Escaping the subprime trap:
Lessons from auto-lending to refugees on the fast track to economic integration

Rescue.org/FastandFinanced

“[The IRC’s] lending shows that resettled refugee finances are already a safe bet and can be even better with the right support... For refugees, a car means better access to jobs, a larger network, education opportunities, and a greater ability to integrate into American communities faster than before.” - *Kasra Movahedi, Director of IRC’s Center for Economic Opportunity*

Like low-income working families across the United States, newcomers to this country need cars to get jobs and to keep them. Acquiring a needed vehicle can be a major hurdle for refugees from conflict zones, who arrive with little savings or assets, and with no credit history to access the marketplace. While refugees quickly find jobs in the U.S., their access to reliable transportation can have outsized influence on their economic wellbeing. In surveys of over 200 refugees conducted by the International Rescue Committee (IRC) in San Diego, access to reliable transportation was consistently cited as the second largest barrier to getting a job after English language ability. And yet, without a credit history, refugees’ options for financing a vehicle are often limited to the subprime loan market, which is characterized by exorbitant interest rates and lengthy loan terms likely to cause strain on family budgets.

The interconnected challenges of living paycheck-to-paycheck, and needing reliable transportation - yet being limited to financial products that are only tenuously within your means - are not limited to refugees. In December 2016, the New York Federal Reserve reported[1] that over 6 million Americans were more than 90 days delinquent on their auto loans, with nearly all of the delinquencies coming from the booming subprime auto loan market.

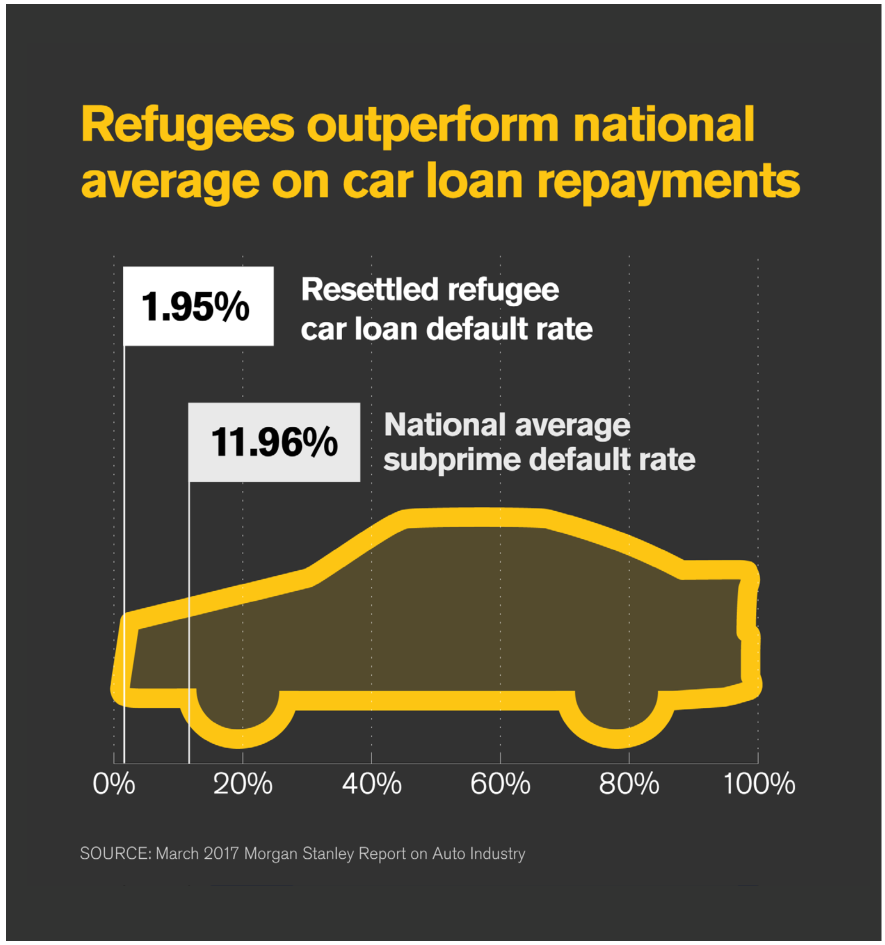
As of the first quarter of 2017, fully 20% of the entire U.S. auto financing market consisted of subprime borrowers – generally defined as having a FICO credit score below 640, and likely to be members of low-income households[2]. The financial burden of a subprime auto loan for families living on thin margins is significant; the average subprime loan is made at 16% annual interest and requires a $381 monthly payment over an average of 61 consecutive months[3]. Any missed payments are likely to result in steep fees, increased interest rates and, ultimately, repossession. Compounding matters, vehicle repossession

