NGA Center for BEST PRACTICES

Issue Brief

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State Policy Options to Encourage Asset Development for Low-Income Families

Summary

Broadly defined, assets are investments that appreciate over time such as savings, retirement accounts, and home and business ownership. Assets also include investments in nontangible property, such as education, training, and skills that can lead to increased wealth and income levels. Tangible assets can be passed down from generation to generation and afford families greater economic stability than income alone can provide. In addition, asset accumulation increases household stability and improves child well-being by providing a cushion that families can use during economic downturns or unanticipated emergencies. Families also receive secondary benefits from asset accumulation, such as increased social connectedness, political participation, and improved goal-setting and orientation towards the future.[1]

For families to achieve self-sufficiency and obtain long-term economic success, it is critical that they increase their level of savings. Those without any savings or assets to leverage can face severe hardships during tight economic times triggered by job loss, divorce, or illness. Asset-poor families often do not have any retirement savings, nor can they witness increased financial status through homeownership. Without savings and resources to draw upon, higher education is often out of reach for children from low-income families as well. Without these and other opportunities to advance through savings and asset accumulation, low-income families are often unable to break intergenerational cycles of poverty.

To help low-income individuals and families gain the resources that can allow them to become self-sufficient, policymakers can implement a range of strategies that promote savings and increase income levels, such as the following:

- Align, eliminate, or increase asset limits on federal means-tested programs.
- Increase awareness of the Earned Income Tax Credit and connect workers to free tax preparation services.
- Enact a state Earned Income Tax Credit.
- Support Individual Development Accounts (IDAs) through state, federal, and/or private resources.
- Increase homeownership through subsidies, support for affordable housing, and mortgage and credit counseling.
- Improve the availability of financial services in low-income neighborhoods.
- Craft legislation to curtail predatory lending practices.
- Enhance economic development efforts in low-income neighborhoods to reduce the costs of goods and services.
- Provide financial literacy education to children, adolescents, and adults.

In addition to these specific policies, states can develop comprehensive approaches to encourage savings among low-income families and individuals. Governors and state policymakers play a critical role in bringing together the diverse stakeholders from the public, private and nonprofit sectors—all of whom are needed to create an integrated network of resources and protections necessary for low-income families to save and acquire wealth.

Introduction

Assets are investments that appreciate over time such as savings, retirement accounts, and home and business ownership. Investments in nontangible property, such as education, training, and skills that can lead to increased wealth and income levels, are also considered assets. Possession of tangible assets affords families greater economic stability than income alone can provide, and the wealth from asset accumulation can be passed from generation to generation. Without any type of savings or safety net to draw upon, families can face severe economic difficulties when confronted with unexpected emergencies.

Research has demonstrated that families receive various positive benefits from asset accumulation. For example, parental wealth can improve socioemotional behavior, physical health, and cognitive development in children. Other research has demonstrated the positive effects of asset accumulation on children's educational attainment levels and adult labor market experiences, health, political interests, and marriages. Studies also have concluded that asset accumulation can have a multiplier effect, wherein people who hold assets tend to add to and acquire more savings.[2]

Public policies, such as the GI Bill and the Homestead Act, have long played an important role in encouraging asset development through incentives to purchase homes and acquire further education. Other policies based on federal and state tax codes—credits for home mortgages, retirement accounts, education savings plans, etc.—also have assisted families in saving for the future and accumulating assets. It is estimated that the federal government spends slightly over $300 billion per year in support of asset-building policies.[3]

Despite such public sector investment, a large proportion of families lack savings and live without any type of safety net. Wealth inequality in the United States is greater now than it has been at any time over the past 75 years, with the wealthiest 1 percent of all families holding approximately one-third of the country's wealth.[4] Over 25 percent of American families do not have enough savings to live for more than three months at the federal poverty level if their incomes were to end.[5] More than one-third of all households owe more than they own, with zero or negative net worth.[6] With few assets, many families do not have the savings necessary to weather financial hardships triggered by a job loss, divorce, or serious illness.

Many of the policies that have traditionally encouraged asset development have only benefited middle- and upper-income individuals. Of the federal funds that are spent annually on tax credits related to asset development (e.g., homeownership, retirement accounts, investments), over 90 percent are provided to households with annual income levels above $50,000.[7] Because many low-income individuals do not own homes or investments and are not employed in positions that offer retirement savings programs, they are excluded from or have low participation rates in these traditional asset-building activities.

In addition, many low-income families face additional barriers to saving because of asset limits placed on public programs. Established to prevent fraud, asset limits within federal means-tested benefit programs can discourage low-income families from saving and acquiring the assets needed to truly achieve economic self-sufficiency. Another area where low-income families often do not realize important sources of income are earned income tax credits, although states and communities are increasing outreach efforts. Refunds offered through earned income tax credits can be valuable resources that can help families recover from economic hardships and increase their level of sufficiency. In addition to these and other barriers, few mainstream retail outlets or financial institutions are located in low-income neighborhoods, forcing residents to pay inflated prices for goods and services and leaving them vulnerable to predatory practices.

