
Latino Lending:

Analysis of the Consumer Loan Portfolio of North Carolina's Cooperativa Comunitaria Latino de Crédito

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This analysis of the Latino Community Credit Union's consumer loan portfolio was conducted by the Center for Community Capitalism, with funding from Freddie Mac, to better understand and serve the financial needs of banked and unbanked Latinos in North Carolina. Opened in 2000, the Cooperativa Comunitaria Latina de Crédito, or Latino Community Credit Union, (referred to as LCCU throughout this report), provides bilingual financial services to credit union members in Charlotte, Durham, Fayetteville, Greensboro, and Raleigh, North Carolina. In addition to providing traditional banking services, LCCU also offers financial education and outreach to Latinos in these areas.

This report is separated into five sections. This first section is an introduction. The second section describes the study's methodology. The third section offers demographic information on LCCU borrowers. The fourth section discusses basic characteristics of LCCU loans. The final section assesses the performance of LCCU's consumer loans.

Introduction

The period from 2000 to 2003 saw the launch of this unique institution on a path of tremendous growth. By the end of 2003, membership stood at 15,000 compared with an original goal of 2,000, while loans receivable had reached about \$7.5 million compared to a target of \$2.8 million. From the start, LCCU provided basic banking products and services for its target market: deposit and checking accounts, check cashing, money orders, wire transfers, financial education, and two primary loan products: personal loans and auto loans. (Abad and Elboim 2004). While lending practices have evolved somewhat at LCCU since 2003, an examination of the loans made during the first three years holds implications for lending to the growing Latino market.

The Center collected data on borrower and loan characteristics for 2,786 loans made by LCCU from 2000 to 2003. Personal loans made up the bulk (60%) of LCCU's consumer lending, and these were broken down into no-collateral (22%), token-collateral (8%), and savings-as-collateral (30%) loans. These loans tended to be small, with most amounting to less than \$2,000. Used-vehicle loans accounted for 38 percent of LCCU's portfolio, with loans averaging \$6,528. While new-vehicle loans were for much larger amounts, averaging \$15,595, they were a much smaller subset (2%) of the portfolio. Interest rates were somewhat above those offered to borrowers with strong, established credit histories, but more affordable than those typically available to LCCU clients. (Abad and Elboim 2004).

A secondary benefit of LCCU's lending program is the opportunity for borrowers to develop credit histories. The savings-as-collateral program is specifically geared to this purpose; however, many other borrowers also stood to benefit from the opportunity to develop their credit history. Seventy one percent of all borrowers did not have a credit score at the time of loan origination. LCCU's willingness to extend loans to these borrowers was a valuable service, since successful repayment might lead to a larger vehicle or home mortgage loan. However, it also exposed LCCU to some risk. The loan data analyses in this report offer a preliminary look at LCCU's borrowers and loans, as well as the rates of delinquency and default among LCCU's vehicle and personal loans.

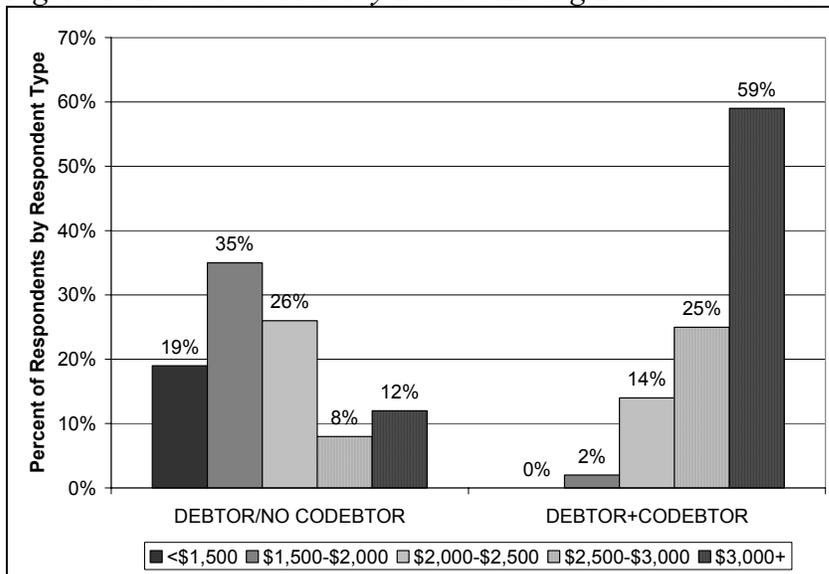
Methodology

The original “population” for this study is composed of 2,786 personal and vehicle loans made by LCCU between 2000 and 2003, with information on borrower characteristics, loan characteristics, and loan performance. To expand the information on borrower characteristics, the Center also collected data for 1,457 loans originated in LCCU’s Durham office. This subset provides an expanded set of borrower characteristics. For the most accurate information on LCCU borrowers/loans, the Center used data from the broad population of LCCU loans whenever possible, supplementing information on borrower characteristics with data from the expanded subset. A complete analysis of the representativeness of the subset is in the Appendix.

