mainstream lenders donate properties or sell them at a deep discount to NHS, which also receives subsidies from the city housing department for housing rehabilitation. On a parallel track, the municipal Troubled Building Initiative is accelerating the foreclosure process to minimize vacancies.

The initiative has kept half of distressed-borrowers' homes from becoming vacant and/or abandoned property (Neighborhood Housing Services of Chicago 2004; Apgar et al. 2005).

North Carolina's Anti-Predatory Lending Law

Banks, mortgage bankers and brokers, nonprofit groups and others coalesced to support the North Carolina Anti-Predatory Lending Law, which was adopted in 1999. The law prohibited certain lending practices and limited high-cost loan terms. In 2001, policy makers enacted the Mortgage Lending Act to supplement the original Anti-Predatory Lending Law. As a result, the state now requires mortgage professionals (lenders, brokers and loan officers) to be licensed. The second law gave the banking commissioner enhanced powers and placed additional prohibitions on mortgage lending practices.

The state banking commissioner has reported denying many mortgage-professional licenses when applicants failed to meet basic requirements, including background checks. Due to data limitations, GAO concluded that additional experience and data are needed to assess impact (GAO 2004). One independent group, the Center for Responsible Lending, estimated the law saved consumers at least \$100 million without reducing low-income borrowers' access to subprime credit (CRL 2002).

Opportunities Credit Union

(formerly Vermont Development Credit Union)

Burlington, VT

<http://www.vdcu.org>

In 2005, the National Credit Union Foundation awarded Opportunities Credit Union (OCU) its highest honor for developing the financial health of disadvantaged communities. OCU currently brings capital and financial services to 14,000 Vermonters in 210 towns and seeks to become the first full-service, statewide community development bank in the nation.

In 1989 the nonprofit, member-owned, federally-insured credit union was founded to help low-income Vermonters become homeowners, build small businesses and obtain affordable financial services. One measure of success is OCU's astounding growth rate, which in some years topped 40%. Credit union officials attribute this feat to strong counseling-based lending (characterized as "we don't say no; we say when") and sound financial management.

Today, OCU offers a wide range of affordable services: low-minimum bank accounts, check cashing, financial education and counseling. Loans from \$50 to \$100,000+ come in traditional (mortgage, home improvement, small business) and innovative forms ("working wheels," computers, individual development and more). OCU's members can access special incentives when they deposit their tax refunds or credits into super-saver accounts, and tracker loans help them build a strong credit history. Because some services most needed by underserved communities may not pay for themselves, OCU, like many CDFIs, depends on external support to finance growth (Stewart et al. 2005). Some of its current partners include non-member investors, Fannie Mae, Banknorth Vermont and the Ford Foundation.

Predatory Lending Solutions Project

Montgomery County (Dayton), OH
<http://www.mvfairhousing.com>

Recognizing a growing crisis in predatory lending and foreclosures, Montgomery County Commissioners created the Predatory Lending Solutions (PLS) project to offer prevention and intervention services to county families. PLS partners include the Miami Valley Fair Housing Center (lead agency); Consumer Credit Counseling Service (a division of Lutheran Social Services of Mid-America); and the Legal Aid Society of Dayton. To help families avoid or escape predatory lending, PLS uses an interrelated group of strategies.

- *Community education and outreach* raise awareness of predatory lending practices.
- *Hotline* responders vet initial inquiries/complaints about potential abuses and then help potential victims get assistance.
- *Integrated intervention and rescue services* are provided by a three-agency team created for each case. Teams investigate complaints that have merit and assist clients or refer them to appropriate local resources.
- *Research* has informed both service planning and advocacy. The University of Dayton's, Center for Business and Economic Research conducted an independent study to identify the occurrence of predatory mortgages by neighborhood. The study found rapid growth in foreclosures, with a disproportionate share from subprime lenders who were targeting low-income and minority residents.
- *Advocacy* has been essential in turning the tide. Community groups used the study to help convince city and state policy makers to enact anti-predatory lending laws.

In just one year, PLS helped to cancel more than \$94,000 in unjustifiable credit insurance and had face-to-face contact with 9,000+ county residents. PLS receives support from the county's general fund and Community Development Block Grant. Montgomery County has received multiple national awards for PLS.

Curtailing Predatory Lending

The case studies all reveal there is no "silver bullet" in helping low-income families protect their economic assets against predatory lending. The three main areas for action are:

- *Prevention*: such as curtailing predatory lending practices, helping low-income families become less vulnerable to predatory lending, increasing access to affordable mainstream financial services.
- *Intervention*: such as helping victims of predatory lending avoid delinquency, negotiate with lenders and, if possible, end their loans before losing assets.
- *Rescue*: such as helping borrowers in crisis minimize asset loss due to predatory lending.

