
PROPOSAL TO SUPPORT CREDIT UNION LOW COST LOANS

Responsible Cabinet Member – Andy Scott, Health and Partnerships Portfolio

Responsible Director – Ada Burns, Chief Executive

SUMMARY REPORT

Purpose of the Report

1. To provide members with details of a proposal to support Darlington Credit Union expand its existing provision of providing an affordable, low cost loan scheme for individuals to help fund the purchase of household white goods and electrical items.
2. To seek Cabinet approval to allocate £50,000 as one-off grant funding to Darlington Credit Union, from the 2013/14 underspend on Social Fund to support the proposal as set out in the report. This funding will be ring-fenced to the Council and the Credit Union to help support the proposal as set out in the report.

Summary

3. There is an increase in the number of residents in Darlington who are either financially excluded, on a low income or are welfare benefit claimants. In Darlington, as at August 2013, an estimated number of 8,720 people between the age of 16-64, were on 'out of work' benefits.
4. This group of people have generally been amongst the hardest hit by the economic downturn and have been further impacted by changes introduced as part of the Welfare Reform Act 2012, which has included the introduction of the Bedroom Tax and the withdrawal of the Council Tax Benefit for some claimants.
5. Historically, Council and/or social housing tenants are known to be among those facing increasing difficulties with finance and exclusion, and are therefore turning to the more costly non-standard consumer credit market for help to meet financial commitments and to sustain their tenancies, and purchase essential household items.
6. The non-standard consumer credit market includes the likes of doorstep lenders, payday loan companies, pawn-broking, log-book loans and high-interest 'pay-weekly' consumer credit through high street stores such as BrightHouse.

7. Darlington Credit Union was set up in 2009 to offer savings and affordable loan facilities to its members, who live and/or work within the area of the DL postcode and provides a responsible and low cost alternative to the non-standard consumer credit market.
8. Darlington Credit Union currently provides eligible members in Darlington with an affordable and low cost loan, even if they have no credit history. The Credit Union also provides a low cost loan scheme for the purchase of various new white goods and electrical items (in association with The Co-operative Electrical).
9. The credit union has historically never specifically or actively promoted their low cost loan scheme for the purchase of various new white goods and electrical items, as a 'direct, comparable and more cost effective alternative' to the (non-standard consumer credit market), and in particular 'pay-weekly' high street stores.
10. The proposal to provide one-off funding of £50,000 to the Credit Union will provide them with a significant opportunity to actively promote and develop their existing affordable credit loan scheme (in association with The Co-operative Electrical), as a credible, responsible and low cost alternative (to purchase household white goods and electrical items), than the more costly pay-weekly high street lenders. It provides a platform and opportunity for the Credit Union to proactively attract people away from the unrealistic and unaffordable costs associated with purchasing such items from such companies.
11. The one-off funding is to be ring-fenced and will provide additional financial support to Darlington Credit Union and will be used solely to:
 - (a) to act as a 'sinking fund' to offset any bad-debts which need to be written off resulting from any default in the repayment on loans which have been approved by the Credit Union (in assisting people towards the purchase of household white goods and electrical items). This fund will only be used to off-set the bad debt once the Credit Union has followed and applied their existing credit control process to ensure every attempt has been made to recover any monies owed by the individuals.
12. This one-off funding will allow the Credit Union to amend, revise and develop their existing proposal to provide low cost loans to individuals wishing to purchase household white goods and electrical items, in order to make the customer experience seamless and similar to dealing with a company such as BrightHouse. The scheme would provide individuals with the opportunity to purchase these items without having to pay for them upfront, and to divide the loan repayments into smaller weekly chunks.

13. The revised Credit Union scheme would not operate in the same way as the 'pay weekly' high street stores who would set out to recover items from the customer in the event of non-payment, as the items are generally purchased under a 'Hire Purchase Arrangement'. In this proposal, because the individual is entering into a loan agreement directly with the Credit Union and not the supplier (i.e. The Cooperative Electrical), no attempt would be made to recover the purchased goods in the event of a default in payments.
14. With effect from 7 April 2014, the Credit Union have also agreed to occupy two counter positions in the customer centre for a period of twelve months in order to widen the reach of the Credit Union and potentially attract new customers; and to support the provision of a joined up money advice service for customers visiting the centre.
15. Individuals can call into the Council's Customer Centre or the Credit Union's offices in Church Row, to apply for a loan and purchase these items and it is envisaged that the proposal will officially launch from May 2014.