Borrower Characteristics

The data collected for the population of 2,786 borrowers reveals multiple characteristics of loan applications, contracts, and performance. First, the mean borrower monthly income is \$2,393 (median is \$2,123); however, income among borrowers with and without a cosigner differ. Where mean income among individual borrowers averaged \$2,165 (median \$1,907), the seventeen percent of borrowers who added a cosigner averaged total monthly income of \$3,288 (median \$3,159).

Figure 1: Household Monthly Income Among Borrowers With and Without a Cosigner



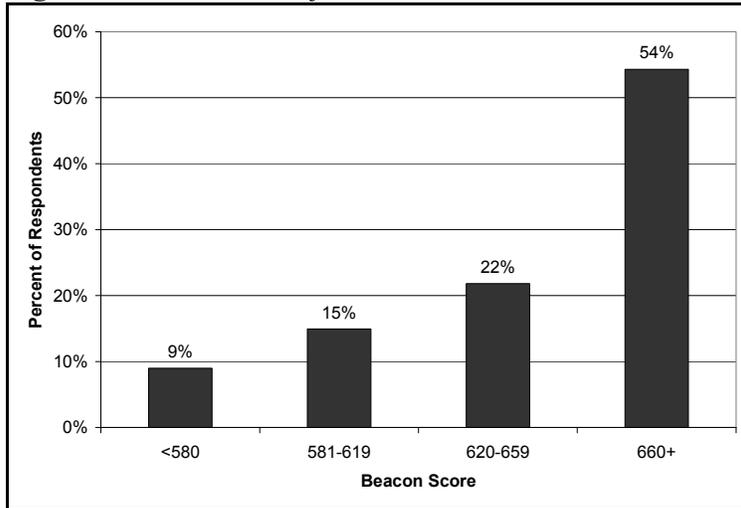
Note: n=1559 for Debtor/No Codebtor; n=398 for Debtor+Codebtor; 787 missing values.

The impact of cosigner income is particularly obvious in the \$3,000-plus income category. Where 12 percent of individual borrowers earned \$3,000 or more per month, nearly 60 percent of borrowers with cosigners generated total income of \$3,000 or more per month. While this difference in income is sizeable, its impact on household well-being is less clear. First, the households of individual borrowers may contain a second earner who is not included on the loan application. Such additional household income would narrow the difference shown in Figure 1. Second, the presence of a co-borrower may be correlated with the presence of a family and the associated expenses.

The original population dataset also included information on borrowers’ credit scores. Beacon credit scores were located for 29 percent of respondents. Of the 71 percent of

respondents whose scores were not found, it is likely that the majority do not have a sufficient credit history to generate a score. For borrowers with a reported score, the mean credit score was 654 (median 666). Over half of these borrowers had scores above 660, while only 9 percent of borrowers had scores below 580. The full distribution of borrower credit scores is in Figure 2.

Figure 2: Distribution of Borrower Credit Scores



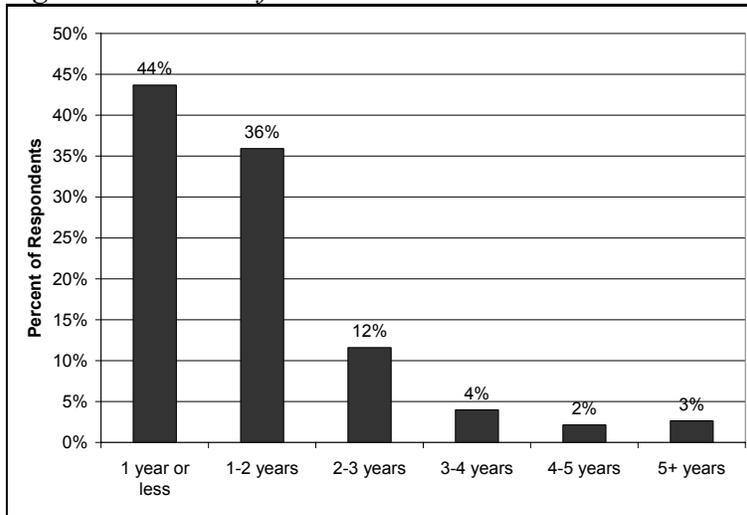
Note: population n=803; 1983 missing scores

The information collected by the Center for the subset of loans also provides information on borrowers' gender, housing, and financial characteristics.¹ Within this subset, 76 percent of borrowers were male.

Over 95 percent of borrowers reported renting a house or apartment, with the remainder reporting owning a home. Correspondingly, borrowers tended to move frequently (see Figure 3). Over 40 percent of borrowers had lived at their present address for one year or less; 70 percent had lived at their present address for less than two years.

¹ See Appendix for comparison of the subset and population of loans. In general, analysis shows that the subset slightly overrepresents higher-risk loans.