To address the barriers that may prohibit many low-income families from saving, states have taken a number of approaches to develop policies that encourage asset accumulation, preserve existing assets, and protect vulnerable citizens against abusive practices that inhibit savings. States can develop tools that directly facilitate asset accumulation such as savings accounts or homeownership. Likewise, states can implement policies and programs that indirectly impact asset accumulation through increasing income levels and reducing living expenses. Specific policy options include the following:

- Modifying asset limits for public programs;
- Improving awareness and access to earned income tax credits;
- Creating state earned income tax credits;
- Promoting savings through individual development accounts and other vehicles;
- Improving opportunities for homeownership;
- Enhancing financial opportunities in low-income neighborhoods;
- Increasing financial literacy.

These policy options as well as the development of comprehensive approaches that incorporate several different strategies can help increase savings among low-income individuals, families, and communities to help them achieve economic self-sufficiency.

Modifying Asset Limits for Public Programs to Encourage Savings

Through such federal programs as Temporary Assistance for Needy Families (TANF), State Children's Health Insurance Program (SCHIP), Medicaid, food stamps, and child care assistance, states have been able to make significant investments in a wide range of support services to help families achieve economic self-sufficiency. Many federal assistance programs, however, include asset limit provisions to restrict benefits to those who truly need assistance. Unfortunately, the unintended consequence of asset limit policies is that often, low-income individuals cannot remain eligible for assistance if they accumulate any savings. This discourages many people from acquiring assets, leaving them vulnerable during economic downturns.

An important component of state efforts to encourage asset development is to review public assistance programs to ensure recipients are not penalized for saving. As many federal programs allow states to set asset limits, states have the opportunity to ensure policies do not discourage low-income families from saving. By aligning, eliminating, or increasing asset limits on federal means-tested programs, states can help encourage low-income families to save and acquire assets. For example, states can do the following:

- Set asset limits at a high level or eliminate limits altogether for TANF program participants. **Virginia** and **Ohio** have eliminated asset limits in their respective TANF programs, while other states have generally set asset limits at $2000 to $3000 for TANF participants. The type of assets that are included in TANF limits also can be determined by states.
- Align asset definitions for the Food Stamp Program with other federal programs such as Medicaid and TANF. Although the federal government establishes the asset limit dollar amount for the Food Stamp Program, states have some flexibility in determining what is included in the definition of an asset and can set more generous disregards for vehicle amounts. For example, **Ohio** excludes the value of all vehicles in both the state's food stamp and TANF cash assistance programs.[8]
- Review and modify asset definitions and limits for Medicaid program participants. More than 20 states have waived asset limits for Medicaid participants, and 48 states have eliminated asset tests for children.[9] Some states, such as **New Mexico**, have found that the reduction in administrative costs due to waiving or modifying asset limits offsets expenses that occur from increased enrollment in the Medicaid program.[10]
- Allow Individual Development Accounts (IDAs) that are funded through private or state resources to be exempt from the asset limits set on various federal programs such as TANF, Medicaid, and SCHIP.[11] Currently, only IDAs funded through TANF monies or created under the Assets for Independence Act are disregarded when determining eligibility for federal means-tested programs.
- Disregard assets acquired through employer-sponsored retirement programs or other retirement accounts when determining eligibility for federal means-tested programs such as TANF, Medicaid, and Medicaid "Buy-In" programs.

Accessing Earned Income Tax Credits

A refundable tax credit for low-income workers, the Earned Income Tax Credit (EITC) is the largest federal antipoverty program and has been widely credited with increasing the number of single mothers who are employed and reducing welfare dependency. The EITC is targeted to working individuals, especially those with dependent children, who earn less than 200 percent of the federal poverty level. By receiving the EITC, low-income working parents can substantially increase their income levels. For example, a single parent with two children who earns between $11,000 to $14,000 could qualify for the maximum credit of $4,300, representing a 31 to 39 percent increase in income.[12]

Although the EITC is a proven antipoverty tool, between 15 and 20 percent of eligible working families do not claim the credit. In 2003, an estimated $11.7 billion went unclaimed by 6.5 million workers.[13] Individuals do not claim the credit for a variety of reasons: they are unaware they are eligible, are intimidated by the required tax forms, or feel their refund is too small to warrant filing a tax return.[14] A related problem is low-income workers who do claim the credit often rely on costly tax preparation services to do so. In 2003, low-income workers paid

approximately $1.2 billion in fees to private companies.[15] The money families spend on tax preparation services—or forgo altogether by not filing for the credit—could be critical in ensuring they meet their basic necessities or are able to save for the future.

Recognizing the EITC can lift many hard-working families out of poverty, state leaders are initiating a range of strategies to ensure low-income residents and communities benefit from the credit. With increased income obtained through the EITC, many low-income families can be better positioned to save and acquire valuable assets. States are increasing awareness of the EITC, connecting workers with free tax preparation services, expanding the availability of free services, and enacting state EITCs (for more detailed information, see NGA Center for Best Practices Issue Brief *State Efforts to Support Low-Income Families and Communities through the EITC*). Examples of state efforts include the following:

- In 2002, **Michigan** Governor Granholm and Lieutenant Governor Cherry launched a statewide campaign to increase the use of the EITC and the availability of free tax preparation services. The governor designated the Michigan Department of Human Services as the lead agency to coordinate the state's efforts and allocated approximately $500,000 in federal TANF funds to pay for the initiative.[16]
- To promote the EITC, **Louisiana** Governor Blanco, along with other public officials and faith-based leaders, appeared on television and radio as part of an aggressive public awareness campaign. In addition to these efforts, representatives from the governor's office; the departments of social services, labor, and revenue; and the IRS worked together to launch the Louisiana Tax Assistance Preparation and Information Network. The state also has provided mini-grants to assist in the expansion of free tax preparation sites and mobile services in rural communities to help people apply for the EITC.
- **Arizona** Governor Napolitano created a task force on the EITC to help increase the number of individuals who applied for the credit and to improve free tax preparation services. The task force encouraged state employees to volunteer at free tax preparation sites, provided information to local social service offices on where people could obtain free tax services, and worked with the IRS to offer free training to tax-preparation volunteers.

