



## NorthSide Community Federal Credit Union: Hot Funds/Cold Cash

### A low-cost alternative to payday lenders

Hot Funds/Cold Cash, a short-term loan program, was started by Chicago's NorthSide Community Federal Credit Union in 1994 out of concern for members who were using payday loans. NorthSide

wanted to offer a low-cost alternative to its members to keep them from getting caught in the vicious cycle of payday loans. In contrast to the annual percentage rates on payday loans, which can rise to several hundred percentage points if unpaid for a year, the interest rate on Hot Funds/Cold Cash is 16.5 percent per year.

The term for Hot Funds/Cold Cash loans is six months. The loans cannot be rolled over, and NorthSide accepts partial repayments. By contrast, payday loans can be rolled over, and partial repayments are not accepted. Unlike most payday lenders, NorthSide aims to help improve the financial situation of its clients. However, clients' finances are currently being improved at the cost of the credit union's own financial health in that Hot Funds/Cold Cash generates no profits and is a net drain on resources.

In 1994, when NorthSide tried to find a viable option to payday loans, it was among the pioneers. Today, the negative impact of payday loans is well documented, and there are efforts across the country to eliminate or at least restrict this kind of loan. While credit unions are appropriate institutions for promoting alternatives to payday loans, their impact is restricted to their members. Over the years, NorthSide has tried to make

<b>Name and Location</b>	NorthSide Community Federal Credit Union, Chicago
<b>Business Model</b>	Alternative payday loan
<b>Services Offered</b>	Payday loans and other credit union products
<b>Constituency Served</b>	Low-income households that live in the credit union's service area and that formerly depended on payday lenders
<b>Success and Outcomes to Date</b>	<ul style="list-style-type: none"> <li>▼ Between 1994 and the end of November 2002, NorthSide made 1,899 payday loans amounting to \$949,500.</li> <li>▼ The default/write-off rate is only 3 percent.</li> <li>▼ Some borrowers have improved their financial condition over time and have moved on to take out car loans.</li> </ul>



Hot Funds/Cold Cash as easily accessible as possible. In January 2002, it removed the requirement for a one-year membership in the credit union for borrowers.

Apart from Hot Funds/Cold Cash, NorthSide offers other financial services to low-income individuals whose needs are not being met by commercial banks and who rely on fringe lending outlets. The credit union has certificates of deposit and savings accounts, and it offers consumer loans for cars, home mortgages, home improvements, education, and debt consolida-

tion. However, it does not provide check cashing, an important service many low-income individuals and households require.

NorthSide offers its services and loans at very low rates; in fact, it breaks even or loses money on 90 percent of its members and makes a profit on only 10 percent. The credit union aims to be self-sufficient without having to seek operating grant support; it generates a small net income, which it distributes as a dividend to its members.



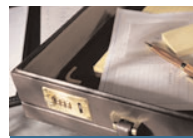
## History

Located on the north side of Chicago, NorthSide Community Federal Credit Union is a nonprofit federally chartered community development credit union owned and controlled by its members. Founded in 1974, NorthSide promotes the financial well being of its diverse community by providing financial services and expanding the availability of financial resources to community residents, businesses, and organizations. It has more than 3,100 members and \$7.2 million in total assets; all deposits are insured up to \$100,000 by the government. The credit union has a small branch with four employees and a volunteer board. It aims to be self-sufficient and does not seek operating grants.

Hot Funds/Cold Cash is a short-term loan program started by NorthSide. The credit union wanted to offer

a low-cost alternative to payday lenders, as well as banking services to people who had been rejected by commercial banks or were wary of the restrictions banks impose.

The Hot Funds/Cold Cash program was born in 1994 out of concern for credit union members who used payday loans.



## Business Model

### Program/Product Description and Outcomes

When it first started in 1994, Hot Funds/Cold Cash was designed as a small, low-cost consumer loan with a

Unlike payday loans, Hot Funds/Cold Cash loans cannot be rolled over and can be repaid a little at a time.

reasonable rate and fee structure. The loan program offered credit up to \$500, to be repaid in equal monthly payments over a one-year term. Borrowers had to have been members of the credit union for at least a year and to have a minimum monthly income of \$1,000. NorthSide also required that prospective borrowers have no current loans outstanding or loan applications rejected in the past year.

Since January 1, 2002, however, NorthSide has been making loans without the one-year membership and minimum monthly income requirements because it received a \$20,000 grant from Northern Trust Bank to be used as a segregated loan loss reserve for Hot Funds/Cold Cash. Loan applicants need to demonstrate current employment status by presenting a payroll stub, and the repayment term has been shortened to six months. Since April 2002, this modified version of the Hot Funds/Cold Cash loan has been called the Payday Alternative Loan (PAL). A current goal is to extend the reach of this product to individuals outside NorthSide's membership base.