1 Quarterly Report on Household Debt and Credit New York Federal Reserve Center for Microeconomic Data,
Q3 2016

2 Value Penguin summaries of data from FICO, Fed Reserve

3 Experian Q1 2017 Automotive Quarterly Webinar

FARHAD YAQOOBI WAS RESETTLED IN SAN DIEGO AS A REFUGEE FROM AFGHANISTAN. THE 24-YEAR-OLD BORROWED $7,500 FROM AN IRC AUTO LOAN PROGRAM TO PURCHASE A CAR. PHOTO: ANDREW OBERSTADT/IRC is likely to undercut a borrower's ability to continue to earn income and often precipitates a catastrophic downward financial spiral. There is a growing chorus of voices expressing concern that the current subprime auto loan market represents a macro-risk to the overall U.S. economy. And yet despite the clearly detrimental effects on borrowers and communities, demand for subprime auto loans continues to rise – a stark reminder of how fundamentally essential reliable transportation is to low-income families.



The IRC – a leading humanitarian organization that helps people whose lives are shattered by conflict to recover and regain control of their future – makes economic stability and wellbeing a critical outcome for the families it serves. To this end, the IRC works to ensure clients are able to enter the workforce, and the agency is proactive in addressing barriers to support timely employment.

The severe lack of affordable financing options for refugees and those with similar financial profiles led the IRC's San Diego office to begin filling the gap by directly making loans. Based on seven successful years making small business loans to refugees, the IRC in 2010 launched an auto loan product to help refugees access jobs that are hard to reach by public transportation. Since then the IRC has piloted a variety of additional loan products, with demand steady and results – including loan repayment –consistently solid.

In recognition of the tremendous benefit of connecting refugees to accessible, affordable loan products, the IRC spun off a subsidiary financial services organization called the Center for Economic Opportunity (CEO) to manage its lending activity at a greater scale in 2011. Since Oct. 2016, CEO has disbursed just under 400 loans in 4 cities totaling $900k in financing. CEO provides participants in the IRC's economic empowerment programs with access to affordable loans, and is so far actively lending through four IRC offices in three states – with further expansion planned throughout 2018. With the experience of over 150 auto loans totaling just under $850,000 disbursed primarily to "subprime" refugee borrowers, the IRC and CEO have successfully helped borrowers overcome transportation barriers without putting their families' economic wellbeing in jeopardy.

By virtually every metric, these low-income refugee borrowers and the IRC's auto loan portfolio have significantly outperformed the national subprime industry. Consider, for example, that while the national subprime auto loan 60-day delinquency rate is 5.07%[4], the IRC's portfolio has 0% 60-day delinquency. Similarly, the IRC and CEO's auto loan portfolios have a combined historical default rate of 1.95%, which is well below the national average of 11.96%[5] for subprime auto loans.

What might explain why these refugee subprime borrowers outperformed the national averages for similarity situated borrowers? Below are learnings gleaned through over 14 years of experience that the IRC and CEO have garnered making loans to subprime borrowers. They may shed light on how to meet the need for low-cost credit among low-income families without putting these borrowers at heightened financial risk.

---

4 "U.S. Auto Loan ABS Tracker: January 2017," from S&P Global Ratings. Accessed July 17, 2017.

5 March 2017 Morgan Stanley Report on Auto Industry

4 reasons why refugee subprime borrowers are outperforming the national average

1

Refugees are better borrowers than their credit scores may suggest. Refugees, like other immigrants, arrive in the U.S. with no credit score and little understanding of how critical this score is to their financial future here. Unaware of the consequences and due to their inexperience, some may make initial missteps that can hurt their credit and haunt them for many years afterward. Yet, the IRC has seen that refugees consistently repay their loans at a rate that exceeds their credit profiles would suggest. The IRC's auto loans are its best performing loan products. But a review of the IRC's entire history of lending, which covers over 3,000 loans and nearly $3 million in financing, primarily to refugee borrowers, reveals a default rate of only 6.5% – and still exceeds the 11.96% subprime auto loan national default rate. The IRC's data suggests that the U.S. credit scoring system is overly conservative in assessing the credit-worthiness of refugees and other new Americans.

