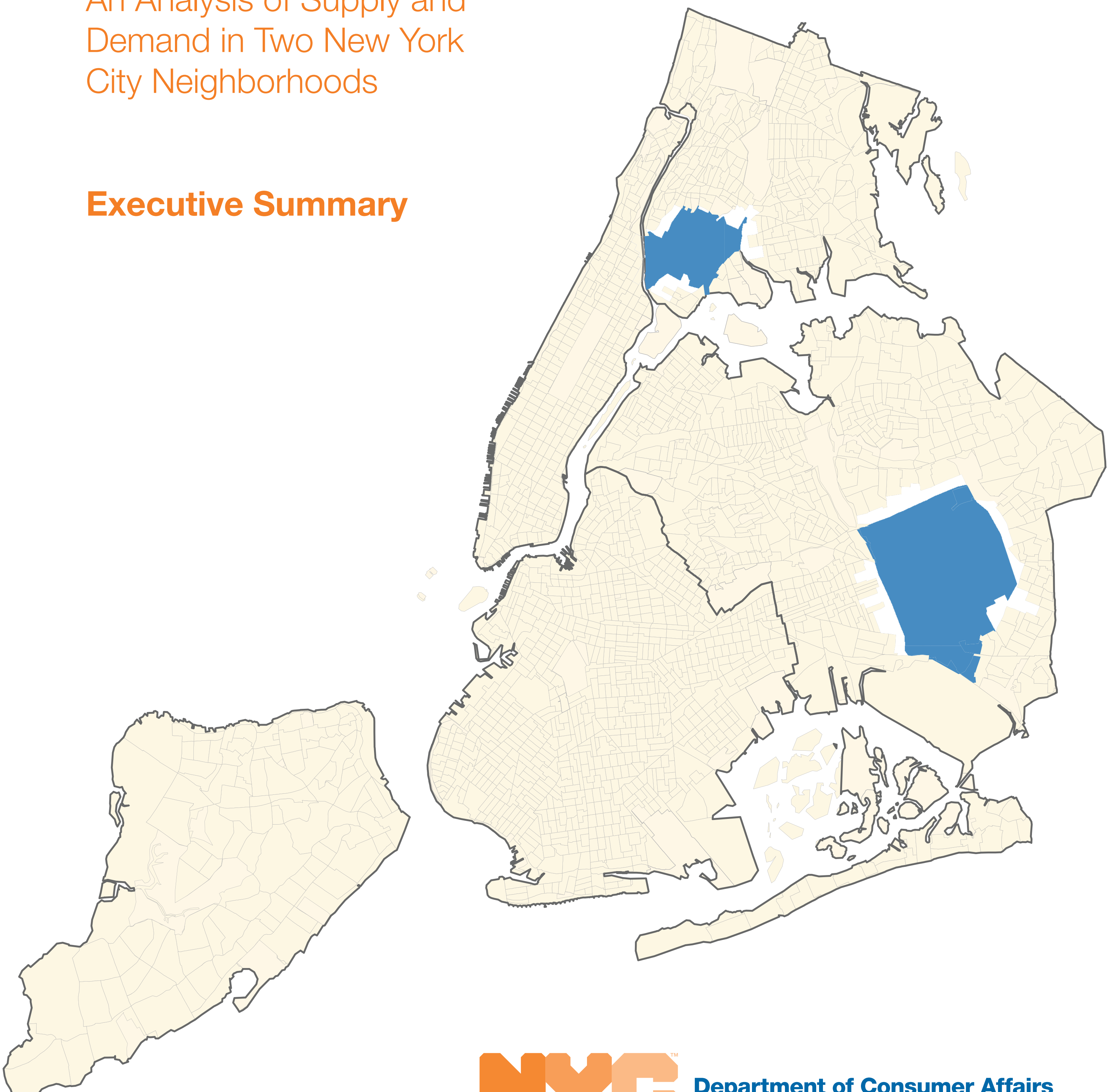
Neighborhood Financial Services Study

An Analysis of Supply and Demand in Two New York City Neighborhoods

Executive Summary



Department of Consumer Affairs
Office of Financial Empowerment

Neighborhood Financial Services Study:

An Analysis of Supply and Demand in Two New York City Neighborhoods

Executive Summary

New York City Department of Consumer Affairs
Office of Financial Empowerment

Michael R. Bloomberg
Mayor

Jonathan Mintz
Commissioner

June 2008

♻ Printed on 30% post consumer recycled paper

Executive Summary

For most New Yorkers, financial services today are more accessible and easier to use than ever before. Yet, for many low-income households, banking has become more costly, unpredictable, and out-of-step with their actual needs. As a result, hundreds of thousands of New York families living on low incomes choose to remain "unbanked" and rely upon "fringe" financial service providers, such as check cashers and pawnshops, for basic financial transactions and credit services. Researchers have posited a variety of reasons why people in low-income communities are more likely to use high-cost fringe transactional and credit products: insufficient financial education and awareness, lack of physical bank availability in their communities, inaccessibility of mainstream loan products, and greater comfort and convenience offered by check cashers and other fringe providers. Instead, the Neighborhood Financial Services (NFS) Study identifies a mismatch between the needs of residents in two low-income New York City neighborhoods and the financial products and services offered, suggesting market-based reasons why residents disproportionately use fringe financial services.

The NFS Study explores the availability and usage of financial services and products in two neighborhoods: Jamaica, Queens and Melrose, Bronx. The New York City Department of Consumer Affairs' Office of Financial Empowerment (OFE) conducted the study under the leadership of the Center for Economic Opportunity as part of Mayor Bloomberg's broader anti-poverty efforts, and with support from the William J. Clinton Foundation. The purpose of the NFS Study is to better understand banking dynamics in low-income neighborhoods to identify public and private opportunities for long-term, high-impact financial empowerment initiatives.

i. Methodology

The New York City Department of Consumer Affairs' OFE conducted the NFS Study to analyze the relationship between consumer financial needs and current product offerings in neighborhoods with low incomes. A survey was developed in English and Spanish, drawing from relevant regional and national surveys, with the help of an experienced consultant. To engage community expertise and voice in this research, OFE partnered with two community-based organizations, Phipps Community Development Corporation in Melrose and Neighborhood Housing Services of Jamaica, to conduct the surveys in person with 640 randomly selected residents. In addition, OFE convened four focus groups to delve deeper into key findings. To better understand the supply of financial services in the two neighborhoods, researchers from the William J. Clinton Foundation analyzed current products and services offered by both mainstream and fringe financial service providers, and analysts from the Neighborhood Economic Development and Advocacy Project (NEDAP) mapped relevant community and city data.

ii. Findings

Finding: There is a fundamental mismatch between current financial product and service offerings and the needs of low-income households. This mismatch appears to play a more prominent role in these communities than bank branch proximity in determining why residents remain "unbanked" and why fringe financial services are widely used.