State Earned Income Tax Credits

Building off the success of the federal EITC, several states have enacted a state EITC. Twelve states—**Colorado, Illinois, Indiana, Kansas, Maryland, Massachusetts, Minnesota, New Jersey, New York, Oklahoma, Vermont,** and **Wisconsin**—and the District of Columbia have enacted refundable state EITCs. Six other states—**Delaware, Iowa**, **Maine**, **Oregon**, **Rhode Island**, and **Virginia**—offer a nonrefundable state EITC. Most states set their credit at a percentage of the federal credit, ranging from approximately 5 percent in Illinois and Oklahoma to around 30 percent in New York and Vermont. Wisconsin's credit varies according to family size—4 percent for families with one child, 14 percent for families with two children, and 43 percent for families with three or more children.

In contrast to promoting the federal credit, creating a state EITC may entail substantial resources or revenues foregone for a state. The cost of a state EITC varies depending on whether it is refundable, the size of the population claiming the credit, and the percentage of the federal credit

at which the state credit is set.[17] States typically use general funds, federal TANF block grant, or state maintenance-of-effort dollars to pay for the refundable portion of the credit.

Despite the recession and budget shortfalls states have recently witnessed, many states have continued to provide assistance to low-income families through state earned income tax credits. Recognizing that providing progressive income support to low-income workers fosters employment, **New York** significantly expanded the state EITC program between 2001 and 2004. In tax year 2003, the state paid approximately $682 million in refundable tax credits to about 1.35 million low-income working families.[18]

Child Care Tax Credits

Similar to earned income tax credits, the Child Tax Credit (CTC) also is a refundable federal tax credit that can increase the resources available to low-income households. Families can receive a tax credit of up to $1000 for each qualifying child under the age of 17 years.[19] Importantly, most low-income working families who qualify for the EITC are also eligible to receive the CTC. Even workers who earn too little to pay federal taxes can claim the CTC and receive a refund without affecting the amount of the worker's EITC refund. States can initiate a broad array of strategies to help improve the use of the tax credit by increasing awareness, helping families file for the credit, and expanding free services to assist families. Most states include CTC outreach in their EITC campaign efforts. In addition to the federal tax credit, states also can enact their own child care tax credit or offer tax deductions for dependent child care expenses. Although federal and state child care tax credits are not designed exclusively for low-income households, many families with limited resources can benefit substantially from the additional income the credits provide and can therefore improve their savings rates.

Promoting Savings through Individual Development Accounts and Other Vehicles

Policies that encourage people to save by contributing to matched employer-based programs such as 401K retirement accounts are widely regarded as effective. States can use a similar strategy for encouraging and supporting savings among low-income families through Individual Development Accounts (IDA). IDAs are savings accounts held by low-income persons generally used to purchase a home, pay for postsecondary educational expenses, or start a business. IDA holders make monthly contributions to an account where funds are matched by public or private sources (or a combination of both) at a predetermined rate. Individual account holders are typically required to take courses in financial management, often provided by local organizations. Accounts are held at local financial institutions and are normally administered by community-based organizations that receive funding for administrative and program costs. Approximately 500 IDA programs are in operation throughout the country, serving more than 20,000 people.[20]

Funding for IDAs

States can fund IDAs through several mechanisms. For example, states can use federal TANF dollars and state maintenance-of-effort monies to provide match funding for IDAs. Currently, IDAs are incorporated in the welfare plans of 34 states, encouraging TANF cash recipients to save money and accumulate assets through the program.[21] States also can support IDAs from other federal programs such as the Community Services Block Grant, Community Development Block Grant, HOME Investment Partnership Program, and Bank Enterprise Awards.[22]

In addition to federal monies, states can use general revenue funds or private resources to support IDAs. Several states, such as **Indiana, Kansas, Missouri,** and **Oregon,** have passed legislation to offer tax credits for individuals who donate to IDA programs. In Oregon, for example, individuals who donate $100 to an IDA program can qualify for a $75 credit against their state income tax. By utilizing private resources, the state was able to raise $660,000 for IDA programs in 2004. In addition to tax incentives, IDAs can be funded through private for-profit companies and philanthropic foundation donations.