In another change of policy, NorthSide now allows borrowers to take out a second loan. In these cases, NorthSide lends the balance of the principal, which has been paid, so the maximum outstanding loan cannot exceed \$500. Members are also limited to two loans a year, and the second loan cannot be funded until the first has been paid down to a balance of \$250 or less. As before, partial payments are allowed, and there is no penalty for early repayment.

As a result of the requests for repeat loans, the credit union has decided to add an optional financial literacy component that is being funded by a two-year \$20,000 grant from Private Bank. Beginning in February 2003, borrowers who attend and complete a financial literacy

class and pay back their loans on time will receive a financial incentive: The final loan payment, approximately \$40, will be moved to a savings account for them. Further, as an added incentive to save, once the borrower accumulates \$500 in savings, a \$20 bonus will be awarded. However, NorthSide will not deny a PAL loan to customers who choose not to attend the class.

The loan application process is simple and brief, asking for identification, employment verification, income, current debt, and the purpose of the loan. NorthSide also orders credit reports to understand the borrower's credit background and history. For certain employer groups, repayment is made through direct payments from the borrower's paycheck.

Between 1994 and the end of November 2002, NorthSide made 1,899 loans, totaling \$949,500, as part of the Hot Funds/Cold Cash program. At the end of 2001, these loans represented about 34 percent of outstanding loans and were the largest single type of loan. The outstanding amount for this product, however, equaled only 3.23 percent of the credit

Hot Funds/Cold Cash does not generate a profit, although it has helped some borrowers improve their financial situation.

union's total outstanding loan portfolio. By the end of 2001, there were 234 Hot Funds/Cold Cash loans out of 693 total outstanding loans. At around 3 percent, the default/write-off rate for these loans is considered low, but it is nevertheless twice as high as the default rate on the credit union's other loans and can strain resources. Even if volume grows, the increased scale would still not generate profit.

According to Edward Jacob, manager of the credit union, the program can benefit both the borrower and credit union: "Making these loans really gives [borrowers] a chance to rebuild their credit and hopefully graduate to longer loans with us."



### Products/Services and Pricing

A minimum deposit of \$15 and a \$1 membership fee are required to open an account. NorthSide offers an interest-paying savings account, no-fee share draft checking accounts, certificates of deposit, Visa credit cards, ATM cards, direct deposit, and payroll deduction plans. The interest rate on its savings account is better than at many other area institutions. Photocopying, faxing services, and bill payment through credit union checks are also available.

The overdraft fee is \$12, instead of the \$29 charged by most large banks. Other fees, like the withdrawal fee for the ATM, the annual Visa fee, and the bill-paying service charge, are all on the low side.

While the credit union will accept cash and checks for deposits, for security reasons it does not dispense cash. It does have an ATM, however, which provides some cash to members. Installing bulletproof glass, hiring guards, and operating security cameras are too costly for the credit union, which also fears changing the nonintimidating character of the office. NorthSide also offers consumer loans for cars, home mortgages and home improvements, education, and debt consolidation.

### Consumer Segment Served

NorthSide members, mainly people who live or work in the Lake View, Uptown, Edgewater, and Rogers Park communities, are eligible for the program. After it modified Hot Funds/Cold Cash to the PAL program in April 2002, NorthSide began to run credit reports on its customers. These reports are not used for loan approval, but rather for statistical and research purposes. The following table shows the credit scores for the 337 PAL customers. It is evident that the loans are being used by people who have poor credit and few options for emergency needs.

Over 620	5%
560-620	14%
500-560	40%
Under 500	27%
No score	13%
Average score	531
Bankruptcy within the past three years	16%
Average number of collection accounts	5

*Note: Because of rounding, scores do not equal 100 percent.*

With PAL, NorthSide also is collecting data on the purpose of the loan. The reasons are typical of emergency borrowing in low-income neighborhoods: utility bills, auto expenses (repair, insurance, tickets, and booting), childcare, rent, and medical bills, as well as the need to pay off other payday loans. The respondent’s answer is taken at face value and is not verified independently.

### Technology

Even though NorthSide represents a “low-tech, high-touch” approach, a basic level of technology—computers, an ATM, and so on—is crucial for smooth operations.

### Location and Hours

NorthSide has four full-time employees: a manager, a loan officer/assistant manager, a teller and member services officer, and a marketing manager. For the first 10 years, volunteers staffed the credit union.

