BANKING ON LA

By: Manuel Pastor
Program for Environmental and Regional Equity
University of Southern California
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Message from the Mayor

This is a perilous moment for our nation’s families. People are working more and making less. The unemployment rate rises with each month’s jobs report, while retirement accounts shrink with every twist and turn of the stock market. And too many Americans lack the resources and assets to build a stable foundation for financial success long into the future.

At this time of change and challenge nationwide, it is the responsibility of leaders across the United States to take bold, decisive action to ensure that our working families have the tools to weather today’s storm and prepare for a brighter tomorrow. We must bring new ideas and a fresh vision to the table, and state in a clear voice: that in the richest nation in the world, the neglect of the poor and the middle class cannot stand.

To that end, this study provides our City and its civic leaders with the evidence and thoughtful framework we need to build an infrastructure that enables local families to access vital financial services and build wealth for generations to come.

Addressing one of our most pressing issues and working with top experts nationwide, Professor Manuel Pastor has presented a body of work that will redefine the way we approach anti-poverty and economic development policy. His paper is a practice in strong research and extraordinary passion, and it will inform our decisions and our thinking long into the future.

As with all truly transformational thinking, this work is the result of strong partnerships between a wide range of people and organizations. In addition to our researchers, I want to extend my sincere thanks to the Annie E. Casey Foundation and the Annenberg Foundation for the funding that made this research possible – with particular appreciation for the trust and vision of Ralph Smith and Wallis Annenberg. Without their help, this project and the policy it supports would not be possible. And with the investment and commitment of individuals and officials throughout the City and around the country, our success will certainly continue in the coming years.

Very Truly Yours,

Antonio R. Villaraigosa
Mayor
Acknowledgements

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Professor Manuel Pastor, Director of the Program for Environmental and Regional Equity

The USC Program for Environmental and Regional Equity (PERE) is a new research unit headed by Professor Manuel Pastor and situated within the USC Center for Sustainable Cities. PERE conducts research and facilitates discussions on issues of environmental justice, regional inclusion, and immigrant integration. PERE’s work is rooted in the new three R’s: rigor, relevance, and reach. We conduct high-quality research in our focus areas that is relevant to public policy concerns and that reaches to those directly affected communities that most need to be engaged in the discussion. In general, we seek and support direct collaborations with community-based organizations in research and other activities, trying to forge a new model of how university and community can work together for the common good.
EXECUTIVE SUMMARY

Being poor is hard enough; being poor and unbanked is worse. Forced to turn to payday lenders, check cashers, and other high-cost financial services, hard-working families see their income depleted and their wealth sapped. Expanding banking services may be one of the most effective and lowest-cost anti-poverty policies available — and as we show below, it can yield benefits for both responsible lenders and the City as a whole.

After all, low-income neighborhoods often hold more financial promise than is usually thought, partly because traditional analyses frequently fail to account for population density and informal economic activities, and thus understate market potential. Unfortunately, the banking industry has not always recognized this potential and lower income residents have lost familiarity - as well as trust - with banks. Bringing them back in requires a new approach to banking, including expanded marketing, specialized training in financial literacy, and collaboration with a neighborhood delivery system that incorporates local non-profits and community leaders. The City could help address the problem by providing neighborhood-based research, shifting deposits to reward new branches, and using zoning and other regulations to restrict the growth of high-cost predatory competitors.

The benefits to Los Angeles and the region are clear. Business, community, and political leaders are increasingly recognizing that the key to our economic health is the restoration of a vibrant middle class. Part of that involves generating jobs and income but the biggest element that has always defined America’s middle class is its capacity to accumulate savings that can be used for buying a house, starting a business, and sending a child to college. Making a permanent difference for the poor requires that we focus as much on assets as we do on income, as much on financial services as we do on job training.