Effectiveness of IDA Programs

Research is beginning to show the effectiveness of IDAs in increasing the asset levels of low-income families. The American Dream Demonstration project, conducted from 1997 to 2003, was the first large-scale IDA evaluation. Results concluded low-income persons, even those living at or near the federal poverty line, can develop savings through IDAs, with the average participant depositing a little over $500 and accumulating approximately $700 per year.[23] Program operations, including financial literacy education and match rates, were more important factors influencing savings rates as compared to the income level of participants. On a less positive note, however, research has not clearly demonstrated IDAs increase the overall net worth of program participants (assets minus debt) and they also are costly to administer because economies of scale have yet to be reached. A high proportion of program participants also withdrew funds from their IDAs before receiving the matched funds, in essence treating the IDA as a checking account instead of a tool for longer-term savings.[24]

Currently, federal efforts are being made to expand the availability of IDAs with the introduction of the Savings for Working Families Act of 2005. As proposed, the legislation would create 900,000 IDAs for low-income individuals in which participants could deposit up to $1,500 per year in a matched savings account. Financial institutions that match individual contributions would be eligible for tax credits of up to $500 per IDA account.

Savings Accounts for Children

In addition to enhancing savings opportunities for adults, a new policy initiative gaining recognition is universal savings accounts for children. By providing children with a matched savings account beginning at birth, assets can be leveraged over time to give individuals the resources necessary to attend a postsecondary institution, purchase a home, or start a business. Many researchers and advocates also argue children's savings accounts should be progressive, providing greater matching dollar amounts and initial deposit levels for children of low-income families. Precedents for children's development accounts stem from both state and international efforts. During the 1990s, the **Oregon** state legislature passed two laws to initiate universal children's development accounts; however, neither was implemented because of a lack of funding. Currently, the Child Trust Fund Program in the United Kingdom provides every child with a matched savings account at birth, with additional funds given to children of low-income families.

Based on these efforts and other research, the American Savings for Personal Investment, Retirement, and Education (ASPIRE) Act was introduced in both the U.S. House and Senate in 2005 with the intent of establishing savings accounts for every child born after December 31, 2006. Under the proposed legislation, the federal government would initially contribute $500 to each account, with an additional $500 provided to children living in

households with income levels below the national medium. Account holders would be able to receive a matching contribution on an annual basis until they reach 18 years of age. The ASPIRE Act has gained wide bipartisan support, but as of this writing, it has not been signed into law.

Although not federally funded, the Saving for Education, Entrepreneurship, and Downpayment (SEED) Initiative is a new, national demonstration project designed to give children a matched savings account at birth that can grow with age and be used for specific purposes such as education or housing. The SEED Initiative is a multiyear project funded through several nonprofit organizations that will include rigorous evaluations to help inform the national dialogue on the potential benefits of universal children's accounts. Twelve sites throughout the country are participating in the project, including the **Kentucky** Cradle to College Commission, an initiative to provide newborns in the state with a college savings account. In return for using the account to pay for postsecondary education, Kentucky students would perform military or community service in the state. There also will be incentives established for students to work in Kentucky after graduation, particularly in teaching, social work, and law enforcement positions.

Improving Homeownership

With wide support stemming from both federal and state policies, homeownership is one of the oldest and broadest forms of asset development in the country. Research indicates owning a home is among the best ways for families to increase their economic resources and acquire wealth. In addition, homeownership has been shown to enhance the stability of neighborhoods and families, increase educational attainment levels for children, and improve civic participation.[25] The tax code has established various deductions for homeowners that have benefited millions of families, allowing them to acquire assets they can pass to future generations as well as leverage during tight economic times.

Despite the known benefits, many low-income families have difficulty becoming homeowners because of a lack of savings, higher interests rates charged because of poor credit, and higher mortgage payments compared to renting. In recent years, efforts have been made to reduce some of the barriers to homeownership for low-income families. Lower interest rates, reduced discrimination in lending, and the deregulation of some financial markets have helped many lower-income families afford homes. Although these changes have been positive for the housing market, potential barriers still exist. The lower mortgage interest rates over the past several years have allowed more individuals to purchase homes, however it has also caused a tightening of the housing market and steep increases in home prices in some areas. The sharp price increase has reduced the potential for many low-income families to afford homes, forcing them to instead rent without increasing their asset levels through property values. In addition, many federal policies provide rental subsidies for very low-income families and tax incentives for wealthier homeowners, but offer little assistance to enable low-to-moderate families to become homeowners.

To help increase access to housing for low-income families, many states have crafted policies to reduce some of the financial barriers to homeownership. In response to a decline in federal investment levels in homeownership programs, states have developed various initiatives such as creating trust funds to support affordable housing production, providing tax incentives for developers to build affordable housing, and using federal and state monies to help subsidize homeownership (for more detailed information, see the NGA Center for Best Practices Issue

Brief, *Increasing Access to Housing for Low-Income Families*). States also can promote homeownership among low-income families by encouraging savings through IDA programs to use for down payments and by offering mortgage and credit counseling. Some states have used TANF block grants funds to promote homeownership among welfare-dependent and other low-income families. For example, **Ohio** has used TANF funds to support programs that offer low-interest loans and down-payment assistance to enable low-income families to purchase homes.

Enhancing Financial Opportunities in Low-Income Neighborhoods

Low-income families often face the dual threat of not having access to mainstream financial services as well as being vulnerable to predatory lending practices. In addition to these factors, the cost of purchasing goods and services is often higher in low-income neighborhoods. States can enact a broad range of policies to increase access to formal banking systems, curtail predatory lending, and reduce the cost of goods and services. Although these policies do not offer direct savings mechanisms for low-income families, increased income levels can lead to the accumulation of assets critical to economic self-sufficiency.

