COMMUNITY DEVELOPMENT CREDIT UNIONS

AS INSTRUMENTS OF REINVESTMENT

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About the Author

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Her recent publications include the following: Community Development Credit Unions as Instruments of Reinvestment; Comprehensive Municipal Rehabilitation Programs; Providing Permanent Reserve Stock Powers for Thrift Institutions as an Incentive for Reinvestment, with Lawrence B. Rosser; and a report "City Finance" which was presented at a 1974 symposium on Chicago: An Agenda for Change and reprinted in Chicago's Future: An Anthology of Reports, Speeches and Scholarship Providing an Agenda for Change (Stripes Publishing, Co., 1976)

In addition to a B.A. from the University of Michigan, Rozran received an M.A. from the University of California at Los Angeles and completed Ph.D. coursework at the University of Chicago Department of Education, where she specialized in Language and Reading Instruction, with a focus on research design and statistical analysis.

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Summary

This paper is one of a series contemplating strategies which can be used by community residents and voluntary associations to assist in achieving reinvestment in inner-city, older suburban and rural areas. Credit unions are cooperatively owned and member-depositor managed financial institutions which are chartered either by state or federal agencies to provide thrift and credit services to their members. The field of membership for credit unions is defined as a group of individuals having one of the following common bonds: occupation; association; or geography.

In addition to discussing the history, chartering and operation of credit unions, the author explains how a credit union's service area and lending policies qualifies it to be considered a "community development" institution. She cites examples from Missouri and Massachusetts to demonstrate how relatively small credit unions can impact positively the economic environment of a specific geographic area.

In her summary, the author discusses the problems and possibilities facing those who attempt to use credit unions as instruments of reinvestment, and she emphasizes the need for this approach to be coordinated with other public and private strategies.

COMMUNITY DEVELOPMENT CREDIT UNIONS AS INSTRUMENTS OF REINVESTMENT

Introduction

Credit unions are not-for-profit financial intermediaries.[1] They differ from other financial institutions in that they are cooperatively owned by the member-depositors who perform credit and supervisory functions on a volunteer basis. Membership in credit unions is limited to groups having one of the following kinds of common bonds: occupational; associational; or geographic.

Community development credit unions (CDCU's) are so-called because regardless of the common bond of their member-depositors, they attempt to serve the housing and economic development credit needs -- as well as the consumer credit needs -- of a particular geographical area. Theoretically, any credit union can contribute to the development of a particular area if it concentrates its loans in that area and if it makes the full range of credits available to its members. Many credit unions, however, do not engage in community development lending as defined above. Instead, as the Missouri Credit Union League recently reported, credit unions have been "closely tied to the economy of consumption . . . for automobiles and consumer goods."[2]

Credit unions had their roots in the self-help societies of Europe and the United States. Today, these financial institutions are chartered, regulated and supervised by either state or federal agencies. Legislation authorizing the state to charter credit unions passed the Missouri legislature in 1927.[3]

State chartered credit unions in Missouri are regulated by the Division of Credit Unions which is part of the Department of Consumer Affairs, Regulation and Licensing.

The Federal Credit Union Act was passed by Congress in 1934.[4] Federally chartered credit unions are regulated by the National Credit Union Administration (NCUA), which was established in 1970 as an independent executive agency. Prior to that time, credit unions with federal charters were regulated by a bureau within the Department of Health, Education and Welfare.

Like other financial institutions, a credit union's charter is the document that spells out its obligations. Unlike banks and savings associations, however -- whose state or federal charters define their obligations to meet thrift and credit needs solely in geographic terms -- credit unions are chartered to serve the needs of their member-depositors.

Thrift and Credit Services

Credit Services

In addition to thrift services, credit unions can provide three types of credit to their members: consumer; business; and single-family. While this paper will focus on their capacity to provide housing credit, it is important to acknowledge the contribution that credit unions can make to community development by providing other kinds of credit. In many older communities, residents who need small consumer or business loans

-- for furniture, materials for home industries, educational expenses, etc. -- are unable to secure them, either because the size of the loan is too small to be financially attractive to a larger financial institution or because the borrower does not meet the generally more stringent credit underwriting standards of a bank or savings and loan.