This paper seeks to do just that, highlighting the energies of hard-working lower-income families, suggesting the market opportunities that may be present for financial institutions, and sketching a policy agenda to which city, community, and business leaders could sign up, support, and strengthen. While there may be debate about the specifics, our central message is simple: we can and should combine community strengths, innovative policy, and market forces to address the needs for financial services throughout our City. Banking on L.A. is in all of our interests.
ACKNOWLEDGMENTS

This report reflects a modest amount of original research and a much more significant reliance on synthesizing the insights and recommendations from the following pioneering reports:


We thank the authors of these works, particularly Matt Fellowes of the Pew Charitable Trust whose early work helped develop this whole field and whose comments on an early draft were insightful. We also thank Sophia Heller of the Mayor’s Office and Elwood Hopkins of Emerging Markets, Inc. for their guidance, and Vanessa Carter of USC for her initial research on this topic.

Finally, and most profoundly, we thank those activists who have long believed that their communities should be recognized for their assets not their deficits, and who have struggled to both chase away high-cost financial services and attract those banking institutions that can fortify local economies. Their hope is ours: that their markets will be recognized, that their communities will be respected, and that their dreams of a better life for their families and the region will be realized.
INTRODUCTION

Los Angeles has long been a place marked by both contradictions and possibilities. The gap between the rich and the poor is among the largest of any metro area — and yet people continue to arrive, full of faith that anyone can remake themselves and find success. The city hosts a diverse social and ethnic landscape often simmering with racial tension — and yet we are also home to some of the most creative and long-lasting cross-community coalitions seen in contemporary America.

Against this backdrop, it is perhaps no surprise that L.A.’s banking system reflects both deep chasms and nascent common ground. The lower-income neighborhoods that dot our city frequently find themselves underserved by mainstream banks and surrounded instead by high-cost financial alternatives — even as careful study suggests that there is both money to be made and a middle class to be built in what may initially seem to be distressed neighborhoods. Making that vision real by finding the “win-win” buried beneath the surface will require the research, policy and political efforts of bankers, public officials, and community groups alike.

What will they find if they look hard enough? First, they will encounter an extraordinary American reality: it’s expensive to be poor. Financial, retail, and other services are often scarce in L.A.’s inner city neighborhoods, resulting in high prices that siphon funds from those who need them most. Second, they will see that enhancing low-cost banking services will facilitate income growth and wealth accumulation. Nearly $150 million could be gained by just avoiding fees on check-cashing and payday loans — nearly four times the federal workforce funds the City spends to raise incomes for roughly the same disadvantaged population — and if the savings gained from better banking was coupled with an attempt to grow the wealth in newly developed savings accounts vehicles, more people could be lifted out of poverty on a permanent basis. Third, they will find that it’s not as easy as highlighting an undiscovered “emerging market.” There are reasons beyond geography why banks have been scarce and reasons why the urban poor shun formal systems. Removing the hard and soft barriers that prevent the the market from functioning will require the collaboration of banks, community leaders, and government officials.

1 The savings from avoided fees ($54.4 million from reducing check cashing and $88.6 from reducing payday loans) come from “The ‘Bank on LA’ Initiative: A Strategy Paper Prepared for the Office of Mayor Antonio Villaraigosa & United Way of Greater LA, p. 2. We think those figures may be underestimates: assuming that we close the gap in the use of check cashers between banked and unbanked lower-income customer in Los Angeles (31 percent versus 84 percent) and that this results in a modest 1.5 percent improvement in net income (according to a 2005 study by the Valley Economic Development Center, A Report on Check Cashing Establishments in Los Angeles, the range of cashing fees in L.A. is between 1-3 percent), the gain across lower-income households is on the order of $61 million, about $7 million more than the United Way estimates for this activity. In 2007, Federal Workforce Investment Funds spent by LA City totaled about $15 million for adults, $10.5 million for dislocated workers, and $15 million for youth. (Sophia Heller, City of Los Angeles Mayor’s Office.)
The stakes are high and the gains equally so. The Mayor, business leaders, and community activists may differ about the need for living wage laws, business tax hikes, and planning regulations but they all seem agreed on one key goal: Los Angeles has to create the conditions for a thriving middle class. Some cities have tried to do this by importing professionals, displacing local residents in the interests of scaling up the city but not necessarily lifting up its people. There is another path: banking on LA — betting on our own — can help chart the road to a revitalized city and region.