Improving Financial Services

Many low-income individuals are not connected to mainstream financial services, with an estimated 22 million U.S. households having neither a checking nor savings account.[26] Mainstream banks are reluctant to serve clients who typically have lower balances, so they often do not locate branches in low-income neighborhoods. Without easy access or a link to formal bank accounts, many low-income families must rely on alternative services such as check cashers and other fee-for-service businesses that often charge exorbitant interest rates. Since the mid-1980s, the number of check-cashing businesses has quintupled with 180 million checks now being cashed every year resulting in $1.5 billion in fees.[27]

Research shows individuals who have a bank account are more likely to own other types of assets.[28] Increasing the physical availability and knowledge of mainstream financial services in low-income communities is a key policy states can enact to encourage savings and asset accumulation. In this light, **New York** launched the Banking Development District program in 1998. The program offers incentives (e.g., property tax relief, real estate assistance, job credits, state deposits at below-market interest rates) for mainstream financial institutions to open an office in an under-served neighborhood. The goal of the program is to increase access to financial services for low-income working families as well as stimulate economic development and job creation in distressed neighborhoods.

Curtailing Predatory Lending Practices

Because they lack access to mainstream financial institutions and do not have many financial resources, many low-income families are vulnerable to detrimental practices such as predatory mortgages, payday lending, credit card debt with high interest rates, and rent-to-own purchases. One of the most harmful practices deterring asset accumulation among low-income families is predatory mortgages, which are estimated to cost owners $9.1 billion each year because of exorbitant fees, higher interest rates than warranted, and foreclosures.[29] Predatory mortgage practices include excessive loan fees, mandatory arbitration that restricts loan holders from seeking court remedies, prepayment penalties for paying off loans early, unnecessary steering of customers to products, and loan “flipping” whereby mortgages are refinanced so lenders can earn more in fees without providing improved benefits to the customer. In particular, subprime

mortgages (i.e., mortgages with higher interest rates for individuals with problematic credit ratings) often include predatory elements that can increase the likelihood of foreclosure or other serious debt. Although not all subprime mortgages are predatory in nature and naturally have higher foreclosure rates due to the credit history of loan holders, they are 10 times more likely than conventional loans to enter into foreclosure and are disproportionately held by Hispanics and African-Americans.[30] For example, **Pennsylvania** conducted a study to determine why there was a high rate of foreclosure among homeowners in particular areas of the state and found that the majority of loans that resulted in foreclosure were subprime.[31]

In response to the negative effects of predatory mortgage practices, several states have passed legislation to enhance consumer protection. In 1999, **North Carolina** passed the NC Predatory Lending Law. Among other protections, the law prohibits prepayment penalties for loans of $150,000 or less, financing of upfront single premium insurance, and loan flipping. In addition, the law requires individuals with high-cost home loans to receive counseling before a mortgage is issued and prohibits balloon payments that require the borrower to make a large lump sum payment. **California** passed legislation in 2001 to protect borrowers with high-cost loans by placing bans on loan flipping, awarding people loans that they cannot repay, and balloon payments, as well as targeting abuses by home repair contractors. Similarly, both **New Mexico** and **New Jersey** passed laws in 2003 providing a wide range of consumer protections against predatory mortgages including limiting the amount of financing fees to 2 percent of the loan amount and requiring individuals to receive counseling before entering into a high-cost loan. In 2004, **Illinois** enacted the High Risk Home Loan Act to protect state residents from abusive mortgage lending practices. As with other states that prohibit loan flipping and prepayment penalties, the Illinois law also allows consumers to take action in certain circumstances against the holder of the loan, not just the original lender. This is an important feature because most predatory home loans are sold shortly after they are originated.[32]

In addition to predatory practices used in the mortgage industry, the availability and frequent use of payday lenders often impacts the ability of low-income families to acquire assets and save for the future. Payday lenders operate by allowing individuals to obtain cash by writing a postdated check. Lenders cash the check on the date, usually allowing individuals two weeks to repay the loan at a high interest rate. Unfortunately, most borrowers are not able to repay the loan in such a short time frame and must either renew the loan or open a new loan. The rolling of the loan(s) forces many borrowers into a cycle of debt that often takes years to pay in full. An estimated 99 percent of payday loans are given to people who have borrowed in the past, with most lenders targeting low-income and minority neighborhoods as well as military personnel.[33] An estimated 9 million to 14 million individuals use payday loans each year, paying $6 billion in fees.[34]

A variety of reasons make it difficult for states to curtail payday lending practices, in particular differences among state laws that create loopholes. Known as the rent-a-bank model, payday lenders are often able to make loans through state-chartered banks located in other states with less stringent regulations. One of the strongest efforts to limit payday lending is in **Georgia**, where in 2004 the state legislature passed the Payday Lending Act. The law restricts small loans to a 60-percent annual interest rate, specifically prohibits payday lenders from partnering with out-of-state banks, and outlines felony penalties for lenders who violate the law. **Maryland** and **Massachusetts** also have specific statutes banning payday lenders from partnering with out-of-state banks to avoid regulations.[35] In 2005, **Illinois** passed the Payday Loan Reform Act to strengthen protections for borrowers. In addition to setting interest rates that can be charged on

payday loans, the act limits borrowers to having two loans at the same time and stipulates borrowers cannot have a payday loan for more than 45 days. Once people reach the 45-day limit, they must remain loan free for at least seven days. The state will create a database so lenders can access a person's lending history before a loan is issued.