Since credit unions are member owned and operated -- although they sometimes have paid staff, members make up the credit committees which do the underwriting -- and because part of the function of credit unions is educating members about using money so that they can become more creditworthy, these institutions are often able to make consumer and business credits that other financial institutions find unacceptable.

In addition, the costs of borrowing from credit unions is sometimes lower. The following quote from the Federal Reserve Bank of Kansas City illustrates why these costs are lower:

> The credit union is limited to an annual rate of 12 per cent (or 1 per cent per month) on the declining balance -- including the cost of credit life insurance and other charges -- while other lenders have higher limits, exclusive of any charges, on most consumer loans. The cost of credit life insurance generally represents about 50 basis points /or, 1/2 of 1 per cent/ of credit union rates. Lower rates are generally charged for fully secured loans (such as auto loans) and higher rates for smaller, unsecured loans. In addition, many credit unions pay interest refunds if net income is sufficient. The most common interest refund is 10 per cent of interest paid.[5]

Thrift Services

Credit unions may receive deposits from members, from

other credit unions, and from non-members in the case of credit unions serving predominantly low-income members.[6] In addition, credit unions may serve as depositories of public funds.[7]

Deposits of all federal credit unions -- and any state credit unions that choose to join -- are insured up to $40,000 and public funds are insured to $100,000 per account by the National Credit Union Insurance Fund (NCUIF).[8] A 1977 amendment to the Missouri Credit Union Act authorizes the organization of a credit union share guaranty corporation, and requires all uninsured state chartered credit unions to obtain share insurance in that corporation, in another state's insurance fund, or in the NCUIF.

Deposits in credit unions have traditionally been in passbook-type accounts -- known as "share accounts" -- in which members receive shares of the credit union ownership for their deposits. Recently, federally chartered credit unions have received statutory authorization to offer a variety of additional thrift services.[9]

Depositors in credit unions do not earn interest on funds on deposit, but instead they earn a "dividend," which is nothing more than a pro rata share of the return on earnings of the credit union. The dividend rate is <u>not</u> guaranteed -- as is an interest rate on savings in other financial institutions -- but credit unions may contract with members to pay a specified rate of return on share accounts if sufficient earnings are available to meet that contract.[10]

Mortgage Loans

Missouri state chartered credit unions are permitted to make mortgage loans. There are no restrictions on the size of mortgages or on the percentage of the portfolio that may be invested in real estate, other than a statutory restriction that the maximum amount of a secured loan be ten percent of the credit union's assets. Herbert Hunter, vice-president of the Missouri Credit Union League, reported that the rule of thumb has been that credit unions should invest a maximum of 25% of their loan portfolio in real estate, but that most credit unions have invested less than that amount.[11]

Federally chartered credit unions will be able to make mortgage loans under the statutory authorization of a 1977 amendment to the Federal Credit Union Act which the National Credit Union Administration expects to become effective early in 1978.[12]

Home Improvement Loans

Both state and federally chartered credit unions in Missouri are permitted to make home improvement loans. State chartered credit unions individually set the maximum maturity for the loans they approve. The 1977 amendments to the Federal Credit Union Act permit federal credit unions to make home improvement loans for members' residences with maturities up to 15 years, except that federal or state government insured or guaranteed loans (e.g. loans insured by the Federal Housing Administration) may have the maturity, terms, and conditions

specified in the law under which such insurance or guarantee is provided. As with real estate loans, credit unions are prohibited from making secured loans which exceed ten percent of the credit union's assets.

Current Impacts of Credit Union Lending On Housing

Residential Mortgages

In Missouri at yearend 1976, state chartered credit unions had $32,017,000 in mortgage loans outstanding.[13] While this figure was only seven percent of all loans outstanding of Missouri state chartered credit unions, Herbert Hunter reports increasing interest among Missouri credit unions in making mortgage loans. "This new impetus for real estate investment," said Hunter, "is because of the 1977 Federal Credit Union Act."[14]

As discussed above, federal credit unions have only recently received statutory authorization to make residential mortgage loans and the regulations have not yet been issued. However, since 91% of all credit unions in Missouri, holding 92% of all Missouri credit union assets, are state chartered,[15] it may be concluded that federal credit unions' authority to make mortgage loans will not by itself significantly increase the volume and dollar value of mortgage loans in Missouri.