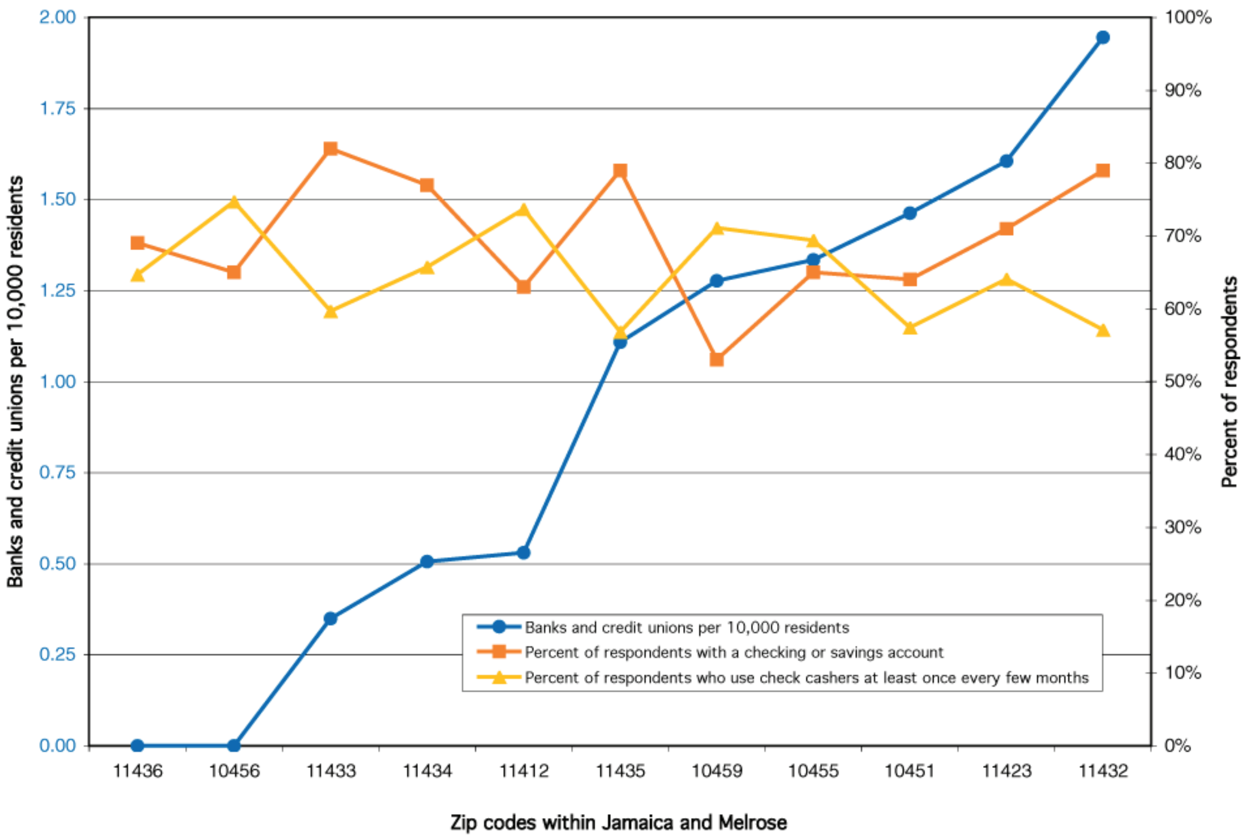
Overall, 31% of Jamaica and Melrose survey participants—translating to approximately 110,000 residents—are "unbanked" (i.e., lacking a checking and savings account). Although residents with the lowest incomes are disproportionately represented among the unbanked, a surprising number of middle-income respondents are also without bank accounts—17% of Melrose and 13% of Jamaica households with annual incomes over $40,000 lack a banking relationship (representing approximately 8,700 households).

Fringe financial services, such as check cashers and pawnshops, are widely used in both communities. However, use of fringe financial services is not limited to the unbanked. In fact, 75% of residents use check cashers at least once every few months. These services come at great cost—*Melrose and Jamaica consumers spend an estimated $19 million per year in check cashing fees alone*.[1]

Why would people rely on expensive fringe services, especially if they are already connected to mainstream financial institutions? This study explores two hypotheses: the lack of physical availability of mainstream financial services and the lack of availability of products that meet the needs of consumers with low incomes.

Although Jamaica and Melrose have less bank branches per capita than the city overall, the NFS Study finds that, within these two communities, *the concentration of bank branches is virtually unrelated to the percentage of residents with bank accounts*. Figure 1 shows that as the density of bank branches increases, the proportion of residents with bank accounts changes very little. Similarly, there is no relationship between the percentage of individuals using check cashers and the concentration of banks and credit unions in their zip code.

Figure 1. Density of bank branches with percent "banked" and percent using check cashers



Rather than physical availability of bank branches, the NFS Study findings suggest that the fundamental mismatch between current financial products offered and consumer transactional needs—getting cash, paying bills, and buying goods—appears to be the major determinate in whether and how individuals with low incomes use mainstream financial institutions. Table 1 illustrates the principal mismatches found by the NFS Study.

Table 1. Comparison of checking account supply and consumer demand

Checking Account Offerings	Consumer Need
Most checking accounts are free only if the consumer has direct deposit.	61% of low-income checking account holders do not have direct deposit.
Checking accounts facilitate bill payment, but only through checks or online payments.	53% of checking account holders cannot pay their rent with a check or online; rather, they must pay in cash.
Overdraft protection plans are common, charging an average of $30 for spending over the account balance.	21% of account holders overdraw their checking account every few months.

The NFS Study finds that unbanked residents recognize these market mismatches and respond by using fringe financial services. Nearly one in four unbanked survey respondents cited excessive fees as the reason they avoid mainstream banking. Fees were the most common response given by NFS Study respondents as to why they avoid mainstream banking. This is especially true among the estimated 54,000 unbanked residents who might be perceived as the most attractive customers to financial institutions because they hold full-time jobs and have incomes over $20,000. Among these residents, 50% cited fees as a deterrent to mainstream banking.