Recommendation

16. It is recommended that Cabinet approve one-off funding of £50,000 to support the provision by the Credit Union of low cost loans for household white goods and/or electricals.

Reasons

17. The recommendation is supported by the following reasons:
 - (a) The loan scheme with the Credit Union (in association with The Co-operative Electrical) provides a credible and low cost alternative to individuals purchasing household white goods and electrical items through other forms of high cost lending.
 - (b) Using the credit union enables individuals to receive advice and support about saving and appropriate lending as well as helping them to avoid reaching crisis through high cost lending it also helps them to meet other commitments including payment of council tax and housing rent.

Ada Burns
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Background Papers

No background papers were used in the preparation of this report

S17 Crime and Disorder	Enhanced support, promotion and development of the Credit Union's existing low cost loan scheme (for the purchase of white goods and electrical items) will reduce the risk of illegal money lending activity to and also reduce the risk of criminal activity to pay off large interest payments on high interest loans.
Health and Well Being	Financial exclusion can impact adversely on the health and well-being of individuals and families. It can also impact on the ability of individuals to maintain housing tenancies.
Sustainability	Increasing the financial knowledge and competencies of individuals can increase the overall prosperity of Darlington, making it more commercially sustainable.
Diversity	This proposal is open to all who require low cost financial support to purchase items such as household white goods and electrical items, although the scheme will primarily appeal to people who are financially excluded and/or on a low income.
Wards Affected	All wards within Darlington have the potential to be positively impacted through enhancement of the existing loan scheme proposal
Groups Affected	Financial exclusion is an issue that affects all age groups.
Budget and Policy Framework	This decision does not represent a change to the budget and policy framework.
Key Decision	This is not a key decision
Urgent Decision	No
One Darlington: Perfectly Placed	The development and promotion of an affordable low cost loan scheme is specifically designed to narrow the gap between those with poor credit ratings and others.
Efficiency	This proposal will promote financial inclusion and ensure all residents of Darlington will be able to access low cost credit .

MAIN REPORT

Information and Analysis

Background Information

19. A study carried out by (Friends Provident Foundation, Policies and the Research¹Unit for Financial Inclusion at Liverpool John Moores University) in 2011, highlighted that for many, credit was the only way of managing cash flow and funding major purchases.
20. Credit use is now widespread and evident particularly amongst those on low incomes, and for many individuals and families, credit use is the only way to make ends meet.
21. The report highlighted that almost seven in ten (69 per cent) of low income households, comprising 10.55 million individuals are credit users. Of these 10 million (66 per cent) use commercial credit and 0.5 million (3 per cent) only use social credit.
22. Two-thirds (68 per cent) of low-income households have no savings, rising to three-quarters (78 per cent) of those in the lowest income quintile. Only one in six are able to save sufficient amounts to preclude the use of credit (saving more than £300). Seven in ten low-income households would find it difficult or impossible to raise £200–£300 in an emergency.
23. Credit use is predominantly driven by a lack of savings safety nets, and competing pressures on budgets that are too tight to manage any peaks of expenditure and unanticipated events or the purchase of expensive essentials.
24. Low income households or benefit claimants who may be financially excluded and therefore not able to access more of the often low cost mainstream credit channels, are likely to use some of the non-standard credit consumer market, due to the attraction of being able to pay for goods and services in smaller weekly chunks. Consequently, they overlook the high interest rates that come with these lenders, which can lead to bigger financial issues.
25. This increase, combined with the impact of the Welfare Reform changes means there are an increasing number of families and households in debt, or are likely to fall into debt.
26. The problems associated with high-cost lending have been extensively explored over the years, and the non-standard consumer credit market (loans for people who are unable to get loans from mainstream lenders such as banks) is increasingly active at both a national and local level.