Figure 3: Number of Years at Present Address

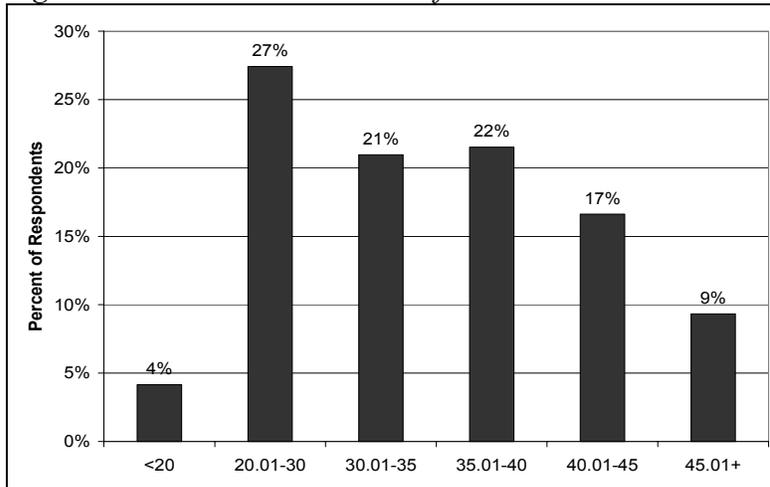


Note: subset n=1353 (103 missing).

Most borrowers had a previous relationship with LCCU before applying for a loan, with over 95 percent owning an LCCU account prior to their loan. Furthermore, 99 percent of borrowers arranged for some form of direct loan payment (i.e., their monthly payment was deducted directly from a specified LCCU account).

Nearly all borrowers carried existing debt. In fact, 96 percent of borrowers paid more than 20 percent of their monthly income toward previous debt obligations. Almost half (48%) of borrowers had a debt-to-income ratio of above 35 (see 4).

Figure 4: Debt-to-Income Ratio of Borrowers

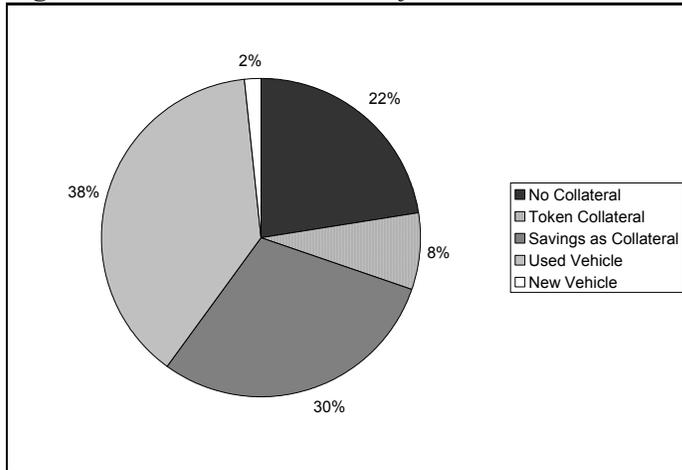


Note: subset n=1083 (374 missing).

Loan Characteristics

Of the 2,786 loans included in this study, 40 percent were vehicle loans; the remaining 60 percent were personal loans (see Figure 5). In the case of both used and new vehicle loans, the vehicle was collateral for the loan. Conversely, just over half of the personal loans carried either no collateral or token collateral. Personal savings of the borrower were used to secure the remaining 50 percent of personal loans.

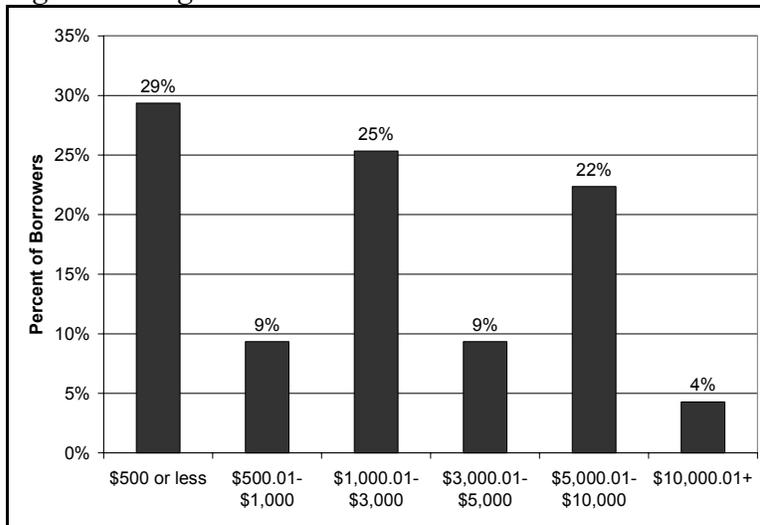
Figure 5: Consumer Loan Portfolio



Note: population N=2786.