Car title loans also have become prevalent in low-income neighborhoods and usually carry triple-digit annual interest rates. Similar to payday loans, car title loans allow a particularly short time frame for individuals to pay back the loan (usually within one month) and are issued without taking into account a person's ability to repay the loan. Many people cannot pay off the debt and either take out an additional loan or lose their vehicle. Without automobile transportation, many low-income families face difficulties maintaining employment, which in turn prevents them from being able to adequately save for the future. Several states have begun to address the predatory nature of car title loans by requiring more favorable loan terms, regulating lenders more carefully, and closing loopholes present in existing laws. To help provide greater protection for consumers, **Florida** statute now limits the amount of interest that can be charged on the first $2,000 of a title loan and also prohibits unauthorized fees or charges.[36]

When used consistently, fee-based bounce protection plans offered by banks and credit unions on checking accounts also are detrimental for low-income families to save and acquire assets. Under these types of programs, banking customers are charged a flat fee to cover overdrafts. Individuals who use bounce-protection plans to cover overdrafts on a regular basis pay fees that equate into annual percent interest rates above payday loans. Rapid anticipation loans (RALs) also are harmful for low-income families. RALs are fees tax preparers charge for providing individuals with a cash advance on an expected refund. Many individuals who qualify for the earned income tax credit use RALs as a means of quickly obtaining cash; however, the cost is exceptionally high with most loans carrying annualized interest rates of over 200 percent.[37]

Reducing Costs in Low-Income Neighborhoods

In many low-income communities, the prices of goods and services are considerably higher than in more wealthy neighborhoods. Many underserved areas lack large retail stores, both because businesses fail to recognize the purchasing power of these neighborhoods and because they perceive a risk of selling goods and services to lower-income families.[38] Families living in low-income neighborhoods generally pay more for utilities, groceries, insurance, security deposits, and other basic necessities, making it more difficult to save and invest for the future. As part of a statewide economic stimulus package, **Pennsylvania** launched the Fresh Food Financing Initiative to help lower costs and increase the availability of food in low-income rural and urban areas. The initiative is funded through a private-public partnership that provides financing for supermarkets to open and operate in traditionally underserved neighborhoods. The initiative creates jobs, revitalizes local economies and provides access to affordable food for low-income communities.

Increasing Financial Literacy

Improving the financial literacy skills of individuals can help ensure families are less prone to predatory lending practices and more able to make sound investment strategies that can lead to economic self-sufficiency. Financial literacy encompasses a wide range of topics including debt management and bankruptcy education, credit reporting, credit repair, budgeting, and savings and

investment information. The public, private, and nonprofit sectors all play a critical role in ensuring children, teens and adults are equipped with the knowledge to make sound investment and money-management decisions.

States have implemented a wide range of strategies to improve financial literacy among low-income family members. In many state TANF programs, for example, cash assistance recipients can attend financial literacy education courses as part of their work requirement. States also have mandated that financial literacy education be incorporated into public school curricula. **Texas** recently passed legislation to join **Alabama, Georgia, Idaho, Illinois, Kentucky, New York**, and **Utah** in requiring students complete a personal finance course to graduate from high school.[39]

To raise awareness and promote financial literacy education for adults and children throughout the state, Former Governor Ryan of **Illinois** created the Task Force on Financial Literacy in 2002. In addition to the task force, conferences were held in 2002 and 2003 to bring Illinois businesses, educational institutions, and civic organizations together to develop a coordinated plan for improving financial literacy education efforts. **Pennsylvania** Governor Rendell created the Office of Financial Education in 2004 to help improve access to financial education programs for adults and children. In particular, the office is charged with developing a clearinghouse of financial education materials, integrating financial education into K-12 curricula, expanding community-based financial education and counseling, helping businesses provide financial education to employees, and encouraging professionals to volunteer in financial literacy efforts. The **Delaware** State Treasurer's office started the Money School to provide community-based financial education courses throughout the state. The Money School is staffed by volunteer professionals and offers a wide variety of courses on money management, investing, retirement planning, and other issues related to financial literacy.

The federal government also supports asset development programs through a wide range of financial education programs. Sponsored by agencies such as the Departments of Commerce, Labor, and Housing and Urban Development and the Federal Reserve Bank, programs cover a broad spectrum of financial issues such as taxes, budgeting, financial goal setting, and retirement security. In 2002, the U.S. Department of Treasury established the Office of Financial Education to help promote national financial education efforts, with programs on credit management, savings, homeownership, and retirement planning. The office also houses an online directory of financial education programs available throughout the federal government.[40] In 2003, the U.S. Department of Treasury established the Financial Literacy and Education Commission to encourage public-private partnerships that promote financial literacy, coordinate federal efforts, identify best practices, and establish a toll-free hotline to disseminate financial literacy information.