“SHOWED MY BROTHER HOW A BANK CAN GIVE HIM A SECOND CHANCE”
BANKING (OR NOT) THE POOR

High-cost financial services — payday lenders, check cashers, and the like — have blossomed over the last two decades. Some of this has represented an odd sort of progress — a combination of regulatory and technological changes, including advances in data processing and sharing, allowed risk-based pricing such that new financial products became available to all income brackets. On the banking side, for example, lenders began using credit scores as a legal and popular way to assess risk and, accordingly, index loans. Although they had to pay dearly, the poor gained access to a broader range of financial services — and with a new way to “safely” lend to lower-income groups, subprime mortgages, for example, exploded in volume, particularly in lower-income communities of color.

Despite the broadening of banking services to lower-income consumers, in practice, high-cost services grew even more rapidly in inner-city neighborhoods. This high-cost boom accelerated when the tight labor markets of the late 1990s lifted many boats and those now working and recently poor generated new demand for short-term financial services. Although banks had developed new products to meet lower-income needs, they couldn’t infiltrate the lower-income markets as quickly as non-bank institutions. A series of growing institutions, including check cashing outlets, pawnshops, payday lender storefronts, and others thus eclipsed traditional banking in the inner-city.

As can be reckoned from our current foreclosure crisis, none of it came cheaply. Payday lenders loan to workers against their incoming payroll checks, with the maximum permissible annualized interest rate hitting nearly 2000% in Missouri and sticking below a more modest 300-600% in most other states. Even those not borrowing against their pay find a large part of

2 Matt Fellowes, personal correspondence, August 2008.

3 A recent study of high-risk mortgage lenders conducted by seven community-oriented advocacy institutions, including the California Reinvestment Coalition and the Woodstock Institute, found that the high-risk share was 20 percent in minority neighborhoods and 4 percent in white neighborhoods, with similar numbers for lower-income and higher-income neighborhoods. In Los Angeles, the disparities by income were less pronounced but the disparities by race were more pronounced. See Paying More for the American Dream: The Subprime Shakeout and Its Impact on Lower-Income and Minority Communities (March 2008); available at: http://www.woodstockinst.org/publications/research-reports/

4 Thus, the number of bank branches in lower-income neighborhoods actually increased through the 1980s and 1990s, largely because of the overall increased demand for financial services. However, the growth of non-bank institutions greatly outpaced the growth of bank branches. (E-mail correspondence with Matt Fellowes; see also Matt Fellowes, “Making Markets an Asset for the Poor,” Harvard Law & Policy Review, 2007, vol. 1, pp. 437-438).

their salary taken when they are forced to use a check-casher, by some estimates around $1,000 a year for a regular user.6

Mortgages and auto lending, when available to lower-income individuals, are typically expensive — with lower-income households paying a percentage point more for house loans and two percentage points more for auto loans than higher-income households.7 And for those who couldn’t even touch subprime, loans come through friends at best and pawn shops at worst. All of these expenses wear on already threadbare budgets of the urban poor.

The financial landscape of Los Angeles illustrates the uneven pattern. In 2006, for example, 944 non-bank cash checkers, 85 pawnshops, and 312 payday lenders outnumbered the 694 banks and credit unions in the city of Los Angeles — and as the figure below makes clear, the mix of traditional and non-traditional institutions varied greatly by neighborhood income.

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levels.⁸ With such non-bank services charging prices near or at the highest rate allowed by law, the promise of democratizing banking has often become the reality of accessible but exceptionally expensive credit.⁹

Financial services are, of course, only one part of the bigger cost picture impacting the poor. Grocery and retail stores are smaller and scarcer in inner cities, weakening competition and driving-up food prices.¹⁰ Limited internet use because of a persistent digital divide by race, income and geography makes comparison shopping difficult.¹¹ Auto and home insurance are higher because of perceived risks and company policies. The combined costs may run into the thousands of dollars.¹² Grabbing back even a part of that — say, an average of $500 for the typical low income family — could result in nearly $20 billion in new spending power at a national level.¹³ But financial services, while not the only element in the cost picture, are an important part of the whole.¹⁴