The size of these vehicle and personal loans varied widely. Figure 6 shows the distribution of loans by loan size. Nearly three-fourths of the loans were for \$5,000 or less and almost 30 percent were for \$500 or less. The mean loan size for the portfolio was \$3,505 (median \$2,000). Similarly, the loan terms ranged widely, from an average of 7 monthly installments for savings-as-collateral loans to 58 installments for new-vehicle loans.

Figure 6: Original Loan Amount



Note: population N=2786.

The annual percentage rates (APR) applied to these loans varied from 5 percent to 15 percent depending on loan type. All borrowers with no-collateral or token-collateral loans received 15.0 percent APR. Similarly, LCCU extended 11.75 percent APR for all used-vehicle loans. New-vehicle loans generally carried an APR of 7.9 percent, though a few borrowers received 8.9 percent (mean APR for new-vehicle loans was 8.0 percent). The APRs for personal loans with savings as collateral exhibited the most variation. These APRs ranged from 5.0 percent to 7.0 percent (mean 5.49%) with respondents receiving multiple different values in this range.

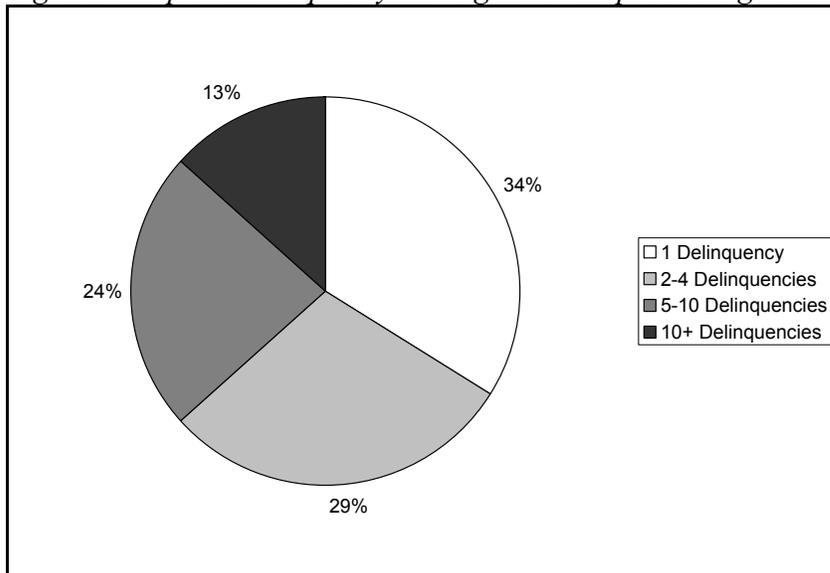
Loan Performance

Of the 2,786 loans included in this study, 18 percent experienced some form of delinquency and 2 percent were charged off prior to data collection. Because multiple loans remained active at the time data was gathered, findings regarding loan performance must be regarded as lower bound rates of delinquency and default. Nevertheless, several findings provide useful information regarding the performance of the LCCU loan portfolio.

The majority of loans did not suffer any serious delinquency. As noted, 82 percent of borrowers were never 30 days late with a payment. Eighteen percent of loans (500 loans) experienced a delinquency of 30 days or more. This delinquency rate decreases even further for 60 and 90 day delinquencies. Where 82 percent of borrowers were never 30 days late with a payment, 91 percent of borrowers were never 60 days late and 95 percent of borrowers were never 90 days late.

However, these rates mask the presence of repeated delinquency. Of the 500 loans experiencing a 30 day delinquency, 330 (66%) experienced multiple delinquencies. In fact, 184 (37%) experienced more than 5 delinquencies (see Figure 7).

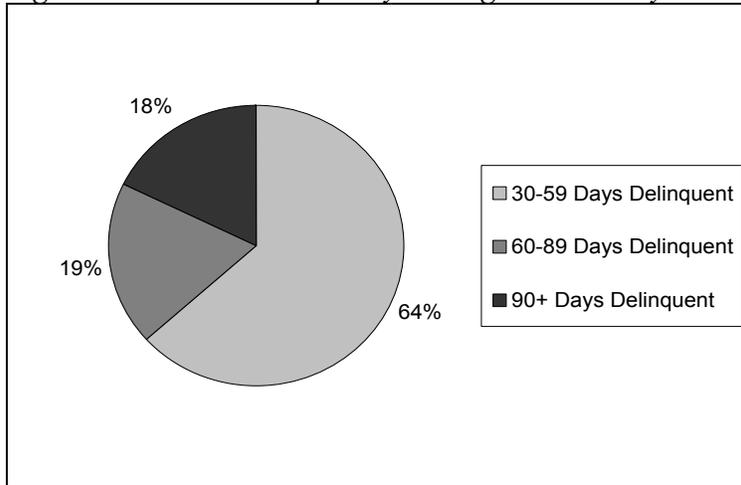
Figure 7: Repeat Delinquency Among Loans Experiencing 30Day Delinquencies



Note: n=500.

