CAR OWNERSHIP AND WORKING FAMILIES:
Barriers and Opportunities

By Tanika Davis

> "[Buy here, pay here] is one of the fastest growing areas of subprime lending."

To commute to work and school, Baltimore resident Sheila Horsey needed a car. But with poor credit and a modest salary, Horsey could not finance a used car with conventional credit. Instead, she negotiated with a small "buy here, pay here" used car dealer to purchase a nine-year-old car with a $3,000 down payment. For several years, the $400 monthly payment was a budget buster. "I tried to pay it," Horsey says, "I actually did it for about a year, but eventually the car wound up breaking down. And the car lot actually closed down. Everybody was telling me that they were getting one over on me, but I really needed a car." Without a car, Horsey's everyday commute required transferring between four city buses in order to take her daughter to school and to go to work.

Horsey's story demonstrates the importance of cars to the everyday needs of working families. Across the country, households with income levels below $25,000 are nine times more likely to be without a car than those earning more.[1] For workers such as Horsey, affordability is often the most significant hurdle to car ownership. The difficulty of obtaining credit because of a poor credit score is also a barrier to purchasing and maintaining a car. Even obtaining a driver's license can be an obstacle for some people. But without a car, job opportunities may be limited by the job's location with respect to where the person lives. The fringes of metropolitan areas are often poorly served, or not served at all, by public transportation. The limited hours of public transportation, particularly for shift and weekend jobs, create additional transportation challenges for workers like Horsey.

Car Ownership and Employment Opportunities

According to The Mobility Agenda, a research network that studies the relationship of transportation to employment opportunity, "low-wage workers with access to a reliable car are more likely to work, earn more, and work more hours."[2] Access to a car promotes employment stability and helps low-wage workers be less susceptible to the tardiness, absences, and inflexible schedules that plague transit-dependent workers.

For low-to-moderate income workers who are single heads-of-households, the importance of a car is even greater. When only one person in the family is responsible for meeting all household needs, navigating a car-oriented community without a car is difficult and time-consuming. For individuals who are dependent on public transit to complete household errands, "it's tremendously difficult to accomplish tasks that most of us do without a second thought, such as picking up a sick child from school, buying groceries, or staying late at work," says Carolyn Hayden, president of Opportunity Cars, a network of more than 150 organizations dedicated to increasing private automobile ownership for low-wage, working families.

Predatory Lending

According to Carolyn Hayden of Opportunity Cars and Sheela Cooper of One World Consulting, "current regulation of the automobile finance industry is woefully inadequate for protecting consumers from unethical lending practices by automotive dealers and finance companies." [3] This gap in oversight has allowed predatory practices to take place in traditional as well as subprime dealerships.

Among the most common practices employed by traditional car dealerships are finance charge markups, or "kickbacks," whereby a dealer works with a lender to offer prospective buyers an interest rate that is several points higher than what the buyer could qualify for from a regulated financial institution. Lenders and dealers benefit from "kickbacks" by splitting the additional revenue. According to *Car Trouble*, a recent report by the Center for Responsible Lending, dealer kickbacks in 2007 amounted to more than $2.1 billion.[4]

Lenders may add fees to the purchase price of a car without clearly informing the buyer. Such fees can be attributed to document preparation, rust-proofing, insurance services, or other dealer services. Dealers also employ "yo-yo sales," which entice a buyer into paying a high interest rate on a car loan. Initially, the dealer verbally agrees upon a financing deal. After the buyer takes the car off the lot, the buyer is told that he/she cannot qualify for the agreed-upon terms and is offered a deal at a higher interest rate.

Many low- and moderate-income car buyers who do not qualify for traditional automobile financing because of a poor credit score, spotty credit, or no credit at all resort to used car dealers who advertise a "buy here, pay here" (BHPH) option or other potentially predatory car financing options. BHPH is one of the fastest growing areas of subprime lending.[5] Some experts estimate that the millions of subprime consumers in the "buy here, pay here" market could represent a minimum of $5 billion annually.[6]

Many BHPH dealers almost exclusively serve subprime borrowers who have limited options for purchasing a car. Dealers often profit from high mark-ups on used cars and high financing fees. For example, a dealer could purchase a used car for $500 and invest an equal amount in repairing the car. The dealer could then sell the car to a buyer for $3,000, ask for a $1,000 down payment, and service a loan for the dealer's profit, $2,000. The high financing or maintenance costs of a used car often cause buyers to miss payments. When the dealer repossesses the car and then quickly re-sells it to another subprime buyer, this business practice is called "churning." The National Consumer Law Center has found that minority car buyers pay significantly higher mark-ups than other car buyers with the same credit scores.[7] Non-English-speaking buyers are also susceptible to such scams.