Casa Credit Union in Springfield, Massachusetts is attempting to serve as a community development credit union in a low income area. It has made residential mortgage loans to its members since 1974.[16] Anthony Cabrera, consultant to the

credit union, indicated that it is a state chartered credit union which was founded in 1965 to serve a geographic area containing less than 1000 families. Casa Credit Union currently has assets of approximately $1,100,000. Membership is open to people who live, work, and worship within the credit union's designated geographic area. Churches are the only non-member depositors and they provide 18% to 20% of the total credit union deposits.

Cabrera reported that as of November 7, 1977, residential mortgages comprised about 15% of Casa's loan portfolio. These 20 mortgages range from $6,500 to $20,000 and have a median value of $9000. He indicated that there have been no defaults and that he feels that "mortgages are the best loans."[17] Because of the limits of available capital, mortgage terms have not exceeded 15 years. Residential structures in the Casa neighborhood are relatively inexpensive, and house one to three families.

According to Cabrera, conventional real estate loans were not available in Casa's neighborhood when the credit union began making mortgages. In spite of Casa's success with this type of lending, banks and savings associations still have not resumed conventional lending, although they are now making a few FHA and VA insured mortgages.[18]

Home Improvement Loans

Home improvement loans are a special category of consumer loans. By offering home improvement loans, credit unions can

increase the economic value of residents in their community and contribute to the sense of community pride. Specific data on outstanding home improvement loans in Missouri is not available. However, a recent report in the Federal Reserve Bank of Kansas City Monthly Review noted that "modernization" loans account for 12% of all credit union consumer loans.[19]

Casa Credit Union has been making home improvement loans since 1974. To date, it has made approximately 15 such loans averaging $3,000 with a term of five to six years.[20] In Missouri, one of the credit unions most active in making home improvement loans has been Visitation-Holy Ghost Credit Union in St. Louis.

Visitation - Holy Ghost is an example of a community development credit union which intends to impact its community primarily by making home improvement loans. Wayland Rivere, business manager of the credit union, reported a demand for home-improvement loans among its black members, "because they say they can't get home financing elsewhere."[21]

As of November 7, 1977, Visitation - Holy Ghost's loan portfolio consisted of a total of 132 loans, of which there were 33 home improvement loans for amounts ranging from $300 to $2300. Rivere estimated that the average home improvement loan was $1500. All home improvement loans written since February of this year have been FHA Title I loans, which are 90% insured and carry terms of up to seven years. All of the borrowers are black with annual incomes below $13,000.

Visitation - Holy Ghost Credit Union has been in existence since 1949.[22] Originally, the membership consisted of members of Visitation of the Holy Ghost parish. Over the years, the field of membership grew to include 17 parishes in the north St. Louis area. In May, 1977, the charter was changed to show a geographic, instead of associational, common bond, and membership is now open to all who live or work in the north St. Louis area or who are members of the 17 parishes. This field of membership includes approximately 250,000 people, all of whom are eligible to join the credit union. With contributions from priests to pay one year's salary, the credit union hired Rivere in February, 1977. Since then, membership has increased by approximately 30% to 440 and deposits have increased by 55% to $110,000. The only non-member deposits are from an out-of-town order of nuns. Rivere reported that the credit union now must attract enough deposits to become self-supporting, and also obtain share insurance for its depositors.

Problems and Possibilities

Problems

Credit unions have the capacity to supplement the thrift and credit services provided by other financial institutions. In some cases, as illustrated above, they are the only financial institutions which will provide mortgage and home improvement loans to low-income and minority neighborhoods. Whether their role is supplementary or primary, however, they face

two major problems: attracting sufficient deposits to meet their members' demands for credit; and adequately managing the resources they do have to insure that their earnings can be passed on to members in the form of dividends and lower interest rates.

Need for additional deposits. Credit unions, similar to all financial institutions, must constantly seek new deposits in order to have additional funds available for lending. The need for additional deposits increases when credit unions make long-term loan commitments, such as home improvement loans and mortgages, because the turnover of these loans is very slow.