Because of the high frequency of repeat delinquency, the 500 delinquent loans produced 1148 thirty-day delinquencies. Of these, 419 (36%) became at least 60 days delinquent and 203 (18%) became at least 90 days delinquent (figure 8). However, 729 (64%) of the 1148 over-30-day delinquencies were resolved before becoming 60 days delinquent. Similarly, 216 (19%) were resolved after becoming 60 days delinquent but prior to becoming 90 days delinquent.

Figure 8: Serious Delinquency Among Ever 30 Day Delinquencies

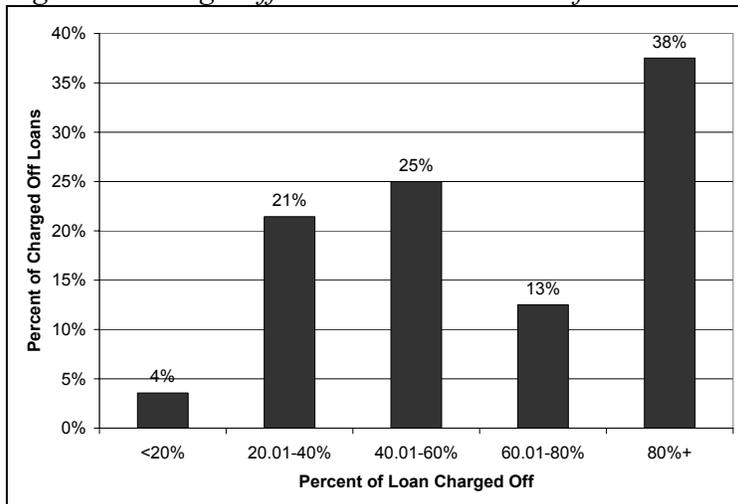


Note: n=1148 ever 30 day delinquencies.

Despite a relatively high rate (12%) of repeat delinquency, only two percent of loans were charged-off. However, the documented charge-off rate may understate the actual charge-off rate, as many loans were still active when data was collected. While mean and median statistics should approximate actual values, the charge-off rate and costs must be interpreted as minimum values.

Of the loans charged-off, just over half were for 60 percent or more of the original principal (see Figure 9). In fact, 38 percent of charge-offs were for at least 80 percent of the original loan amount. The mean amount charged off was \$1,856 (median \$1,159). When spread over LCCU's portfolio, these charge-offs cost \$37.31 per loan extended.

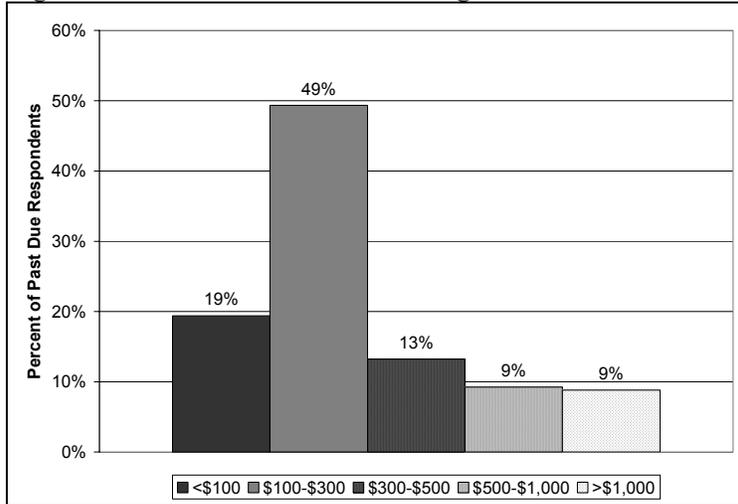
Figure 9: Charge Off Amount as a Percent of Loan Amount



Note: n=56 charged-off loans.

Prior to the end of data collection in December 2003, 227 loans (8% of all loans) had recorded a past due balance at some point during the loan's tenure (see Figure 10). While a few of these balances reflected severely overdue loans, most past due balances were for \$300 or less; the mean amount past due was \$362 (median \$204) and the mean number of overdue payments was 2.4 (median 1).

Figure 10: Amount Past Due Among 227 Overdue Loans



Delinquency (and past due balances) were concentrated among no-collateral and used-vehicle loans. Twelve percent of no-collateral and 11 percent of used vehicle loans experienced some form of delinquency at some point, compared with 9 percent of new vehicle loans, 7 percent of token collateral loans, and 2 percent of savings as collateral loans (see Figure 11)

No-collateral and used-vehicle loans also had higher levels of serious delinquency. Where none of the token-collateral, new-vehicle, or savings-as-collateral borrowers missed three or more payments, 3 percent of no-collateral and used-vehicle borrowers recorded three or more missed payments.