Focus group participants further indicated that unpredictability and complexity of fees are as important to the unbanked as actual cost. Analysis of the checking accounts offered in both communities reveals multiple fees levied on low-balance accounts, including minimum-balance monthly maintenance charges, transaction limits, and insufficient funds fees. Since these fees are the result of consumer actions, rather than fees charged up-front (like check cashing fees), they are perceived as "unpredictable" by consumers, many of whom might not closely monitor their accounts or may not fully understand the terms and conditions associated with checking accounts.

Finding: Households in Jamaica and Melrose have more savings than might be expected, although analysis of savings products offered in these two communities reveals a mismatch between consumer needs and current product offerings.

The NFS Study finds that many low-income households in these two communities save money. Sixty-three percent of community members have formal or informal savings (informal savings refers to mutual savings groups, at-home savings, or saving in a friend or family member's bank account). Respondents with savings reported an average savings of $1,200.[2] Further, 31% of the unbanked reported having some type of savings, averaging $25, whether informal or formal (for the unbanked, formal savings typically refers to savings in a retirement account). In addition, 16% of NFS Study respondents make automated regular contributions to savings, and have an average primary savings balance of $3,000.[3] Contrary to conventional asset-building wisdom, savers in both neighborhoods are less likely to be motivated to save for concrete goals, such as buying a car or house, and more likely to save for emergencies or "the future" in general.

Receiving a refund from the Earned Income Tax Credit (EITC) and participating in financial education are both linked to residents' savings behavior. EITC-filers are twice as likely as non-filers to have savings, even after controlling for income, education, age, race, and other demographic variables. Similarly, holding all else constant, people who have taken a financial education class, seminar, or workshop are twice as likely to have savings compared to those who have not.

This study also finds that few residents accumulate savings without also accumulating debt. Only 21% of individuals with savings hold no debt compared to 36% of individuals who hold no savings and have no debt. Moreover, individuals with debt are more likely to hold savings (68%) than individuals without debt (48%).

Focus group members shared that product features, such as automation and restricted access, help them save. However, analysis of savings products offered at banks in these communities reveals a mismatch between household needs and available products. Supply-side analysis indicates that most savings accounts available to low-balance savers in these neighborhoods have fees greater than their interest. Two-thirds of savings accounts available in these communities earn less than 1% in interest, and the majority have monthly maintenance fees averaging $3. The savings accounts available to residents in these neighborhoods may actually erode savings rather than help accumulate savings.

Finding: Even the lowest-income segments of these communities have access to mainstream credit; however, access to mainstream credit does not replace use of fringe credit sources, despite being costly and a strong predictor of financial instability.

Although historically the chief concern about credit in low-income communities was its lack of availability, credit is now widely used by consumers with low incomes. According to the NFS Study findings, 73% of residents in Melrose and Jamaica hold some form of debt. Most residents with debt accessed credit from a combination of mainstream sources (such as banks, credit unions, and credit card companies) and fringe sources (such as tax preparers who offer refund anticipation loans, rent-to-own stores, pawnshops, and Internet or informal payday lenders). More than one in three respondents have credit card debt; even among unbanked respondents, 20% hold credit cards. The average credit card debt is $2,500, or roughly 10% of card holders' average annual income of $26,000.

Fringe credit is widely available in Jamaica and Melrose, and accessed by residents for short-term, emergency needs. In fact, despite storefront payday lending being illegal in New York State, 9% of respondents reported accessing a formal or informal loan with a term of less than one month. Respondents reported that loans were provided by a friend or family member, moneylender, Internet or telephone-based company, or local business. Nine percent is a notable figure when compared to short-term lending in locations where payday lending is available legally. For example, a study of low- to middle-income Detroit residents conducted by the Brookings Institution and the University of Michigan revealed that 6% of working residents had applied for a formal payday loan.[4]

Also of note, even those with access to mainstream credit use fringe credit products. For example, although 58% of Jamaica and Melrose residents have credit cards, one-quarter of credit card holders have resorted to credit card cash advances at least once every few months. Furthermore, nearly 50% of respondents who use rent-to-own stores and pawnshops and 66% of respondents who have gotten a refund anticipation loan have at least one credit card.

Fringe credit is not only more expensive than mainstream credit, it is a strong predictor of financial instability. For purposes of the NFS Study, financial instability is defined as respondents being unable to pay rent or utility bills in the past 12 months and being "short on cash a few days before being paid." Fully four in 10 fringe credit users could not pay their rent at least once in the last year. Even when controlling for income, employment, family composition, and other factors, those who carry fringe debt have nearly three times the odds of experiencing financial instability as those without it. This is a significant finding, given that 46% of study participants reported using fringe credit.