¹ Credit and low-income consumers :A demand-side perspective on the issues for consumer protection
Anna Ellison, Claire Whyley, Rob Forster and Paul A. Jones

Darlington Credit Union

27. Credit Unions have traditionally been well placed to develop credit products for low income consumers, and can offer members small loans , repayable on a weekly or monthly basis.
28. Darlington Credit Union is one of 82 credit unions taking part in a national £38m 'Credit Union Expansion Project' (which started in May 2013 and is funded by the Department for Work and Pensions). The project aim is to expand and grow the credit union industry and membership to offer help to people on low incomes.
29. The Darlington Credit Union has recently announced plans to expand after seeing its membership soar to almost 4,000 from 600 four years ago, and is currently experiencing a monthly growth of around 100 members.
30. The Council has entered into preliminary discussions with the Credit Union to support the promotion and development of their existing low cost loan scheme to help support individuals with the purchase of household white goods and electrical items.
31. In agreeing to occupy two counter positions in the customer centre for a period of twelve months, the Credit Union will look to widen the reach of the Credit Union and potentially attract new customers, as part of a wider remit to provide a joined up money advice service for customers visiting the centre. This presence can also be used as the basis for enhancing and promoting the development of their low-cost loan scheme, as a viable alternative to the more expensive pay-weekly high street stores.
32. The Council will help promote the scheme to Darlington residents. A comprehensive marketing campaign will include advertisements in publications such as Hot News and Darlington Together alongside direct promotion in the customer contact centre, where screens will publicise the scheme and visitors will be able to browse The Co-operative Electricals website on self-serve computers and make a loan application with the Credit Union there and then for items. This will ensure the scheme becomes a well-known and popular alternative to other, high-interest, pay-weekly stores.

Support for purchase with household white goods and/or electrical items

33. The Credit Union is proposing that the following restrictions/exclusions are applied for individuals who wish to apply for a low cost loan to purchase household white goods and electrical items (via The Co-operative Electrical) in order to safeguard the financial viability and reach of the scheme:
 - (a) The maximum loan amount (per application) proposed by the Credit Union to be set at approximately £600. This amount has been based on the Credit Union advising that an individual would be able to purchase a white goods package via The Co-operative Electrical (cooker, fridge freezer and washing machine) for this amount.

- (b) A maximum loan term of 12 months; as an example, a loan amount of £500 over 52 weeks would result in a weekly repayment of £10.93 a week, with the total interest payable of £68.14 based on an APR of 26.8%.
- (c) Under this proposal, and in order to promote and market the scheme as a comparable and viable alternative to the pay-weekly high street stores, the Credit Union needs to be able 'lend instantly' and approve loans almost immediately. Therefore under this proposal, individuals can apply for a loan without having previously saved with the Credit Union. The Credit Union would still carry out a 'Budget Statement' with the individual and encourage responsible saving for the future.
- (d) In the event of a default in non-payment of the loan, the Credit Union would follow their existing Credit Control Policy to control repayments by borrowers and recovery of outstanding loans. The policy sets out how the Credit Union would safeguard the interests of all members, borrowers and all those who provide funding to support the objectives of the Credit Union.

Support for purchasing furniture items

- 34. Darlington Credit Union's low cost loan scheme for household goods and electrical items works in association with The Co-operative Electrical. There is no arrangement in place with The Co-operative for purchasing household furniture.
- 35. Since December 2012, the Council currently has a contract in place with Palatine Beds, a company overseen by the Newcastle Furniture Service (NFS) and run by Your Homes Newcastle (YHN). The contract helps the Council access appliances such as cookers, fridges washing machines and soft furnishings such as carpets and curtains which the Council is then able to provide to all Darlington Borough Council tenants for additional charge on top of their rent account.
- 36. The Credit Union can also provide eligible individuals with a low cost affordable loan to support them to purchase household furniture items from organisations like Kings Church, which runs a furniture scheme offering good quality used furniture at low prices to those on income based benefits, and with FRADE which is a local furniture recycling charity. FRADE has also recently applied for a white goods licence so will eventually provide an alternative for individuals who purchasing new is not a financially viable option.

The Credit Union's proposed low cost loan application process

- 37. The following section outlines the proposed application process for providing a low cost loan to individuals to assist with the purchase of household white goods and electrical items:
 - (a) The individual will call into the Credit Union offices at Church Row or at the Customer Contact Centre and request financial support to purchase household white goods and/or electrical items. The individual may already have identified some products from The Co-operative Electrical website, or will be shown the website on the staff computers when they call into the office/centre.

- (b) Having identified the products the individual is looking to purchase, the member of staff will carry out a loan calculation with the, and discuss whether they wish to proceed with a full loan application.
- (c) If the individual is happy with the quote/and or repayments, the individual will be required to complete a loan application form and to present the required forms of identification. As part of the loan application process, the staff will also complete a 'Budget Statement' with the individual.
- (d) Following completion of the loan application form, subject to approval of the loan by the Credit Union's authorised loan officer, the order is completed on The Co-operative Electrical website and the individual is notified of when the order is due for delivery.