While no-collateral and used-vehicle loans carried roughly equal levels of delinquency, Figure 11 shows that no-collateral loans were substantially more vulnerable to default (although defaults on used-vehicle loans carried a higher cost). Of 624 no-collateral loans, 33 (5.3%) were eventually charged-off. A smaller percentage (1.5%) of used-vehicle loans ended in default; however, these loans resulted in much higher charge-off amounts. Whereas defaulted no-collateral loans averaged \$881 at the time of default, defaulted used-vehicle loans, on average, left \$4,078 outstanding. When these costs are spread across all such loans, defaults cost LCCU \$47 per no-collateral loan and \$61 per used-vehicle loan.

Figure 11: Characteristics and Measures of Loan Performance by Loan Type

	New Vehicle	Used Vehicle	Savings as Collateral	Token Collateral	No-Collateral
# of Loans	45	1072	827	218	624
Mean Loan Amount	\$15,595	\$6,528	\$899	\$1,620	\$1,553
Mean APR	8.0%	11.75%	5.5%	15.0%	15.0%
Mean Loan Term (in months)	58	40	7	16	15
Accounts Charged Off	1 (2.2%)	16 (1.5%)	1 (0.1%)	5 (2.3%)	33 (5.3%)
Average Amount Charged Off	\$3,063	\$4,078	\$44	\$1,311	\$881
Cost per Loan (of Loan Type)	\$68	\$61	\$0.05	\$30	\$47
Percent of Loans with Delinquency ²	8.9%	11.3%	1.7%	7.3%	11.5%
Percent of Payments Delinquent ³	1.4%	2.9%	2.0%	3.2%	8.1%

Perhaps the most important finding in Figure 11 is the relative absence of delinquency and default among savings-as-collateral loans. These loans, designed to build the borrower's credit history, play a major role in creating access to mainstream financial services. For borrowers without prior credit histories, these loans offer the first step toward a vehicle loan or home mortgage. Equally important, such loans increase access to short-term credit such as a credit card or personal loan, which provide the borrower with alternatives to payday lenders and predatory credit providers.

The savings-as-collateral loans experienced very low delinquency and nearly no default (Figure 11). Ninety-two percent of savings-as-collateral loans experienced no 30-day delinquencies and only 1 loan of 827 (0.1%) defaulted. Furthermore, savings-as-collateral loans carry a mean number of 30-day delinquencies of 0.11 delinquencies per loan (see Figure 12).

A final speculative finding is that borrower credit score may not be a precise predictor of loan performance in this sample (see Figure 12). For instance, used-vehicle borrowers with scores between 621 and 660 were more likely to be delinquent with payments than were borrowers with scores below 580. Furthermore, no-collateral borrowers with scores

² Percent of loans with delinquency is defined as the ratio of the total number of loans ever past due to the total number of loans of that type. A delinquency rate (ratio of currently delinquent loans to the number of outstanding loans) is not possible because of missing data.

³ Calculated within each loan type as the number of delinquent payments divided by the total number of payments.

between 581 and 620 were also more likely to be delinquent than no-collateral borrowers with scores of 580 or less. While Figure 12 shows only a bivariate analysis, these findings suggest that borrower credit score may provide only a rough predictor of loan performance.⁴

Figure 12: Mean Number of 30-Day Delinquencies by Credit Score and Loan Type

	Used Vehicle	Token Collateral	No Collateral	Savings as Collateral	New Vehicle
% with Credit Score	31%	50%	55%	0%	42%
No Score	0.65	0.33	0.46	0.11	1.08
580 or less	0.62	1.00	1.04	-	2.5
581-620	0.44	0.27	1.26	-	-
621-660	0.71	0.11	0.54	-	-
Greater than 660	0.27	0.11	0.48	-	-

Note: Used Vehicle n=329 (borrowers with credit score); Token Collateral n=108; No Collateral n=343.

One possible explanation for the decreased precision of this relationship is that the credit scores of many borrowers are based on limited or short credit histories. If this is the case, then credit score may provide a less relevant tool for assessing risk. Figure 12 shows that the loans extended to borrowers without credit scores outperformed several sets of borrowers with relatively high credit scores. For instance, no-collateral borrowers without credit scores generated fewer delinquencies per loan than any of the sets of no-collateral borrowers with reported credit scores. These figures suggest that the importance of credit score relative to other predictors of risk may be diminished for this population of borrowers. This is not to argue that credit score does not provide a central tool for assessing risk, only that its weight relative to other measures of risk may be smaller for individuals with limited or short credit histories. This finding is further limited by the small sample sizes available for each grouping of loan type and credit score.

Limits

The analysis presented in this report relies on data provided to the Center and collected by the Center for loans originated between 2000 and 2003. The relevance of this report to current LCCU operations requires that the experience of LCCU borrowers between 2000 and 2003 can be generalized to current borrowers.

Figure 13 displays substantial improvements in charge-off rate, cost, and delinquency from 2000 to 2003. These improvements may result from differences in economic climate. On the other hand, if these improvements represent improved ability of LCCU to screen loans, findings from this data may not be able to be extrapolated to LCCU's current loan portfolio.