Finding: Financial education is strongly associated with positive financial behaviors, such as being linked to mainstream financial institutions, having savings, and avoiding use of fringe debt. There is no relationship found in the NFS Study, however, between financial education and indicators of overall financial stability.

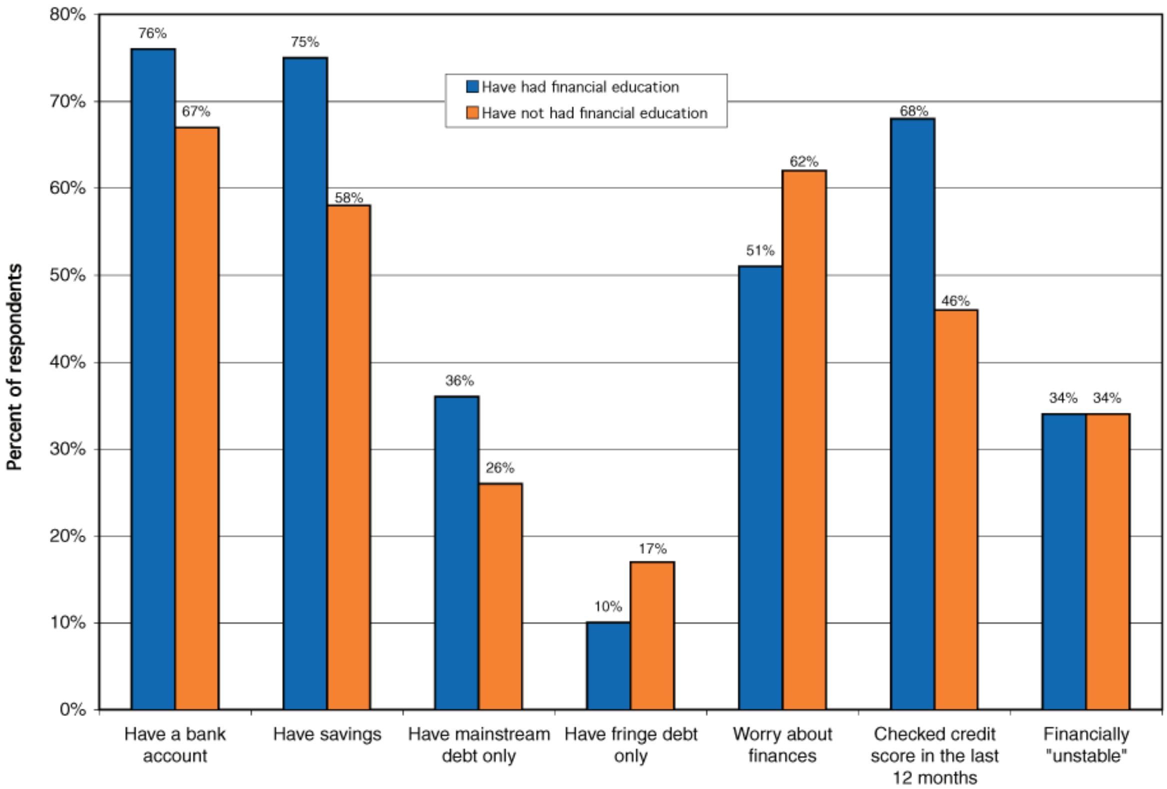
The NFS Study shows notably positive financial behaviors associated with attending a class, seminar, or workshop about money. As illustrated in Figure 2, respondents who have had financial education are more likely to have a bank account, hold savings, check their credit score, and exhibit less worry about their finances. For example, 75% of respondents who have taken financial education reported having savings, compared to 58% of respondents who have had no financial education. Multivariate analysis reveals a strong relationship between financial education and savings behavior even after controlling for income and education. After controlling for demographic factors, people who have attended a financial education class are nearly twice as likely to hold savings.

Nevertheless, the NFS Study finds that attending a financial education class is not associated with a difference in overall debt holding, nor is it relevant to rates of financial stability for residents in these two neighborhoods. These findings indicate either that financial education is most effective for households with consistent, stable incomes or that financial education offerings are more focused on basic banking and savings than on credit issues, which is likely to have a greater impact on financial stability.