"Buy here, pay here" dealers tend to use "churning" and "self-help repossession" aggressively. "There's only one place in the economy that the creditor is allowed self-help and that's in cars," says Bill Myers, senior fellow at the Aspen Institute's Economic Opportunities program. "If you want to foreclose on a house, there are steps and legal proceedings, and it takes a year. With cars, there's no judge involved, no third party. [Used car dealers are] allowed to pretty much universally take the car away." In addition, "With 'buy here, pay here,' they've paid for the car in the beginning, usually with the down payment. So if they can get it back and sell it again, it's pure profit," says Myers.[8]

BANK HELPS WITH CAR OWNERSHIP PROGRAM

By Sarah Eckstein

Photography: Courtney Mailey

During a breakout session, partners share best practices for providing better access to cars for working families.

In early September, the Federal Reserve Bank of Richmond teamed up with the Annie E. Casey Foundation, the Aspen Institute and the National Consumer Law Center to sponsor, "Cars and Working Families: Expanding Opportunities in a Changing Economic Environment," to explore the economic issues of car ownership. The event addressed a broad range of issues relating to car ownership, car finance and consumer protection.

For many families, car ownership is a key to securing employment and being self-sufficient. Yet, consistent access to affordable and reliable cars is often difficult for low-income families. Participants of the conference worked together to identify the most common barriers to car ownership, pinpoint successful models for overcoming these hurdles, and new strategies to promote car ownership. The conference focused on the wide range of barriers to car ownership, including access to credit, auto insurance pricing and availability, maintenance costs, driver's license requirements and basic financial literacy.

"Many of the higher-paying jobs requiring low skills are located on the outer fringes of metropolitan areas, making reliable auto transportation necessary for employment. These jobs also tend to require night and alternative shifts which exacerbate the difficulties of relying on public transportation," said Ellen Janes, community development regional manager. "We wanted to begin developing a network of partners who share trends and best practices about car financing in particular, and car ownership in general, for low-income workers."

Bob Carpenter, a financial economist at the Richmond Fed, helped paint the picture of a changing economic landscape for credit availability and unemployment that can be a barrier to auto-financing opportunities. Carpenter pointed to auto loan delinquency trends and sales forecasts to help participants see the context for the future of the auto financing industry.

Participants were able to move closer to developing action steps to address priorities for improving access to cars for low-income consumers. The group intends to study the effectiveness of various car ownership programs and policies, compile best practices on car financing, thoroughly research and analyze relevant data, and build a multi-disciplinary network to develop a national policy agenda.

For conference materials and information on the event, visit **www.richmondfed.org/conferences_and_events/community_development/2009/cars_working_families_20090903.cfm**.

Regulatory Prospects

The practice of automobile lending is generally not covered by state and federal consumer protection. In the Fifth District, West Virginia has attempted to regulate BHPH dealers, but Charli Fulton, the state's senior assistant attorney general says, "We can hit a few individual ones here and there, but just the sheer number of them is a little overwhelming."

As a result, many advocates believe federal legislation is necessary to protect consumers. "There's no overarching legislation that governs the terms and conditions under which these loans can be made," says Carolyn Hayden of Opportunity Cars. In *Disclosure and Transparency in the Automobile Finance Industry: A Call for Action*, Carolyn Hayden and Sheela Cooper co-authored a call for federal legislation that would have a similar purpose as the Home Mortgage Disclosure Act, but would serve to improve automobile lending practices.[9]

Researchers have predicted that "simple changes in laws and regulations could dramatically help [low- and moderate-income] consumers in the car arena. *Car Financing for Low and Moderate Income Consumers*, produced by The Aspen Institute and the Consumer Task Force for Automotive Issues, recommends data-gathering mandates, such as requiring credit reporting agencies to collect payment records from "buy here, pay here," rent-to-own and other nontraditional payment arrangements.[10]

Charli Fulton also suggests that "buy here, pay here" businesses should be separately regulated. But Bill Myers of The Aspen Institute recommends a three-pronged approach that includes legislation and regulations, consumer education and more competition in the financing marketplace.