⁴ In multivariate analyses not presented, credit score was not a significant predictor of default. However, these models are not presented because the data did not provide sufficient power to identify any meaningful predictors of default other than loan type.

Figure 13: Loan Performance by Year of Origination

	2000	2001	2002	2003
Percent of Loans Charged-Off	21.7%	7.1%	1.9%	0.4%
Cost per Loan of Charged-Offs	\$272	\$184	\$25	\$4
Mean Number of 30-Day Delinquencies per Loan	4.7	2.7	0.9	0.1

Summary/Conclusions

The analysis presented in this report offers primarily descriptive information regarding the characteristics of LCCU borrowers and loans. The data show that LCCU borrowers have relatively small monthly incomes (mean \$1,722) and relatively high levels of existing debt (median debt-to-income ratio 35). These borrowers tend to apply for loans of less than \$3,000 and often accept APRs above 10 percent. Eighteen percent of borrowers are 30 days delinquent at least once and two percent of loans must be charged-off.

With respect to loan performance, this study's findings are twofold. First, borrowers who become delinquent once are likely to become delinquent multiple times. Second, no-collateral loans are most vulnerable to delinquency and default, while savings-as-collateral loans experience low delinquency and virtually no default.

While these findings present initial guidance for improving loan screening and maintenance, further investigation into these findings is also necessary to isolate factors that contribute to varying loan performance trajectories. The Center attempted more sophisticated analytical techniques, but found that missing data and small sample sizes among loan and borrower subgroups prevented reliable analysis.

As of July 2005, LCCU had 35,000 members and \$22 million in assets, making it the fastest growing credit union in the United States. One of its major goals now is achieving profitability, which it hopes to do by 2008. (Cohen 2005) A challenge that management has recognized for some time -- and that is underscored by the findings of this project -- is to find a way to increase the profitability of lending while continuing to offer affordable products that meet the mission of the institution (Abad and Elboim 2004).

According to LCCU, the lending strategy is being adapted to meet this challenge. Notably, LCCU has started making mortgage loans. These loans are larger and better-secured than even the vehicle loans, and many of the borrowers have an established track record with LCCU. The mortgages -- which are running about 40% of lending by dollar volume - are mostly adjustable-rate, first mortgages of 90 percent and higher loan-to-value. Used auto lending has also grown as a percent of total lending activity, comprising 50 percent of loans (by both number and dollar amount) through June of 2005 (compared to 38% of loans in the population we analyzed). To encourage customer retention, LCCU introduced a reduced rate product for repeat car loan borrowers with a good payment history. At the same time and not surprisingly, adjustments have been made to unsecured consumer loans, which demonstrated unsatisfactory loss levels.

Management cited the example of repeat borrowers who started with small loan amounts, performed well until they built up to loans of \$2,500-\$3,000, and then defaulted.⁵

The LCCU serves as both a model and a consultant to institutions seeking to serve the emerging Latino market. It benefits its constituency by introducing them to and preparing them for mainstream banking relationships. But it also seeks to attract and retain customers by offering competitive loan products so that it can flourish as a sustainable institution. As its market continues to evolve, its products and services will have to continue to adjust likewise.

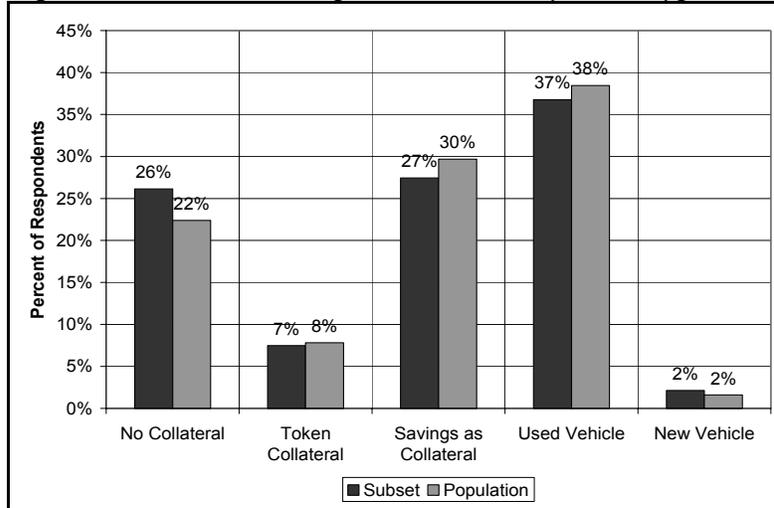
⁵ Interview with Randy Chambers, Treasurer of LCCU. August, 2005.

APPENDIX: Representativeness of the Subset

The characteristics of borrowers in the subset closely match the characteristics of the population of loans with respect to most borrower and loan characteristics. This section details and discusses those variables on which the subset differs from the loan population.