The table below identifies opportunities to curtail predatory lending and help families protect and grow their economic assets. It also provides information about intervention effectiveness. **Evaluations have found that these interventions provide some benefits, but not one is a cure-all for the problem of predatory lending. As a result, experts widely agree a multi-faceted approach is necessary to help low-income families avoid predatory lending.**

Effectiveness of Selected Policy and Program Interventions to Curtail Predatory Lending

Policy or Program Intervention	Effective?	Notes
Consumer Assistance		
Community-Development Financial Institutions (CDFIs)	Yes	CDFIs are developing a market niche with products tailored to traditionally underserved consumers. Low-cost, fair credit services, accessible bank accounts and financial education and counseling have helped consumers avoid predatory lending and build savings. Delinquency rates are low. (Carr et al. 2001; CDFI Data Project 2004; Bair 2005)
Financial Counseling: General	Can Be	With skilled, unbiased counselors, personalized financial advice, planning and assistance are effective; however, poor quality services are a waste of resources. (Page-Adams et al. 2001; Calhoun et al. 2005)
Financial Counseling: Homebuyers/ Pre-purchase	Can Be	For borrowers who completed their programs, individual and classroom-based counseling reduced 60-day mortgage delinquencies by 13-41%. Counseling has limited effectiveness if counselors do not have a full set of loan documents. (Hirad et al. 2001; GAO 2004)
Financial Education	Mixed	Many programs are new and use different curricula, so effectiveness is yet to be determined. Some studies indicate financial education is useful but does not always thwart predatory lending, as when loan terms are not adequately disclosed and lenders use deceptive practices. Well-designed and -delivered financial education programs obtain the best results. (Carr et al. 2001; GAO 2004; Schloemer 2004)
Foreclosure Prevention Services (includes homeowner post-purchase counseling)	Yes	A study involving 4,200 mortgagees who were given community-based assistance—intensive case-management services, individual post-purchase counseling and/or assistance loans – indicates foreclosure services were cost-effective; results were comparable to other evaluations of foreclosure prevention. (Quercia et al. 2004)

Policy or Program Intervention	Effective?	Notes
<i>Industry and Public/Private Interventions</i>		
Low-Cost, Fair Financial Services and Products for Lower Income Consumers at Mainstream Financial Institutions	Yes	Low-cost payday alternative loans have been in wide demand, and one credit union estimates its low-cost alternative has saved borrowers \$2+ million in fees since 2002. Loan recycling, however, suggests limited success in helping borrowers end the debt cycle. At least one credit union avoided this problem by requiring borrowers to put 5% of their loans in savings. Many credit unions have been able to make a fair profit from their payday alternatives. (Bair 2005; Shirk 2005)
Innovative Marketing Strategies to Attract Lower Income Consumers	Can Be	Initial data from a mainstream/fringe partnership demonstrates that innovative marketing strategies—including product design—can help low-income consumers transition to mainstream services. The partnership reduced the fees paid by consumers and helped many customers open bank accounts. (Carr et al. 2001).
<i>Policy/Regulatory Interventions</i>		
Anti-Predatory Lending Legislation (see Policy Recommendations section for core components)	Mixed	<p>The effectiveness of these state laws is mixed to some extent because of federal preemption. Although 14 states have made payday lending illegal—and others have tightened restrictions – payday lending continues unabated in part due to gaps in federal regulations and enforcement.</p> <p>Expanded licensing requirements in North Carolina appear to have reduced the number of potentially abusive mortgage professionals. Also, one analysis estimates that the North Carolina Anti-Predatory Lending Law saved consumers at least \$100 million by preventing predatory loan terms; in addition, subprime credit for low-income borrowers remained available. In contrast, Georgia’s lawmakers amended a very strong anti-predatory lending law after mortgage lenders and credit agencies threatened to leave the state.</p> <p>Limitations in available mortgage lending data have contributed to what appear to be conflicting outcomes in evaluations of such laws. Also, rapid changes within the predatory lending industry mean regulatory frameworks may need frequent updates. (Clevenger et al. 2002; CRL 2002; GAO 2004; McGill 2004; Shirk 2005)</p>