For example, the Center for Responsible Lending, a national policy institute, estimates that “borrowers pay $4.2 billion every year in excessive payday lending fees” — and in our own state of California, borrowers pay annualized rates of over 400 percent on payday loans.¹⁵,¹⁶ Nationally, payday lenders and pawnshops charge 25-30 times the average rate of credit cards.¹⁷ And even more formal institutions overcharge: the Brookings Institution

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⁸ The Pew Charitable Trust, “City Profile: Los Angeles.”
¹² Brookings (2006) assumes food costs run several hundreds of dollar more (p. 50), offers a more precise figure of up to $300 for home insurance (p. 42), and estimates between $50 to over $1,000 extra for auto insurance (p. 37).
¹³ Brookings estimates that the total income from lower-income households (those making less than $30,000 a year) is $650 billion and suggests that a one percent reduction in spending will yield a $6.5 billion improvement in income. For those households making below $30,000 in 2000, the median household made about $16,370; a saving of $500 is three percent of that income and we use the three percent figure to calculate out the suggested total effect (2006: 9).
estimates that between 14 and 20 percent of all borrowers who wound up with a high-interest mortgage could have qualified for a better loan.\textsuperscript{18} Thus, the poor, who can least afford it, waste thousands of dollars each year on non-traditional financial services that do not even afford them vehicles for effective saving.\textsuperscript{19}

Indeed, such institutions accomplish exactly the opposite. One estimate suggests that a full-time worker forced to rely on cash checkers over the course of his or her working life will lose about $40,000 to unnecessary fees. Sounds like a lot — but it’s even worse because if a bank had not only deposited the check but then provided access to a savings bond, the total kitty at retirement would be nearly $90,000. If the individual had instead opted for a mutual fund — one designed exactly for such small-scale investors — the total would have hit over $360,000.\textsuperscript{20} Of course, the savings might be spent along the way on investments such as homes and education — all of which are more productive than squaring with payday lenders. In short, part of the answer to re-establishing middle-class America appears to be in upgrading our banking system.\textsuperscript{21}

\textsuperscript{18} Brookings 2006:11.
\textsuperscript{19} Brookings 2006: 24.
\textsuperscript{20} Brookings 2008: 1, 14.
\textsuperscript{21} Of course, it’s not just banks. As Adam Carasso and Signe-Mary McKernan point out, the tax system is biased against home ownership for lower-income individuals because the tax savings on mortgage payments only accrue to those earning enough to pay higher taxes. See Carasso and McKernan, “Portraits of the Assets and Liabilities of Low-Income Families,” Opportunity and Ownership Project, The Urban Institute, no. 9, May 2008.
FINDING THE MARKET

Expanding lower-cost financial services is critical to developing lower-income communities as well as supporting lower-income families. While there is emerging evidence that bank branches have finally begun growing in the poorer communities where they once couldn’t, researchers have found continuing geographical differences in the availability of low- and high-cost financial services in Los Angeles.\textsuperscript{22} In some places, such as Central City, the Wilshire Corridor, and mid-Crenshaw, non-traditional institutions, including payday lenders and check cashers, co-exist with banks and credit unions, essentially completing the tapestry of financial services. But in other locations, the financial landscape is more than dominated by the high-cost non-traditional institutions. In Southeast Los Angeles, for example, residents can choose from five times as many non-traditional institutions than banks or credit unions.\textsuperscript{23}

But this is hardly a real choice. The market system, after all, associates choice with competition — the way in which the healthy rivalry between firms broadens the variety and drives down the price for consumers. Non-traditional institutions thrive in lower-income areas, however, precisely because of the lack of competition. High-cost financial services like check cashers, remittance agencies, and pawn shops make high profit margins. Larger, traditional banks could provide cheaper, more diversified financial services, potentially lowering the costs of services and putting payday lenders and others out of business. Indisputably, there is money to be made; why the banks stay out is the subject of debate.