Meeting the need for additional deposits is particularly difficult in areas where people have equally convenient access to other financial institutions that offer a broader range of services. Numerous studies have shown that people choose financial intermediaries primarily on the basis of convenience.

Public education is necessary to inform the public of the role that their money, when selectively deposited in financial institutions, can play in revitalizing their community. Potential credit union members, and members who are inactive depositors, may not recognize the importance of depositing funds and participating in the management of an institution which reinvests in their community.

Management. The most attractive feature of credit unions

for some people is that they are owned and run by the shareholders. The other side of this is that these institutions are only as strong as the commitments of their member-volunteers. All credit unions, including those with sufficient paid staff, rely on members' volunteer assistance for a number of tasks. The credit committee, composed of credit union directors, meets regularly to process loan applications and to interview prospective borrowers. The supervisory committee, composed of member-depositors, has the responsibility of safeguarding members' interest by conducting periodic audits and examinations of the credit union records. In addition, depositors are given the opportunity to serve on a membership committee, which has the responsibility for recruiting new deposits and members.

Some credit unions have found that they need to hire professional staff to manage the day-to-day operations of keeping books and records, doing credit checks on loan applicants, etc. Many others, however, manage the entire operation with part-time employees and/or volunteer member-depositors, because they do not have the resources to hire full-time staff.

Obviously, the fact that some credit unions have few resources and must rely heavily on volunteers, can be cause for concern among regulators, insuring agencies and even for depositors. In spite of these problems, however, some observers of the financial institutions industry predict that in the next ten years "the credit union is going to be one of the major, if not the major

threat to the banking industry."[23]

As a further illustration of this point, a recent article in the Missouri Courier -- a publication of the Missouri Credit Union League, forecasts an increasing role for all types of credit unions in the home financing market:

> New loan markets must be opened. More significance needs to be placed on credit union financing of energy needs and home improvements. The new federal legislation has paved the way for credit unions providing long-term mortgage loans, and this is an area which needs a serious commitment from credit unions.[24]

In spite of this forecast, credit unions have a number of mortgage lending disincentives. Some are similiar to those of other mortgagees, such as commercial banks, savings associations and even mortgage bankers.

First, a credit union which chooses to make mortgage loans will obligate large portions of its assets on a long-term basis, diverting those resources from availability for making other types of loans. Herbert Hunter reported that in Missouri, employee credit unions tended to make real estate loans when they had a cash surplus.[25] He also indicated that the Credit Union National Association -- the credit union trade group -- is setting up an organization to package mortgage loans for the secondary mortgage market. If a credit union can sell its mortgage loans and thereby regain the liquidity that it had prior to making the mortgages, one disincentive for mortgage lending will be removed.

Second, like other financial intermediaries, credit union credit committees must consider risk in evaluating loan

applications. Hunter noted that cautious credit committees might be reluctant to make mortgages since credit unions lack experience in making loans secured by real estate.[26]

Credit unions have an additional mortgage lending disincentive not shared with other mortgagees. Since most credit unions are of limited size with assets under $ 500,000,[27] few credit unions can make a sufficient number of mortgage loans to become major mortgage lenders in the communities they serve. A number of credit unions will be ineligible to make any mortgage loans because credit unions may not loan more than ten per cent of their assets for any one secured loan.[28]

Possibilities

There are at least two reasons for viewing credit unions' community development potential in Missouri as promising. First, the state's Division of Community Development of the Department of Consumer Affairs, Regulation and Licensing has expressed an interest in fostering credit unions whose primary focus is community development.[29] Second, the 79th General Assembly passed the Neighborhood Assistance Act in 1977.[30] This statutory recognition of the need to focus public and private attention on neighborhoods, if used together with instruments like community development credit unions, could result in an increased flow of public and private capital into older neighborhoods and rural areas.

Footnotes

1 Financial intermediaries are depository institutions which accept deposits and make loans. The term includes commercial banks, mutual savings banks, savings associations, and credit unions.