Policy or Program Intervention	Effective?	Notes
Capping/Restricting Lending Terms and Structures	Unlikely	Insufficient data are available to fully evaluate the effectiveness of caps and other lending restrictions. Over-reaching provisions can distort markets and have unintended negative consequences, such as reducing access to fair subprime credit and stifling innovation. (Barr 2001; Carr et al. 2001; Clevenger et al. 2002)
Disclosure of Lending Terms Requirements	Mixed	Disclosure is useful but its effectiveness in reducing predatory lending has yet to be established. Disclosure does not address many consumers' lack of financial sophistication or overcome the complexities inherent in mortgage lending. (Barr 2001; GAO 2004).
Foreclosure-Hotspot and Foreclosure Avoidance Initiatives	Can Be	A case study of Chicago's Troubled Building Initiatives suggests initial success. The city's partnerships with community-based organizations helped reduce abandoned property and other negative consequences resulting from high foreclosure rates in some communities. Foreclosure hotlines that are well-marketed also appear promising. (Neighborhood Housing Services of Chicago 2004; Apgar et al. 2005)
Strong Regulatory Enforcement	Can Be	Boosted federal and state regulatory efforts appear to have deterred some predatory credit practices. Because of enforcement actions, lenders have reimbursed or given financial compensation to borrower-victims. Jurisdictional disputes between different levels of governments and finite resources can limit effectiveness. (GAO 2004)

Policy Recommendations for Governments

Because predatory lending perpetuates, even worsens, the poverty of families and neighborhoods, steps must be taken to curtail the practice. Low-income families with children should be a priority for efforts to combat predatory lending. Government savings from reduced foreclosures and regulatory fees can offset the cost of increased

enforcement, consumer assistance and other recommendations listed below.

Senior officials at the Fannie Mae Foundation recommend *federal and state* policymakers adopt a three-part policy response to limit predatory lending and improve the financial services environment in low-income communities. The use of all three strategies is necessary in order to be effective (Carr et al. 2001). Independent recommendations from

researchers and organizations working with low-income families advocate a similar approach.

1. Improve *Enforcement of Lending and Consumer Protection Laws*

Beyond enacting anti-predatory laws, policy makers should commit to stronger enforcement of lending and consumer protection laws. To improve enforcement, researchers and practitioners recommend:

- *Creating a national database on loan performance, defaults and foreclosures* so regulators and others can effectively monitor and examine questionable lending practices (Skillern et al. 1999; Carr et al. 2001; Neighborhood Housing Services of Chicago 2004).
- *Simplifying and updating laws concerning predatory lending.* The multiplicity of laws governing lending reduces the ability of regulators, consumers and their advocates to combat unfair and fraudulent lending. Uniform laws would help minimize the additional regulatory burden and aid judicial proceedings (Carr et al. 2001; Clevenger et al. 2002).
- *Adequately funding lending and consumer protection agencies* so they can have sufficient staff and resources to ensure compliance with laws.

Adoption of Anti-Predatory Lending Legislation

In addition, many experts and consumer-assistance groups are calling for the adoption of anti-predatory lending legislation. Such laws should be balanced so responsible lenders stay in the market and compliance costs are not a

burden on lenders. Yet, clear and strict statutory protections should assure loans are affordable, fair and safeguard borrowers' assets. Key legislative components include:

- *End incentives for lenders to make predatory loans* by closing regulatory loopholes, repealing laws that impose unfair loan terms on borrowers (such as laws requiring 30-day full repayment of title loans) and requiring lenders to consider repayment ability.
- *Assure a fair, competitive market in which lenders responsibly extend credit.* Laws should:
 - Require lenders of all types to be licensed, bonded, examined and required to submit reporting data. They should be monitored on the suitability and soundness of their products.
 - Set fair and affordable loan terms by lengthening loan terms, pegging interest rates to a reasonable standard, etc.
- *Protect borrowers' rights* by eliminating not only mandatory arbitration clauses but also prepayment penalties that deter canceling or switching to a loan with reasonable terms. Borrowers should have the right to pursue legal redress before harm occurs and use the court system to challenge statutory violations.
- *Strengthen essential consumer safeguards at all levels of government,* such as by:
 - Creating a no-pressure three-day waiting period during which consumers can obtain third-party review of loan documents. Such provisions should be paired with efforts to link consumers with appropriately trained counselors.

- Sponsoring an ombudsman office to serve consumers who need assistance with predatory lending.
 - Expanding the types of information that lenders must disclose and explain to consumers.
 - Extending borrowers' post-default protections by establishing reasonable repossession or foreclosure processes, requiring lenders to give borrowers any surplus after the sale, etc.
- Augment regulatory powers by closing loopholes so predatory lenders and mortgage brokers can be held accountable for their actions. At the federal level, the General Accounting Office has recommended clarifying the Federal Reserve Board's authority to monitor and examine nonbank financial institutions, which have a significant portion of the subprime market.
 - Updating laws governing the foreclosure process to streamline and better coordinate inter-agency processing and connect borrowers to reliable credit counselors. Quick transfers of potential abandoned properties to a land bank or a trusted non-profit organization can reduce squatting and illicit activities. Such actions would substantially lessen the total social cost of foreclosures.