\textsuperscript{22} See Brookings 2008 for evidence on the changing national picture; on p.12, they acknowledge that Los Angeles has not been part of this trend, a fact confirmed by CFSI.
\textsuperscript{23} Social Compact 2008:16-17. The calculations are based on the number of traditional and non-traditional financial institutions per 10,000 households.
Traditional Banking Institutions (left) and Nontraditional Financial Institutions (right) in central and south Los Angeles. 
Source: Social Compact 2008: 18, 19.

After all, places like South L.A. are often asset-rich. Across the U.S., after all, lower income households boast more than $650 billion in annual buying power, an amount that is more than 25 percent of the entire United States federal budget. 24 Many inner city communities find their market potential underestimated, partly because researchers and grant-makers have become proficient in highlighting needs — also known as weaknesses — and partly because the basic data used to estimate local markets are often outdated and outmoded. 25 In considering bank locations, for example, population, income, and stability counts — but all three tend to be underestimated in areas with high proportions of minorities, sizable participation in the informal economy, and new flows of immigrants.

Social Compact, a national non-profit corporation focused on stimulating private investment in underserved communities, has tried to correct for this underestimation problem in a study of nine Los Angeles neighborhoods — mostly in South L.A., East L.A. and the central city. Supplementing traditional Census information with data from the IRS receipts, the Department of

Housing and Urban Development, the U.S. Postal Service, and information collected under the aegis of the Home Mortgage Disclosure Act, the analysts provide a picture that is far more robust:

- People and household counts are roughly 10 to 20 percent higher than recorded by the census, suggesting residential density that should attract services.

- Neighborhood income is often higher than Census data would indicate, partly because of the informal economy, suggesting a potential for healthy deposits.  

- The majority of buildings are owner, not renter, occupied, suggesting a high degree of stability and neighborhood commitment.  

Population density is especially high in Southeast LA and Boyle Heights and income density is especially high in Leimert Park, Crenshaw, Hyde Park, West Adams, and Jefferson Park. Density increases the value of typically overlooked poor neighborhoods. For sure, individual lower-income customers are comparatively less attractive clientele than higher-income customers. More clients will have to be served to break-even, clearly requiring more resources. But, a single branch will be able to serve many more customers, and accumulation will yield higher profits in the long-run. Unfortunately, the profit potential these four factors signal is often picked up on mostly by non-traditional financiers — and even these tend to veer to the lower-quality and higher-cost end of the spectrum, since the scarcity of grocery stores and retail stores limits the availability of the “safer” (and lower-cost) cash checking options that tend to reside within such enterprises.

It all adds up to a waste: lost income for the poor, lost revenues for the banks, lost development for the city. Los Angeles, faced with the challenges of inner-city poverty, has sought to invest millions in new infrastructure, affordable housing, and job training; it should also work on simply insuring that demand and supply find their place in a functioning market.

26 The Social Compact report fails to adjust for inflation in its income estimates, resulting in an overstatement of the gap between Census and their estimates. However, even if one controlled for inflation, the Social Compact method would still yield a nearly 10 percent higher figure for income for the areas that it studied (Social Compact 2008:12-14).  
28 Over $300K/acre. (Social Compact 2008: 9, 12.)
MAKING THE MARKET

How do we lead banks and communities to this opportunity? While part of the problem is clearly information, something that can be partially remedied by the sort of studies Social Compact provides, the challenges go well beyond that. In fact, as Brookings research Matt Fellowes notes, the case is actually obvious: “strong intuitive reasoning [suggests] that there is a market opportunity created today by the exorbitant prices of alternative financial services.”29 Indeed, the truth is that some banking corporations have already found the opportunity but not in the best way — they own both low- and high-cost financial services, and they deploy them separately and unequally. Part of the challenge is to insuring that leading financial institutions employ the same low-cost, high quality approach in all communities. This will require nudging and prodding, partly through regulation and partly through the bully pulpit. But it will require an active approach to helping banks build new relationships and develop new products that better suit the markets they hope to serve.