Although positive behaviors are associated with financial education, more than one-half of survey respondents reported that they have never gotten financial advice from anyone (53%). The second most prevalent source of information reported is friends and family (40%). Only 5% of survey respondents chose school as "teaching them the most about money." While relatively few study participants have taken a class, seminar, or workshop about money (29%), most focus group participants shared the belief that financial education would be valuable. Said one Melrose focus group member:

> There needs to be a consultant in the neighborhood to help you and it needs to be free because we don't all make that kind of money. A consultant could explain to you "Look at all these bills I have" and you can ask them "How can I use this little check to pay all these bills?"

Figure 2. Financial behaviors of those who have and have not attended a financial education class, seminar, or workshop



iii. Gap-Closing Opportunities

The NFS Study findings identify multiple opportunities for mainstream financial institutions to engage markets they have missed while benefiting residents with low and moderate incomes. The continuum in Figure 3 posits such products as they would intersect with relevant populations. Transactional, savings, and credit products are coordinated to the product and service demands of households as they progress from financial instability to stability, and the legend identifies the size of those market segments in the two communities. At the left, the continuum begins with unbanked households with no formal credit history or savings. Moving to the right, products address families' demand for reducing the costs associated with everyday financial services, managing their debt, and building assets.

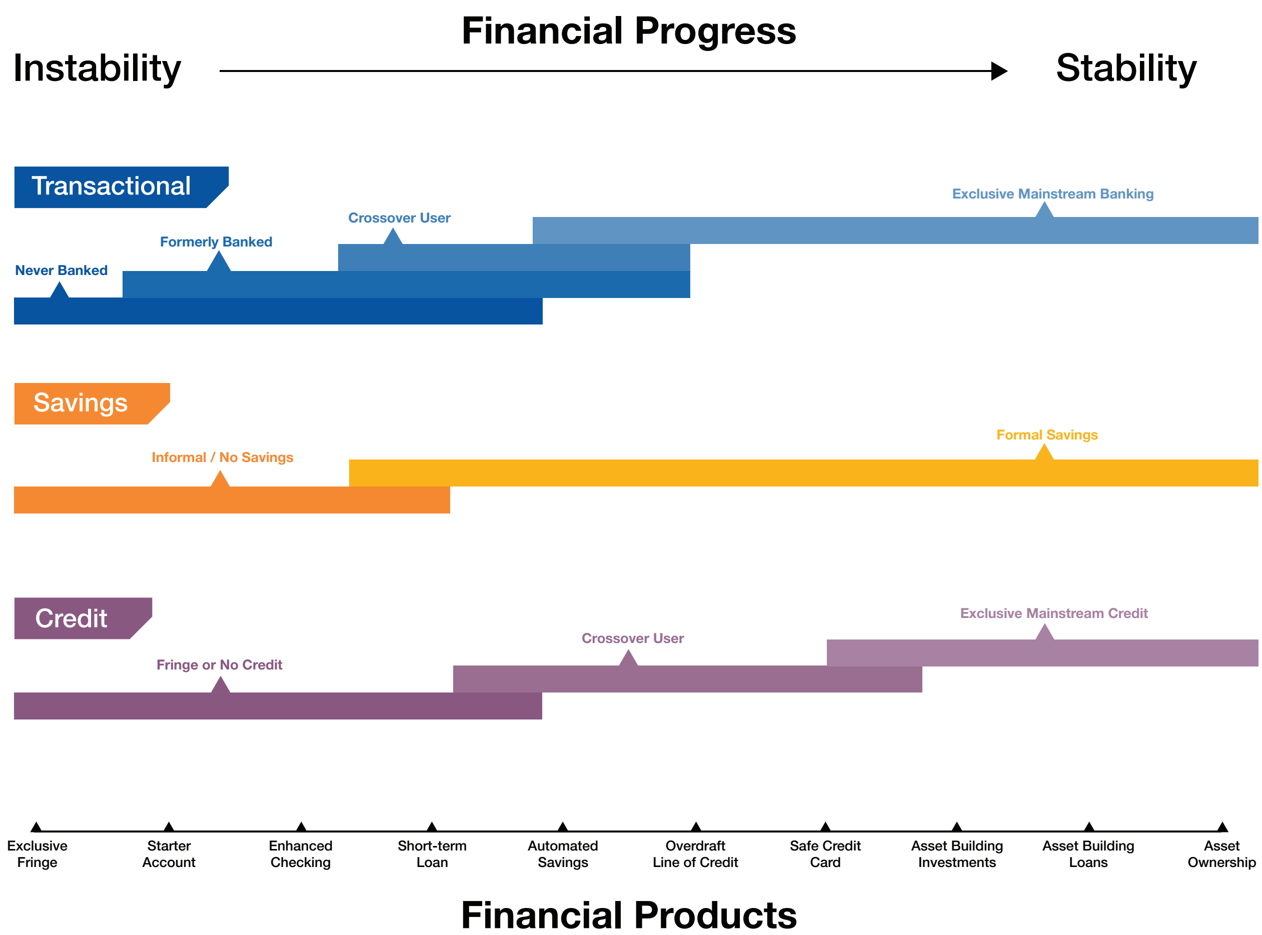
Basic Banking Services

The NFS Study findings demonstrate a fundamental mismatch between the checking products available to low-income households and their basic financial needs. Reconciling this mismatch would prove mutually beneficial to financial institutions and consumers alike. Consumers avoid banking relationships that might protect their earnings, facilitate savings, and build assets, while financial institutions are missing out on a market that is currently spending more than $225 million per year across New York City on check cashing fees alone.[5]

Bank usage patterns revealed by this study indicate that simply increasing branch presence in low-income communities, while still valuable, will not ensure mainstream financial institutions strategically capture this market. Innovative product development, combined with tailored marketing and improved customer service in low- to moderate-income branches, may better connect to customers who have stable incomes, genuine savings, and community longevity.

The continuum outlined in Figure 3 suggests a range of basic banking products that could connect to residents who have never held an account before or those who have closed accounts. In Jamaica and Melrose, approximately 90,000 individuals (25%) have never held a checking account before. An additional 47,000 (13%) lack a checking account currently but have previously held one. A no-fee, limited functionality starter account could allow consumers less expensive access to cash without exposing them to costly overdraft fees.

Figure 3. Continuum of financial products