An example of model state anti-predatory lending legislation is available from the National Community Reinvestment Coalition (see resources section).

Sources: Barr 2001; Carr et al. 2001; Carr et al. 2001; Clevenger et al. 2002; National Community Reinvestment Coalition 2002; GAO 2004; Apgar et al. 2005; Bowdler 2005; Quester et al. 2005

2. Increase lending by mainstream financial services in lower income communities.

When low-income families use mainstream services, they will have the means to avoid costly fringe services, develop a positive credit history and build assets.

Growth in the fringe services and predatory lending industries indicates the existence of a large, underserved and inefficient market. Many low-income families are eager for affordable financial services, as demonstrated by the success of CDFIs. Experience also suggests that once traditionally underserved consumers are in mainstream institutions, their deposits will grow and they can be moved up into other product lines (Carr et al. 2001).

Governments can encourage the expansion of mainstream services in lower income communities. A direct policy response would be *strengthening the federal Community Reinvestment Act* (CRA), which requires mainstream financial institutions to make capital available in low- and moderate-income neighborhoods (Bair 2005). A joint HUD-Treasury task force on predatory mortgage lending recommended awarding CRA credits to financial institutions that help borrowers move up from subprime to prime lending either directly or indirectly by investing in CDFIs (Barr 2001; HUD-Treasury Task Force on Predatory Lending 2001; Tansey 2001). Others have recommended using CRA to penalize mainstream institutions that are involved in predatory lending (ACORN 2002).

Also, government-sponsored research—and efforts that communicate those findings—should explore potential market niches in underserved communities and profile innovative approaches by industry leaders. Public encouragement and

regulatory flexibility can encourage mainstream financial institutions to develop low-cost alternatives to car-title and payday loans (Bair 2005).

In addition, governments can *establish public/private partnerships* to:

- Assist the development or expansion of CDFIs.
- Facilitate the extension of mainstream financial services in underserved communities.
- Create loan pools to help victims of predatory mortgages switch to subprime loans from mainstream financial institutions.

3. Support Consumer Financial Education and Counseling.

The goal of this strategy is to help low-income families gain the knowledge, skills and expert assistance to be better informed, more sophisticated consumers. Through unbiased financial counseling and high-quality education programs, consumers can improve their financial management practices, develop a better understanding of their financial services options, learn how to identify potential predatory lenders and more.

Through *public/private partnerships*, federal, state and local governments can:

- *Establish and support homebuyer programs for low-income families.* Key components include financial education and counseling. Some also provide financial assistance for down-payments and in emergencies. Local governments can finance these programs with their federal housing and community development funds and local tax revenue

(National League of Cities et al. 2005). To be most effective, programs should use well-designed and tested curricula delivered by skilled instructors and counselors.

- *Conduct and fund consumer financial education programs.* To be most effective, programs should use well-designed and tested curricula in classroom settings.
- *Develop Centers for Working Families* in low-income neighborhoods (see case studies section).
- *Standardize lending information* to help consumers compare products and be wary of predatory ones.
- *Monitor foreclosure data and intervene* in foreclosure hot spots (Neighborhood Housing Services of Chicago 2004).
- *Create a predatory lending hotline* or use a non-emergency response system (often 2-1-1³) to link borrowers with qualified, unbiased financial counseling and facilitate reporting of abusive practices (Neighborhood Housing Services of Chicago 2004).

Recommendations for Human Service Agencies and Intermediary Organizations

A wide variety of human service and community-based organizations provide critical assistance to families caught by predatory lenders. CDFIs, legal aid societies, consumer groups and many others can make a difference by:

- Helping consumers recognize and report predatory lending.

³ See the Family Strengthening Policy Center's brief, "Strengthening Families by Increasing Access to Needed Benefits: The New Technologies," available at www.nassembly.org/fspc/index.html.

- Working with local governments to identify and intervene in foreclosure hot spots.
- Maintaining periodic contact with distressed borrowers so help can be provided before a crisis occurs.
- Documenting the case for curtailing predatory lending and effective practices.
- Offering second mortgages or bridge credit when families hit rough times.
- Advocating for anti-predatory policies and enforcement.