Part of the problem is marketing. Banks have developed very low-cost checking accounts, and can often utilize alternative identification to set up customers. But information about the accounts is often poorly publicized. Part of the problem is patience. Typical branches are expected to turn a profit in three to four years, but this may not happen with what are called “de novo” branches. But experts project that such branches need at least five years and maybe more, as both sides of the market learn to work with each other.30 And part of the problem is practice. Banks tend to react to small deposits, thin credit histories, and occasional overdrafts with high interest rates or exorbitant fees — but this just discourages consumers who are making a slow and sometimes unsteady shift from payday lenders to formal banking.

It’s not just the banks. The consumer base needs to be educated and developed. The lower the consumer’s income, the less likely they are to use and understand financial services.31 This “soft” barrier to banking is exacerbated because the poor are concentrated and thus less likely to have neighbors who use and understand banking. And even within poverty enclaves,

29 Brookings 2006:56.
30 Pacheco 2008: 7.
lower-income residents tend to associate with other unbanked while banked lower-income residents associate with others who are banked — the social network effects are thus further exacerbated.  

The Center for Financial Services Innovation has usefully profiled the unbanked in lower and moderate income communities in Los Angeles. The racial dimension is striking: while whites are 24 percent of the residents of these areas, they are less than two percent of the unbanked. Latinos, meanwhile, make up over three-fourths with African Americans at 21 percent. Over 60 percent of the unbanked are foreign-born and while the plurality of the unbanked — nearly 40 percent — claim that lack of funds prevents them from having a checking account, nearly 20 percent suggest the main reason for not banking is lack of proper identification.

PACOIMA AND BEYOND

Pacoima is a lower-income, heavily immigrant community in the San Fernando Valley. While many banks avoid such places, community leaders convinced Wells Fargo to invest — and in 2003, the neighborhood celebrated the opening of what was the second bank in its entire history. Five years later, this Wells Fargo branch is 25 percent ahead of schedule in deposits, has enabled $1 million in EITC tax refunds to flow into the community, and has contributed loans to 16 small business start-ups.

What was the secret for success? Strong community partnerships created the “neighborhood delivery system” that bridged information gaps between banks and unbanked Pacoima residents, and provided the sort of financial literacy training necessary to effectively join the system.

Rather than relying on costly cash-checkers, pawn shops, and wire transfers, Pacoima residents are now investing and creating local wealth. Wells Fargo has increased their market share, all-the-while decreasing the high cost of poverty.

Wells Fargo is not alone. Bank of America has launched an “American Block-by-Block Initiative” that is working in Westlake and now in the Vernon-Central and Boyle Heights neighborhoods. Washington Mutual has initiatives in Baldwin Village and Leimert Park, signaling a new dawn for families and communities.

Another striking pattern is the degree of workforce attachment: in the United States, of the 10 million who are without a transaction account, 65 percent work steadily. In Los Angeles, the unbanked are also younger and more likely to be married.

32 CFSI 2007: 34.
33 CFSI 2007: 54. CFSI also reports that more than half of the unbanked reported that their application for a bank account was denied because of insufficient identification.
and have children.³⁵ Often living at the economic edge, these working families need the financial security that a banking relationship can provide, particularly to weather the sorts of financial set-backs (such as illness or short-term job loss) that disproportionately plagues those households earning below $50,000 a year.³⁶ This is, in short, exactly the sort of hungry but hard-working market segment financial institutions would hope to attract — but it requires a special touch to both serve and make profitable.

Into the breach have stepped intermediaries like Emerging Markets, Inc. A sort of non-profit in spirit and for-profit in execution (partly to convince banking clients that this is a market exercise and not a philanthropic affair), Emerging Markets has helped develop “neighborhood delivery systems” that can serve as a sort of neutral interface between the large and often anonymous system of a bank and the smaller-scale intimacy of the neighborhood. This means helping “growing the market” by collaborating with local non-profits, churches and others to create financial literacy classes, offer small business training, and enhance other community assets. The personal touch seems to work and the demand is clearly there: about one-third of unbanked Angelinos who have never participated in financial workshops are interested in doing so.³⁷

The challenge is getting to scale, especially since that is required to make a profit. It is one thing to have good examples, emerging best practices, and boutique firms and community groups. It is another to make it standard practice for banks to invest in and serve distorted markets, and for community members to shed their fear and unfamiliarity. To get to this stage will require leadership from public officials as well as financial and community leaders.