Putting It All Together: States Promote Comprehensive Asset Development Strategies

Recognizing that building wealth is critical to achieving economic self-sufficiency, several states have initiated comprehensive efforts to connect policies and programs that allow low-income families to more easily save and acquire assets. State policymakers can play a critical role in bringing together diverse programs from the private, nonprofit, and public sectors that are

necessary to develop comprehensive networks that enable savings and asset accumulation. As more light is shed on the needs of the working poor, the creation and integration of asset development policies can help many families gain economic self-sufficiency.[41]

In 2004, **Pennsylvania** Governor Rendell established the Governor's Task Force for Working Families to promote financial literacy, reduce abusive financial practices, increase savings and asset accumulation, and help working families develop their own jobs and security through entrepreneurship and retirement accounts. The task force is composed of a diverse group across several state agencies such as the departments of education, health, aging, and revenue, as well as members from the private, nonprofit, philanthropic, and legislative sectors. Recommendations to improve savings include enhancing EITC outreach, increasing the scale and impact of the state-operated family savings account programs, increasing asset limits under the TANF program, and creating a state retirement account program for small employers. The recommendations also include a blueprint for action that outlines steps each state agency can take to improve asset development efforts and create a comprehensive system for all low-income families.

In 2001, Governor Minner of **Delaware** established the Task Force for Financial Independence in an effort to promote financial education and asset development for low-income families throughout the state. The task force, composed of representatives from the public, private, and nonprofit sectors, developed short-term and long-term policy recommendations. Short-term proposals that did not require extensive costs for the state included increasing access to financial education and improving assistance for families applying for the EITC. The task force also recommended longer-term policies such as creating a state EITC (signed into law in August 2005) and improving access to affordable healthcare. As a result of the initiative, financial education is now a recognized work activity for TANF cash recipients, the Delaware Bankers Association has adopted financial education as the organization's primary mission, the Boys and Girls Club is participating in the national SEED Initiative, and the legislature passed regulations curtailing fringe banking.

Stemming from the efforts of a local nonprofit organization, the Asset Policy Initiative of **California** promotes asset development policies for low- and moderate-income families. The statewide coalition is composed of state agency leaders, elected officials, business members, academics, advocates, and philanthropic leaders to help create comprehensive asset development policies throughout the state. The task force is concentrating efforts on developing state funding for IDA programs, raising or eliminating asset limits for means-tested programs, promoting homeownership through a state trust fund, and expanding health insurance coverage.

Conclusion

States can play a critical role in improving the lives of low-income families and people through asset development policies. With more than one-third of all U.S. households owing more than they own, state policies that help to increase income and savings levels are important to improving the vitality of communities.[42] Asset development includes a broad range of strategies designed to help strengthen the economic status of individuals by protecting against predatory practices, encouraging savings, and preserving existing assets.

Policy options states can enact to encourage savings and asset accumulation include the following:

- Modifying asset limits for public assistance programs to ensure recipients are not penalized for saving;
- Increasing awareness of the EITC and CTC, expanding the availability of free tax preparation services and connecting filers to these services, and enacting a state EITC;
- Promoting direct savings through IDAs and other savings vehicles;
- Improving homeownership through low-interest loans, tax incentives, and other state investments;
- Improving the availability of mainstream financial services in low-income neighborhoods;
- Providing financial literacy education to children, teens, and adults.

Policy options states can enact to protect and preserve income and assets include:

- Curtailing predatory mortgage practices through legislation;
- Strengthening protections for payday loan and car title loan users by limiting interest rates and loan amounts; and
- Reducing costs in low-income neighborhoods through economic development efforts, so individuals and families have more income that can be invested.

States may want to develop a more comprehensive approach to asset development by doing the following:

- Forming a statewide task force to determine how best to encourage savings among low-income individuals and families;
- Conducting an inventory of existing policies and practices to recognize where changes can be made to improve savings rates;
- Creating a uniform vision throughout state government of how best to promote asset development;
- Developing a network of state leaders, business members, advocates, community-based organizations, elected officials, philanthropic organizations, and others to further advance asset development policies.

Understanding the role assets play in alleviating poverty, states are implementing a range of strategies to increase savings among low-income families and individuals. Policymakers have the unique ability to bring together a wide range of stakeholders to develop comprehensive approaches that encourage savings and increase the economic self-sufficiency levels of their constituents.

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End Notes

[1] Michael Sherraden, "Inclusion in Asset Building–Testimony for Hearing on 'Building Assets for Low-Income Families,' Subcommittee on Social Security and Family Policy, Senate Finance Committee," April 28, 2005, 5.

[2] Sherraden, 6.

[3] *Federal Reserve Forums Advance Asset-Building Strategies for Low-Income Americans* (CFED, June 27, 2005), 1.

[4] Carolina Reid and Heather McCulloch, "Savings in the Spotlight, Making a Case for Asset Building Policies and Programs" *Community Investments* (May 2005), 3.

[5] Heather McCulloch "Expanding the Ownership Society: State Asset Policy Initiatives," presentation for the National Governors Association, June 18, 2005.

[6] Charles Palmer, "Building Assets for Low-Income Families–Testimony for Hearing on 'Building Assets for Low-Income Families,' Subcommittee on Social Security and Family Policy, Senate Finance Committee," April 28, 2005, 1.

[7] Sherraden, 3.

[8] *States' Vehicle Asset Policies in the Food Stamp Program* (Center on Budget and Policy Priorities, Revised September 23, 2005), 2.