To improve low-income families' access to affordable and appropriate credit, organizations with sufficient expertise can help them:

- Locate private lenders that offer affordable and appropriate mortgages and loans.
- Strengthen loan applications (e.g., ensuring clients' traditional credit score is updated with bill-paying performance⁴).
- Navigate the lending process.
- Offer well-designed financial education programs.
- Provide high-quality, individualized financial counseling by skilled professionals.

⁴ For example, intermediaries can help clients work with mortgage professionals and other lenders to have their credit scores updated to reflect bill-paying performance (see <http://www.payrentbuildcredit.com/main/about/prbc-20051003.php>).

RESOURCES

This is a small selection of the many organizations that are working on predatory lending issues.

Annie E. Casey Foundation

<http://www.aecf.org>

Among the many family-strengthening resources on its website, the foundation's winter 2005 issue of *ADVOCASEY* magazine explores predatory lending and access to financial services (<http://www.aecf.org/publications/advocasey/winter2005/index.htm>). The website also contains research summaries on predatory lending and information on Centers for Working Families.

Association of Community Organizations for Reform Now (ACORN)

<http://www.acorn.org>

ACORN offers model anti-predatory lending legislation and other resources on its website.

American Bankers Association (ABA)

<http://www.aba.com>

ABA's website offers a free financial literacy curriculum for grades 7-12.

Center for Responsible Lending (CRL)

<http://www.responsiblelending.org>

A nonprofit, nonpartisan organization, CRL is an important source of information, research, policy analysis and advocacy on predatory lending.

Coalition of Community Development Financial Institutions

<http://www.CDFI.org>

The CDFI Coalition coordinates industry-wide initiatives to increase the availability of capital, credit and financial services to low-income communities across the nation. The CDFI Data Project generates high quality, comprehensive data on community development finance.

Fannie Mae

<http://www.fanniemae.com>

As the nation's largest source of financing for home mortgages, Fannie Mae actively works in communities to curtail predatory lending and shrink homeownership disparities.

Fannie Mae Foundation

<http://www.fanniemaefoundation.org>

The Fannie Mae Foundation creates affordable homeownership and housing opportunities through innovative partnerships and initiatives. The foundation sponsors **DataPlace** (<http://www.dataplace.org>) and **KnowledgePlex** (<http://www.knowledgeplex.org>), which offer a rich set of affordable housing and community development resources.

Joint Center for Housing Studies at Harvard University

<http://www.jchs.harvard.edu>

The center's research on housing and mortgage lending is available on its website.

Local Initiatives Support Corporation (LISC)

<http://www.lisc.org>

LISC helps resident-led, community-based development organizations transform distressed communities and neighborhoods into good places to live, do business, work and raise families. LISC's capital, technical expertise, training and information supports community development.

National Consumer Law Center

<http://www.consumerlaw.org>

The center's website resources include research on predatory lending and guidance for consumers and advocates for low-income Americans.

National Endowment for Financial Education (NEFE)

<http://www.nefe.org>

NEFE sponsors a Financial Education Clearinghouse that offers a variety of curricula, self-study programs and internet resources. The NEFE website also has links to potential grant sources.

National Community Capital Association

<http://www.communitycapital.org>

The association provides financing, training, consulting and advocacy for CDFIs.

National Community Reinvestment Coalition (NCRC)

<http://www.ncrc.org>

NCRC presents model anti-predatory legislation in its Anti-Predatory Lending Toolkit.

NeighborWorks Center for Homeownership Education and Counseling (NCHEC)

<http://www.nw.org/network/training/homeownership/default.asp>

The center is working with industry partners to promote quality standards, expand training and certification opportunities for counselors and support counselors with tools, information and continuing education. Each year the center aims to train and certify 2,000+ homeownership counselors and educators.

Stop Mortgage Fraud

<http://www.stopmortgagefraud.com>

Sponsored by the Mortgage Bankers Association, this website educates consumers about the warning signs of abusive lending and enables visitors to report potential abuses.

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This series of policy briefs produced by the Family Strengthening Policy Center (FSPC) seeks to describe a new way of thinking about how to strengthen families raising children in low-income communities and how this approach can and should influence policy. The premise of “family strengthening” in this context, and as championed by the Annie E. Casey Foundation, is that children do well when cared for by supportive families, which, in turn, do better when they live in vital and supportive communities. The series describes ways in which enhancing connections within families and between families and the institutions that affect them result in better outcomes for children and their families.

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For more information about the Family Strengthening Task Force and its membership, please see the Family Strengthening Policy Center website at: www.nassembly.org/fspc/aboutus.html.