First, the subset contains slightly more no-collateral loans and slightly fewer loans that use personal savings as collateral. A1 compares the make-up of the subset and population with respect to loan type.

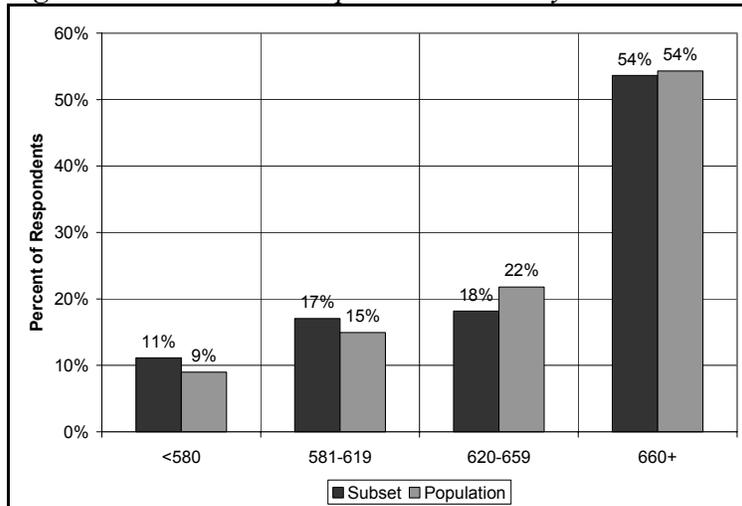
Figure A1: Subset and Population Loans by Loan Type



Note: subset n=1457; population N=2786.

Second, the subset also overrepresents individuals with credit scores below 620. Where 28 percent of borrowers in the subset have credit scores of less than 620, only 24 percent of borrowers in the full sample have scores in that range. (See Figure A2.)

Figure A2: Subset and Population Loans by Credit Score



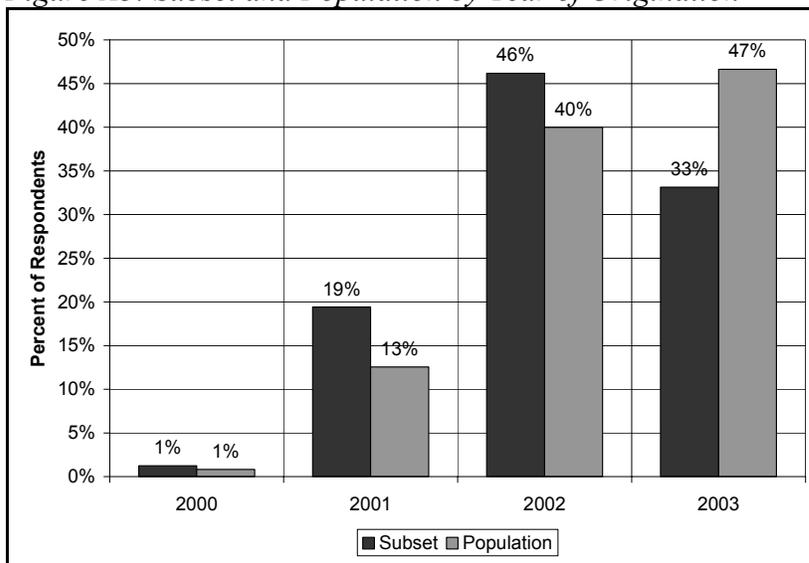
Note: subset n= 440 (1017 missing values); population N= 803 (1983 missing values).

Third, the subset suffers from a higher rate of charge-offs. Where 2.0 percent of loans in the population were charged off, 3.1 percent of loans in the subset were charged off. This

higher charge-off rate is consistent with overrepresentation of borrowers with lower credit scores and no collateral.

Lastly, the subset overrepresents loans originated in 2001 and 2002 and underrepresents loans originated in 2003 (see Figure A3). This deviation from the population may help to explain the characteristics of the subset sample explicated above. It may be the case that the economic downturn of 2001 hurt borrowers' abilities to provide collateral or that the downturn forced some borrowers to reenter the credit market prior to paying down other debts (lowering the borrower's credit score). These weakened borrower characteristics, in turn, may have contributed to the higher charge-off rate experienced by loans in the subset.

Figure A3: Subset and Population by Year of Origination



Note: subset n=1457; population N=2786.

While the above characteristics suggest that the subset slightly overrepresents higher-risk borrowers, the impact of this bias on the findings presented in the body of this report are unclear. The population, of course, remains an unbiased source of information on the population of loans; however, the bias shown above may cause slight error in findings that rely on the expanded borrower characteristics of the subset.

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The Kenan Institute's Center for Community Capitalism engages in multi-disciplinary research and outreach activities that explore ways to apply private sector approaches to revitalization of America's distressed communities. The Center's work focuses on techniques that are both effective in building wealth and assets in disadvantaged communities and are sustainable from a business perspective.

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