NorthSide has one small location on the north side of Chicago near the lakefront. The office is open from 8 a.m. to 3 p.m. on Tuesday and Wednesday, from noon to 7 p.m. on Thursday and Friday, and from 8:30 a.m. to 1 p.m. on Saturday. On Friday, staff travel to the office of the members' largest employers from 1 p.m. to 3 p.m. and offer transactions on a laptop connected to the main computer in the office. The credit union is closed on Sunday and Monday.

### Education/Outreach/Marketing

Some financial education occurs one-on-one with members. There is also formal course training that lasts several weeks. These courses are usually given with employer partners. NorthSide staff prepare and present these programs.

Marketing is done mostly through relationships with local employers (these tend to be nonprofit organizations) using the credit union's services. Flyers, promotions, and presentations are the strategies used.



## Bottom Line

### Financial Costs and Profitability

NorthSide has good overall financial standing and a good organizational performance record. It has grown steadily over the past six years, generating more of its income from interest and fees than from investments. Ironically, the major obstacle to growth is the self-imposed goal of being operationally self-sufficient. It is true that the goal has strengthened the organization, but it has stymied growth as well because it keeps NorthSide from seeking operating grants. However, the lending volume is increasing—both the number of loans and the outstanding loan amounts—and it is likely to continue to grow. This is important because the credit union probably does not have enough volume to

generate economies of scale. A larger volume of operations will allow it to provide services at a lower cost and to generate greater net income. The credit union is also heavily dependent on one depositor, Lakefront

SRO, a local nonprofit housing development corporation, which has \$2.7 million in deposits. At its present scale, losing this account could be devastating.

While detailed information on the Hot Funds/Cold Cash program is not available, its overall performance is lower than that of the total portfolio. At the end of November 2002, the number of write-offs was 103, or 5.45 percent of the total loans (1,899) distributed. It is estimated that the charged-off dollars for the Hot Funds/Cold Cash program total \$29,219, equaling 3.08 percent of total dollars disbursed. While this is a low rate in general, it is roughly twice the 1.55 percent non-payment rate for the credit union's total portfolio. Delinquencies also have run at a higher rate under this program—roughly three times more than for its overall portfolio, which was 2.44 percent at the end of January 2001. In addition to actual losses, it is likely that the program generates a small operating loss. The credit union estimates that of the 272 PAL loans, about 23 (about 8.5 percent) are delinquent over 30 days. It makes approximately \$25 on each PAL loan, which mostly covers expenses.

### Start-Up Costs and Funding Sources

Because of the way it is structured, NorthSide can plan and implement new products and programs very inexpensively. A marketing committee composed of board members and the credit union manager considers new ideas, reviews other organizations, and undertakes all the planning and any necessary training internally with very little overhead. The loans require at least 10

Over the past few years, NorthSide has started doing a better job of lending to members, and its income has risen accordingly.

minutes of staff time to originate, and that time increases greatly if there are collection problems. NorthSide received a \$20,000 grant from Northern Trust Bank to create a separate reserve pool for Hot Funds/Cold Cash to protect against unpaid loans.



## Major Findings

The Hot Funds/Cold Cash program is an exemplary undertaking for a small credit union with relatively low assets and limited operational resources. NorthSide hopes to break even or make a small profit from this program, but the primary goal is to help customers.

NorthSide has emphasized the following in designing Hot Funds/Cold Cash as an alternative to payday loans:

▼ *A focus on building credit history is important.* A major focus of Hot Funds/Cold Cash and PAL is to help customers build, or rebuild, their credit histories. According to Jacob, many customers have little experience with mainstream financial service providers and products. Through Hot Funds/Cold

Cash or PAL, customers can establish a credit history. For example, Jacob said that a customer who successfully paid off her PAL loan had a credit score of 633 when she later applied for an unsecured loan.

▼ *Payday loan alternatives can be used as a bridge to mainstream banking services.* Hot Funds/Cold Cash loans and PAL have helped customers move to other loan products. Although the credit union does not have firm data on the precise number of customers who have made the transition to other loans, anecdotal evidence is that a number of Hot Funds/Cold Cash and PAL customers have moved on to secured loans and auto loans.

▼ *Increasing volume and building scale are key.* Experience with Hot Funds/Cold Cash demonstrates the importance of volume to bring these loan programs to scale. Lack of scale is reflected in the credit union's vulnerability to losses under the program.

▼ *Long-term success requires integrating financial education.* As of February 2003, NorthSide began offering financial education and savings incentives to customers who use PAL.

Hot Funds/Cold Cash has demonstrated that a credit union can offer low-cost credit alternatives to exploitative payday loans.

### Northside Community Federal Credit Union

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