[9] Leslie Parrish, *To Save or Not to Save? Reforming Asset Limits in Public Assistance Programs to Encourage Low-Income Americans to Save and Build Assets* (New America Foundation, Asset Building Program, May 2005), 3.

[10] Parrish, 9.

[11] IDAs are savings accounts held by low-income people that can be used to purchase a home, pay for postsecondary educational expenses, or start a business. IDA holders make monthly contributions to an account in which funds are matched by either public or private sources (or a combination of both) at a predetermined rate.

[12] *Facts About the Earned Income Credit: Tax Time Can Pay for Working Families* (Center for Budget and Policy Priorities, 2005), 25.

[13] Calculations compiled by the US. Department of Health & Human Services, Administration for Children and Families, Office of Family Assistance, based on Zip code data provided by the Internal Revenue Service. Estimated unclaimed dollars should be interpreted only as an indicator of the need to raise awareness.

[14] *Facts About the Earned Income Tax Credit* (Center on Budget and Policy Priorities, 2003), 19.

[15] *The High Cost of Quick Tax Money: Tax Preparation, 'Instant Refund' Loans, and Check Cashing Fees Target the Working Poor* (National Consumer Law Center, Consumer Federation of America, 2003).

[16] For more information, see http://www.michiganeic.org/

[17] For more information, see *How Much Would a State Earned Income Tax Credit Cost?* (Center on Budget and Policy Priorities, April 2003).

[18] Approximately 90 percent of the New York's EITC program is supported by state TANF maintenance-of-effort (MOE) spending-comprising the largest proportion of the state's MOE funds.

[19] The child must be claimed as the tax filer's dependent; under the age of 17 at the end of the tax filing year; is the tax filer's son, daughter, adopted child, grandchild, stepchild or eligible foster child, sibling, stepsibling or their descendant; and is a U.S. citizen or resident alien.

[20] See CFED's *The Seed Policy & Practice Initiative* at http://www.cfed.org .

[21] Ray Boshara, "Individual Development Accounts: Policies to Build Savings and Assets for the Poor," Welfare Reform & Beyond #32, Policy Brief (Brookings Institution, March 2005), 2.

[22] Michelle Miller and Debbie Gruenstein, *Encouraging Savings: Financing Individual Development Account Programs* (The Finance Project, October 2002), 7.

[23] Boshara, 3.

[24] Boshara, 3.

[25] *Homeownership and Predatory Lending* (Annie E. Casey Foundation, Family Economic Success, Fact Sheet, August 2005), 1.

[26] Anne Stuhldreher and Jennifer Tescher, "Breaking the Savings Barrier: How the Federal Government Can Build and Inclusive Financial System," *Issue Brief #6* (New America Foundation, Asset Building Program, February 2005), 1.

[27] "The High Cost of Banking," *Double Jeopard –Advocasey Explores the High Cost of Being Poor* (Annie E. Casey Foundation, Winter 2005, vol. 7, no. 1), 20.

[28] Stuhldreher, 2.

[29] "Predatory Mortgage Lending Robs Homeowners & Devastates Communities," *Fact Sheet* (Center for Responsible Lending, 2005), 1 and *Quantifying the Economic Costs of Predatory Lenders* (Center for Responsible Lending, 2001), 2, both found at www.responsiblelending.org .

[30] *Homeownership and Predatory Lending* (Annie E. Casey Foundation, Family Economic Success, Fact Sheet, August 2005), 1.

[31] See the Pennsylvania Department of Banking Report on Residential Mortgage Foreclosures and Abusive Lending Practices at http://www.banking.state.pa.us

[32] "Blagojevich Takes Action to Protect Consumers Against Abusive Lenders." (Office of Governor Rod Blagojevich, August 20, 2003), 1.

[33] "Predatory Payday Lending Traps Borrowers," *Fact Sheet* (Center for Responsible Lending, 2005), 1.

[34] *Double Jeopardy–Advocasey Explores the High Cost of Being Poor* (Annie E. Casey Foundation, Winter 2005, vol. 7, no. 1), 23.

[35] Center for Policy Alternatives: Payday Lending, online at http://www.stateaction.org/issues/issu.cfm/issue/PaydayLending.xml

[36] Amanda Quester and Jean Ann Fox, *Car Title Lending–Driving Borrowers to Financial Ruin* (Center for Responsible Lending, 4/14/05), 15.

[37] Alan Berube and Tracy Kornblatt, *Step in the Right Direction: Recent Declines in Refund Loan Usage Among Low-Income Taxpayers* (The Brookings Institution, Survey Series, April 2005), 2.

[38] *The High Cost of Being Poor* (Annie E. Casey Foundation, Family Economic Success, Fact Sheet, August 2005), 1.

[39] *Survey of the States–A Report Card, March 2005* (National Council on Economic Education), http://www.ncee.net/about/survey2004/NCEESurvey2004web.pdf, 5.

[40] For more information, see the Office of Financial Education's Web site at http://www.treas.gov/financialeducation

[41] Information on state comprehensive asset development strategies is from the work of Heather McCulloch, an independent consultant. Please see *Promoting Economic Security for Working Families, State Asset-Building Initiatives*, July 2005, Fannie Mae Foundation, for more information.

[42] Palmer, 1.