2

Underwriting due-diligence matters. Recent reports have revealed that one of the nation's largest subprime auto lenders, Santander, verified income on only 8% of all of its subprime auto loans. By contrast, the IRC requires not only income verification, but a meeting with a financial coach, financial education training, and a completed family budget as part of our loan making. This personalized review of the potential borrower's situation – even for modest loan sizes – leads to careful decisions about readiness to take out the loan. The IRC helps borrowers plan for the loan and aims to set them up for success. By contrast, many subprime auto loans are being made with shockingly little due diligence. Given the unabated growth in size and number of actors in the subprime auto loan market, one can readily question whether the real business model is predicated on loan repayment margins, or if it is actually organized around borrowers defaulting and vehicles being repossessed and resold over and over again. Low-income families need greater protection from loans that undermine rather than bolster their financial footing.

The below table offers a quick comparison of key metrics between IRC's auto loans and figures of the national subprime auto loan industry, and underscores how much more viable an auto loan from a non-profit can be for low-income families:

METRIC	IRC AUTO LOANS	NATIONAL SUBPRIME AVERAGE
Average Interest Rate	**9%**	**16.48%**
Average Term	**42 Months**	**61 Months**
Average Loan Size	**$5,571**	**$16,026**[4]
Average Monthly Payment	**$162**	**$381**[4]

3

Embedding loan products in other financial capability services yields results. All of the IRC's lending is implemented alongside financial education and other economic empowerment programs. For example, participants in financial education training are eligible to apply for credit-builder microloans, while those engaged in workforce programming - employment-focused, skills-building programs - are able to apply for auto or education loans. This helps to ensure that these borrowers have access to additional wealth-building services in parallel with their loan – creating a synergy that fuels borrowers' financial stability and enhances their ability to repay. This integrated model has proven to be successful for refugees. With a few tweaks it may become a model that can yield compelling outcomes for other low-income populations. To this end, the IRC and CEO are actively seeking partnerships with other social service providers to pilot expansion of our model to address the financing needs of a broader swath of low-income families.

4

There is a dearth of socially-minded consumer financing in most communities. While hard data on the availability of non-profit lenders that offer consumer or auto loans is hard to come by, it is generally accepted that the vast majority of socially conscious lending capital is focused on commercial loans to small businesses. Consumer and auto loans are typically smaller amounts and come with greater regulatory constraints, and thus offer less margin for lenders. Only a limited handful of organizations offer consumer loans to their clients, either directly or through partnerships, and even fewer offer auto financing. A lack of non-profit actors in the auto loan sector may, in part, have helped to fuel the surging national demand for subprime auto loans. Simply put: a personal vehicle is crucial to getting and keeping a job, and low-income consumers are all but forced to accept whatever financing they are offered – even if it ultimately makes their financial circumstance more precarious.

The results of the IRC's research suggest that expansion of socially-minded consumer financing paired with financial education, and other asset-building programs, could help more low-income families achieve financial stability and at the same time reduce the risks the current subprime auto loan market represents to the overall U.S. economy. Rescue.org/FastandFinanced

FRONT/BACK: FARHAD PAYS BACK $190/MONTH FOR HIS AUTO LOAN. IN LESS THAN A YEAR, FARHAD HAS LEARNED ENGLISH, STARTED A JOB AND IS STUDYING TO BECOME A DENTAL ASSISTANT. PHOTO: ANDREW OBERSTADT/IRC

The International Rescue Committee responds to the world's worst humanitarian crises, helping to restore health, safety, education, economic wellbeing, and power to people devastated by conflict and disaster. Founded in 1933 at the call of Albert Einstein, the IRC is at work in over 40 countries and 28 U.S. cities helping people to survive, reclaim control of their future and strengthen their communities.

New York
122 East 42nd Street
New York, NY 10168-1289
USA

From Harm to Home | Rescue.org

INTERNATIONAL RESCUE COMMITTEE