³⁵ When taken as averages, the unbanked have 1.7 children while those who use a bank have 1.1 children. (CFSI 2007:10)
³⁶ CFSI 2007: 51, 52.
CHANGING THE NORM

Banking the unbanked in Los Angeles holds great potential: it can help lift families from poverty, it can help build business for bankers, and it can help forge the basics necessary for a middle class city that saves and invests in our city’s future. While one would hope that the market alone would do the trick, Los Angeles has the third highest percent of residents without checking accounts — the market is coming up short and public and private sector leaders are going to need to stand tall.

BANKING IN THE BAY

Bank on San Francisco, launched in September 2006, is a comprehensive city-initiated effort to bring the unbanked in from the financial cold. Working with the Federal Reserve Bank of San Francisco, a local non-profit focused on wealth development for the poor, and the city’s financial institutions, the goal was to improve the range of starter products, provide the unbanked marketing and financial literacy, and check the growth of high-cost financial services like check cashers and payday lenders.

The goals for Bank on San Francisco were not modest: start with 15 to 20 financial partners and work to help 10,000 of the 50,000 unbanked individuals in the city get accounts. As of August 2008, 16,000 accounts had been opened and over 170 banks and credit unions were participating in the effort. Other municipalities have taken notice and the National League of Cities is pushing its members to adopt the model.

While much of the success is due to the development of new banking products for the poor and the training of community residents, it’s not all carrots: in December 2007, San Francisco also passed an ordinance forbidding new payday lenders and check cashers from setting up within one quarter mile of an existing lender or casher. And it’s all about leadership: the Mayor and the City Treasurer have been constant advocates and champions, cheerleading their way to a new model for their city and for America.

Part of the leadership will need to come from the Mayor’s office. Consistent with his strategy to “repair the economic ladder,” the Mayor can help frame a communications approach that addresses inner-city neighborhoods as untapped markets, rather than charity cases. With the help of business leaders, he can talk with reluctant bankers about how the expansion of financial services will strengthen the regional economy, and complement the human capital development essential to L.A.’s competitive position. And with the help of community leaders, including faith-based institutions, he can talk with the urban poor about the dangers of non-traditional financial institutions and the wealth creation potential of formal banking.

38 Pacheco 2008: 7.
It’s more than talk, however. Banks, community organizations, and the public sector need to work together to remove the “hard” barriers through research and development. To that end, the City can continue funding research, like that synthesized in this report, with one immediate task being a better understanding of the dynamic between those high- and low-cost financial institutions that often exist in the same neighborhood. The City can also help community organizations and banks in exploring the best financial products for these communities, like accounts that can be opened with small amounts of money or that offer “second chances” for those who may modestly and infrequently overdraw. And given the data on what the unbanked point to as a central barrier, banks will need to determine alternative ways to securely identify their account-holders.

All this will require an unlikely set of partnerships. Part of what has made Wells Fargo’s new Pacoima branch work is the use of community organizers and institutions to develop financial training, recruit customers, and provide counseling. Residents tend to trust organizers because they are part of the fabric of the community — and they can be a more effective way to address basic branch functions like education, marketing, account openings, and deal referrals. And organizers can help shepherd-in new banks and acquaint them with the neighborhood, helping them distinguish better between those who are good credit risks and those who are not.

The City can also support banks through their start-up phase. Because de novo banks in lower-income communities may take longer to break-even, the City could help incubate the branches with “linked” banking, placing government deposits in those banks that open branches in underserved communities and sign-up the unbanked wherever they may live. The City can also continue advocating for Banking Development Districts (BDDs) at the state level. BDDs identify neighborhoods in need and support new branches fiscally and in developing new, more appropriate financial products. New York’s South Jamaica, Queens has rebounded from high foreclosure rates and bank scarcity through such legislation. BDDs have received strong mayoral support in California and soon could be part of the statewide picture.