Target Population	Definition	% of NFS Sample / Population Projection for Jamaica and Melrose
Never Banked	Never had a checking account	25% / 90,000 residents
Formerly Banked	Currently do not hold a checking account but once did	13% / 47,000 residents
Crossover User	Current bank account holders who use fringe providers to remit money or purchase money orders	51% / 184,000 residents
Exclusive Mainstream Banking	Exclusive mainstream banking use	24% / 87,000 residents
Informal/No Savings	Exclusively informal savings or no savings	47% / 166,000 residents
Formal Savers	Formal savings such as a bank account with a balance or retirement account	53% / 195,000 residents
Fringe or No Credit	Exclusive fringe credit or no reported debt	42% / 152,000 residents
Crossover User	Fringe and mainstream credit use	30% / 108,000 residents
Exclusive Mainstream Credit	Exclusive mainstream credit use	28% / 101,000 residents

Beyond starter accounts, banks could explore enhanced checking accounts with features tailored to meet the unique demand of consumers with low incomes. An enhanced checking product could be marketed to two major sectors of low-income communities: the most "bankable" who remain unbanked (54,000 unbanked residents—or 15%—in Jamaica and Melrose with full-time jobs and incomes over $20,000); and the "crossover" population (184,000 residents—or 51%—who currently have checking or savings accounts but rely on check cashers for some or most of their financial transactions). This market has steady income, although 61% of account holders are paid by check or cash. With 53% unable to use personal checks for bill payments, an enhanced checking product with competitively priced money orders, free checking linked to qualifications other than direct deposit, or overdraft lines of credit rather than "bounce protection" could draw many new customers into banking and ensure currently underbanked consumers take full advantage of banking relationships, according to NFS Study findings.

Savings

Households in the NFS Study demonstrate considerable propensity to save, although the products available to them make accumulating savings challenging. Few high-yield, restricted accounts with automated contributions are available to people with low initial contributions. In fact, the NFS Study's supply-side analysis indicates that most savings accounts available to low-balance savers in these neighborhoods have fees greater than their potential interest, meaning these accounts may actually erode savings rather than help accumulate savings.

Mainstream financial institutions share with consumers an interest to maximize long-term deposits. Innovative products offered through mainstream financial institutions are already encouraging informal or infrequent savers to transition to formal products by promoting "easy savings" programs. Opportunities in which leftover change from an account holder's purchases is deposited into a savings account or a "sweeper account" to facilitate funds being moved quickly and easily between checking and savings accounts could help facilitate savings for small account holders. Existing programs could be expanded by linking them to higher-yield products, such as low minimum balance certificates of deposit or money market accounts. Additionally, matched savings experiments and targeted outreach to encourage the purchase of treasury bonds or other low-risk investments could facilitate "growing" money through savings while protecting it from everyday use.