2 David Gutting, "Credit Union Growth and New Economic Realities," Missouri Courier XIX (June, 1977): 107.

3 Credit Union Act, Revised Statutes of Missouri, Chapter 370 (Supp. 1977).

4 Federal Credit Union Act. U. S. Code, Vol. 12, Secs. 1751-1790 (1977).

5 Peggy Brockschmidt, "Credit Union Growth in Perspective," Monthly Review (Kansas City, Missouri: Federal Reserve Bank of Kansas City, February, 1977), pp. 10-11.

6 A credit union serving a neighborhood with a median income level at or below the lower level Standard of Living Classification as established by the Bureau of Labor Statistics is considered to serve low-income members and is eligible to receive non-member share deposits from individuals, businesses, churches, religious communities, corporations, and foundations. This definition was obtained from the following sources: telephone interview with E. Anthony Barnicle, Director, Division of Community Development, Department of Consumer Affairs, Regulation and Licensing, State of Missouri, Jefferson City, October 28, 1977; Floyd H. Agostinelli, Community Development Credit Unions (Washington, D. C.: Alternative Economics, Inc., 1977), pp. 36, 46.

7 The selective deposit strategy for public funds is discussed in another of this series of working papers.

8 This program is administered by the National Credit Union Administration.

9 In Missouri, state chartered credit unions are able to offer various classes of share certificates (similar to

certificates of deposit), share drafts (check-like instruments which pay interest on savings until the draft clears the bank on which it was written), and Christmas shares (similar to Christmas accounts). The 1977 amendments to the Missouri Credit Union Act give state chartered credit unions the right to exercise powers granted to federally chartered credit unions upon approval of the Director of the Division of Credit Unions.

According to 1977 amendments to the Federal Credit Union Act, following issuance of regulations by the National Credit Union Administration which are expected in November, 1977, boards of directors of federal credit unions will be authorized to issue different types of share accounts with varying dividend rates and share certificates with varying dividend rates and maturity dates.

Information regarding these thrift services was obtained from the following sources: Federal Credit Union Act (Publ.L. 95-22), Statutes at Large 91, Sec. 49 (1977); Missouri General Assembly, House, An Act to Amend the Credit Union Act, Act 43, 79th. General Assembly, 1st regular session, 1977, H.B. 48; Telephone interview with Robert Monheit, Attorney, Office of General Counsel, National Credit Union Administration, Washington, D. C., October 26, 1977.

10 Monheit, Interview.

11 Telephone interview with Herbert Hunter, Vice-President, Missouri Credit Union League, St. Louis, October 24, 1977.

12 Monheit, Interview.

13 Telephone interview with Charles Cockburn, Statistician, Office of Research and Analysis, National Credit Union Administration, Washington, D. C., October 26, 1977.

14 Hunter, Interview.

15 At yearend 1976, of the 445 credit unions in Missouri, 38 were federally chartered and 407 were state chartered. Assets of the federally chartered credit unions totalled $ 52,340,000. Assets of the state chartered credit unions totalled $ 604,078,000. This information was obtained from Cockburn, Interview.

16 Information on Casa Credit Union was obtained from telephone interviews with Anthony Cabrera, Consultant, Casa Credit

Union, Springfield, Massachusetts, October 24, 1977, and November 7, 1977.

17 Ibid., November 7, 1977.

18 Ibid.

19 Brockschmidt, "Credit Union Growth in Perspective," p. 10.

20 Cabrera, Interview, November 7, 1977.

21 Telephone interview with Wayman Rivere, Business Manager, Visitation - Holy Ghost Credit Union, St. Louis, Missouri, November 7, 1977.

22 Information included in this paragraph was obtained from a telephone interview with Wayman Rivere, October 25, 1977.

23 Carol A. Bishopric, "Competition, NOWs Could Improve Bank Pricing," American Banker, November 1, 1977, pp. 1, 24.

24 Gutting, "Credit Union Growth and New Economic Realities," pp. 108-109.

25 Hunter, Interview.

26 Ibid.

27 Cockburn, Interview.

28 Credit Union Act, Revised Statutes of Missouri, Chapter 370, Sec. 310.1 (1969). Federal Credit Union Act. U. S. Code Annotated, Vol. 12, Sec. 1761c (June, 1977).

29 Barnicle, Interview.

30 Missouri General Assembly, Neighborhood Assistance Act, 79th General Assembly, 1st reg. sess., 1977, S.B. 375.