Consumer lending, including automobile microloans, to low-and moderate-income people or communities is not routinely reviewed for Community Reinvestment Act (CRA) credit by banks under the CRA, unless consumer lending constitutes a substantial majority of a bank's business. Nonetheless, a bank may provide examiners any information it deems relevant about its lending, investments, or services for consideration regarding its performance, including data from microloan programs. It is important to note that small, intermediate and large banks are subject to different evaluation standards and processes under the CRA. Larger banks are evaluated on their lending and community development investments and services, while small banks are often evaluated primarily on their lending activity.

Boosting Car Ownership

Across the United States, community-based organizations are providing low-wage workers with affordable, reliable cars. Nationwide, approximately 130 nonprofit organizations are associated with local social service or employment and training providers who assist low-wage working families in obtaining an affordable and reliable car, obtaining a low-cost car loan, or saving for an automobile down payment.

Ways to Work, a nonprofit organization in Winston-Salem, North Carolina helped Loretta Ridgill with purchasing a car. Ridgill, a single mother of three, was having trouble commuting to and from work. A loan from Ways to Work helped Ridgill purchase a used Buick Sentry with a $90 monthly payment plan. The vehicle and the affordable loan catalyzed a series of improvements in Ridgill's life—she was able to secure a better job with more reasonable daytime hours and no longer needed public assistance. Last year, Ridgill bought her first home. Today, Ridgill is working on getting her GED. "I can get to school now without having somebody taking me," says Ridgill, "I don't need to depend on [anyone] else. This showed me that I can do it myself."

Nonprofit car ownership programs such as Ways to Work serve an estimated one-third of one percent of consumers such as Ridgill who are likely to experience difficulty when purchasing a car with conventional or predatory financing.[11]

Community-Based Lending

Steer Clear of Predatory Car Loans, a report by the National Credit Union Foundation, examined ways to help credit unions recognize how to take on the added risk of community-based lending to subprime borrowers.[12] "We're finding that non-prime borrowers are much [more] likely to repay than those with a high credit rating," says Lois Kitsch, national program manager of the National Credit Union Foundation's REAL Solutions program, "and it's because they really need access to that transportation. So we're finding that they really are good candidates to get loans at traditional institutions." At one Latino Community Credit Union, the default rate on automobiles and other loans "is minimal," says Nancy Wilberg Ricks, policy analyst for the National Council of La Raza. Fulton, of West Virginia, says old-fashioned banking models that rely on a lender's knowledge of a borrower's personal circumstances would benefit low-income car buyers in the long-term. "One thing that might help is if there were a way for consumers with low income to get small personal loans, individually through their banks. Sort of mini-lending," Fulton says. "Without that kind of activity, these people have to go to these (predatory) places, because there's no one else that will lend to them."

Bill Myers of The Aspen Institute hopes lending institutions envision the nation's pool of borrowers along a continuum, with people at the top having the best credit and people at the bottom having the worst credit or none at all. "There's a stretch point in the middle that the banks haven't figured out how to get to and the nonprofits can't get to," Myers says, "and that middle ground right now is populated by predators."

To reach out to borrowers, Myers suggests the use of alternative credit scoring in order to determine a potential borrower's stability, particularly if he or she has little or no credit. For a borrower who has no credit history, Myers suggests examining school databases to determine the number of years that a borrower's child has been enrolled in the same school. This proof of stability may indicate that a borrower would be a good candidate for a car loan, albeit at a higher rate than a borrower with established credit.

Conclusion

Since June 2006, advocates from car ownership programs and experts in the fields of car finance, policy, and consumer protection have met by conference calls and in four national symposia sponsored by the Annie E. Casey Foundation to create a nationwide network that can stem predatory car lending practices and eliminate barriers to car ownership. The network includes nearly 100 organizations and public agencies. The group's most recent gathering was held in September of 2009 at the Federal Reserve Bank of Richmond's branch in Baltimore. The forum, entitled "Cars and Working Families: Expanding Opportunities in a Changing Economic Environment," was hosted by the Federal Reserve Bank of Richmond with the Annie E. Casey Foundation. Over 70 participants attended the forum, which was facilitated by Opportunity Cars, The Aspen Institute and the National Consumer Law Center.

"We've got ownership programs [involved in the movement for change]; we've got people interested in bringing credit unions and other lending institutions to the table involved; we've got people interested in policy change at the table," says John Van Alst, an attorney with the National Consumer Law Center. "All of us realize that there is something wrong with the way things are going right now. We've now realized that we all have to work together to help low-income families get and keep reliable cars that they can afford."

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Note: A special thanks to Beadsie Woo, Carolyn Hayden and John Van Alst for their editing assistance.

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