Credit

The NFS Study reveals a population of consumers who pay significant amounts of money for high-cost credit products, even at the expense of their financial well-being. An estimated 9% of Jamaica and Melrose residents (totaling 33,000) reported getting short-term, payday-type loans, while 25%, or a total of 90,000 residents, access credit through pawnshops or rent-to-own stores at least a few times per year.

Mainstream financial institutions could capture more of this consumer market by providing safe and sustainable credit alternatives. Credit repair or builder loans could help consumers consolidate high-cost debt into a much lower-cost, regular payment vehicle or help consumers who rely exclusively on fringe credit establish a credit record. Short-term, small-dollar loans could help replace informal or illegal payday-type lending or reliance on credit card cash advances. An affordable credit card, with credit limits linked to a borrower's ability to pay and reasonable interest rates that do not change based on penalties, could help low- and moderate-income families weather income and expense fluctuations without jeopardizing their financial futures.

In reaching this underserved market with credit products and services, the presence of strong consumer protections can have a tremendous impact not only in securing the safety of those with low incomes but on the safety of the industry. As evidenced by the crisis in the sub-prime mortgage industry, a lack of clear and responsible lending guidelines can both undermine a borrower's financial stability and the broader economy simultaneously. Reinforcing clear underwriting guidelines that are fundamentally linked to a borrower's capacity to repay the debt obligation is critical to both family stability and economic well-being. Moreover, there is a demonstrated need for greater clarity in the terms and conditions of credit products, which could be alleviated by stronger and clearer disclosures in the primary language of the borrower.

Financial Education

The complexity of today's financial products, especially credit products, requires a high degree of financial sophistication and knowledge. This study finds strong associations between financial education and positive financial behaviors, such as having a bank account, building formal savings, and accessing mainstream credit. Yet, as the research shows, less than one in three individuals has actually attended financial education classes or received one-on-one counseling. Efforts to maximize the availability and quality of financial education classes and counseling can help New Yorkers with low incomes make informed choices to move them toward positive financial behaviors.

Additional Research

This in-depth examination of two neighborhoods has illuminated a need for more data to better understand basic banking, savings, credit, and financial education behaviors and needs throughout New York City. Citywide research would help further clarify and quantify missed opportunities for financial institutions, policymakers, and financial education providers. The Department of Consumer Affairs' OFE expects to conduct a citywide telephone survey in summer 2008 to gain reliable data on the number of people lacking bank accounts, overall savings accumulated in low-income neighborhoods, and the levels of—and cost of—debt held by low- and moderate-income households. New York City will also work with other municipalities in this research effort, beginning with the Cities for Financial Empowerment (CFE), a coalition of municipal governments dedicated to advancing innovative financial empowerment initiatives, to compare and aggregate findings across the United States.

---

[1]Total check cashing fees are estimated using the percent of respondents reporting check cashing usage by income for each neighborhood, and applied to the household population for that income group from the 2000 Census, adjusting for the proportion of the population that receives public assistance, which is distributed via a stored value card. We assume that those who visit check cashers weekly incur fees of 1.7% (New York State maximum as of March 1, 2007) on 100% of their gross income; those who visit monthly incur fees on 50% of their income. We do not include any costs for those that visit check cashers once every few months.

[2]Average savings reported is 5% trimmed means. Trimmed means are used throughout the NFS Study to eliminate outliers.

[3]The 16% of respondents who make automated contributions to savings also have higher incomes. On average, the household income for a respondent making automatic contributions is $37,000, compared to $19,000 for those who do not.

[4]Barr, M. (2007). Financial services for low- and moderate-income households. National Poverty Center Conference on Access, Assets, and Poverty.

[5]OFE analysis of data provided by the New York State Banking Department, February 7, 2008. Summary statistics can be found in Neiman, R. (2007). Report and recommendation to the governor pursuant to banking department study regarding geographic and fee restrictions imposed on locations used primarily for the cashing of checks, New York State Banking Department.

Department of Consumer Affairs
Office of Financial Empowerment

Center for
Economic Opportunity

Michael R. Bloomberg
Mayor

Jonathan Mintz
Commissioner

Veronica White
Executive Director