Larger non-profit institutions could also play a role. The United Way, with its focus on “Pathways Out of Poverty,” is a natural ally, and unions, particularly given their reach to L.A.’s working poor, are a useful vehicle for a mass marketing campaign.


40 The proposed, but blocked, BDD legislation in California was titled AB 1502. For more on New York’s BDDs, see The State of New York Banking Department at http://www.banking.state.ny.us/bdd.htm.
Workforce development agencies, so often focused on job training, should include the asset management part of the equation that will truly make work pay.

Of course, as tempting as it may be, it is not enough to just look for the win-win. There are bad actors out there, getting wealthy from excess charges for short-term loans and check-cashing. Among the most egregious offenders are those offering refund anticipation loans—they generally charge lower-income tax payers dearly for fronting the bulk of the tax refund at the time of filing, often saving just a few days for the consumer. Some practices just need to be restricted by zoning and other regulations—and while Los Angeles is rightly concerned about presenting an anti-business image, this has not stopped the City Council from passing a recent moratoria on new fast food outlets that risk a community’s health. Financial health is just as important—and many who have supported the much celebrated Bank on San Francisco initiative do wish they had applied higher standards to the banks that joined and pushed for earlier restrictions against the sort of predatory financial services that thwart community development.41

Finally, the City needs to think ahead to monitor and further develop de novo banking. The immediate metrics are clear: new branches, new bank accounts, new customers. But the real promise of expanding financial services is the possibility for wealth creation. Even before San Francisco opened its first de novo branch, the City was investing time and money in understanding lower-income financial services. With branches opening, the City should now forward-cast to standards that include the second phase of full-service banking: loans that help individuals buy houses, start business, and finance job training and education. Both should develop tracking mechanisms for that effort, collecting lessons and continuing to share best practices with other institutions and cities—as has been critical in the collaboration between New York, San Francisco, and Los Angeles. For a city with the largest number of the unbanked—and the biggest dreams for its residents—nothing less should be on the table.42

41 For more on Bank on San Francisco, see Anne Stuhldreher, Bank on San Francisco: An initiative to bring all residents into the financial mainstream, New American Foundation, http://www.newamerica.net/files/Bank%20on%20SF%20case%20study%20electronic%20version%20FINAL.pdf
WINNING OUR FUTURE

Improving banking is just one piece in the puzzle of revitalizing neighborhoods in South and East Los Angeles — but it is an important piece. By re-capturing income currently lost to the pockets of high-cost lenders, wealth can be created and circulated in what are currently poor neighborhoods. And such wealth is perhaps more important than even income: what distinguishes the middle class is not its flow but its stock, not its paycheck but its assets, not its spending but its security, including the ability to own a home, start a business, and secure an education.

And there is truly nothing more important for L.A.’s future than building that middle class. Cities cannot long survive in a Dickens-like stew of the rich and poor; the tensions build, the tax base falls, and the public square soon becomes an uncomfortable archipelago of disconnected, privatized, and heavily policed spaces. The Mayor has sought to counter that dystopian possibility with a commitment to public safety, a focus on job creation, and an effort to expand parks, plazas, and transit. Shaking up the financial system — helping banks see new clients and helping new clients see the banks — is part and parcel of this broader agenda for a great city.

It’s also of national importance. What happens in Los Angeles does not stay in Los Angeles: if L.A. joins San Francisco, New York, and other major metropolitan areas, the whole of the banking industry might shift. The poor in smaller cities and rural area will profit from new services developed in our nation’s metropolises but translated to towns. Once banks learn how to work more effectively in lower-income neighborhoods, and discover that it is profitable, they may want to tap into new parallel markets all on their own. And once lower-income households find their way to high-quality banking, they are not likely to head back to the check-casher; instead, they will stick with the path of saving and creating wealth, of buying and improving homes, of supporting and educating youth.

And that’s something worth investing in.