Comparison Information

38. The table below provides a useful comparison of how lending across the non-standard competitive market varies and compares with Darlington Credit Union, based on a loan amount of £300.

	Amount of Loan	Typical APR	Term of Loan in Weeks	Weekly Repayment Amount	Total Repayable	Total Interest Payable
Illegal Lender (Loan Shark)	£300	2000%	52	£300.00	£6,000.00	£5,700.00
High Street (Shopacheck)	£300	254%	50	£10.50	£525.00	£225.00
Payday Loan (Wonga)	£300	5853%	52	£337.67	£17,559.00	£17,259.00
Doorstep Lender (Provident)	£300	272.2%	52	£10.50	£546.00	£246.00
Pay-weekly High Street Store (BrightHouse)	£300*	64.7%	156	£3.80	£591.00	£291.00
Darlington Credit Union (Loyalty Loan)	£300	26.8%	52	£6.64	£345.31	£45.31

*includes compulsory insurance for the purchased good which makes products significantly more expensive even before interest is applied.

39. In the UK, the pay-weekly high street store, BrightHouse alone has approximately 288 stores, and the company has identified another 400 possible locations across the UK where new stores could be opened, as part of an aggressive campaign to bring its unique rent-to-own, high-interest model to more customers. For many, particularly those who cannot afford upfront payment, pay-weekly high-interest stores are seen as the most suitable alternative to buying upfront.
40. Items such as essential household goods like cookers and washing machines may initially appear to be affordable due to the low weekly payment arrangements that the high street stores can offer, and therefore appeal to many individuals (particularly those financially excluded, welfare benefit claimants and/or low income households). However, in the longer term the total repayments will often mean the purchase cost is substantially higher than if purchased from other mainstream high street retailers. This is known as the "poverty premium:" the poorer you are, the more you pay.
41. Credit Unions can play a significant part in reducing and eliminating the need for individuals to access the costly non-standard consumer credit market.

Financial Implications

42. This proposal would result in the Council providing the Credit Union £50,000 as one-off funding to promote, develop the loan scheme and to act as security in the event of a default in payment of any loans issued in support of the purchase of household white goods and electrical items. The Council has an underspend in relation to the Social Fund which will be used in this way to help drive down the causes of financial crisis which the Social Fund is designed to address rather than being used to fund other elements of the Council's obligations. In the future the scheme can help to ensure that there are realistic options for people to avoid the need for crises support by planned saving and low cost loans.
43. The Credit Union will also provide financial support to individuals to help with furniture purchases from the organisations via Kings Church or FRADE, although it is envisaged that loans for these purchases will be significantly lower than the £600 maximum being proposed for new purchases via the Co-operative Electrical.
44. Since March 2012, the Credit Union has successfully approved 5 applications for household goods and/or electrical items. The Credit Union has obligations to its savers and investors to balance risk. Providing financial backing for the scheme enables the Credit Union to promote the scheme and take on more loans without taking risk. The Credit Union believe that through the support in promoting the scheme they will be able to help many more individuals from launch date.
45. As of 10 April 2014, the Credit Union currently has a loan book to the value of £715,347, and has consistently operated with a bad debt ratio of 3.8% (the target rate being 4%). The Credit Union has savings to the value of £894,680.
46. The funding of £50,000 will be ring-fenced and provide security for the Credit Union in the event that there is a default in the repayment of loans approved to support people to purchase household white goods and electrical items. The Credit Union will not be able to use this £50,000 funding to issue as loans; the Credit Union will continue to issue loans from their existing membership pooled fund.

47. Prior to launch of the scheme, a reporting mechanism will be agreed between the Council and the Credit Union which will need to monitor and detail the number of loan applications approved under this proposal, the value of the loans approved, the value of the outstanding debt and the amount of debt that has/may be subject to write off.

48. The Council is able to use existing general powers to take steps to fund initiatives which it believes will benefit the area whether or not these form part of the Council's core obligations. Tackling poverty and the causes of poverty is a legitimate reason for providing financial support. The precise details of the arrangement will be agreed with the Credit Union and will be designed as far as possible to protect the Council's investment. The Credit Union already have measures in place to avoid exposure to risk which will be applied to the scheme some of which are highlighted in the report. In the event that the scheme becomes viable without the financial backing of the Council a decision will be made between the Credit Union and the Council as to how the remaining sum can be re-applied to support other initiatives designed to tackle debt and high cost lending or returned to the Council.