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COMMUNITY CREDIT LAB

CONCEPT NOTE

RYAN GLASGO & SANDHYA NAKHASI

255 S King Street, Seattle, WA 98104

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Background

This concept note is the result of a research effort combining desktop research, phone calls, and conversations with over one hundred stakeholders from nonprofits, community based organizations, community development financial institutions, credit unions, the public sector, foundations, investors and corporations in King County. Although Community Credit Lab's strategy will continue to evolve as we seek to adapt to gaps and collaborate across stakeholder groups, this Concept Note is meant to provide an overview of Community Credit Lab's trajectory based on our learnings to date.

During the course of this research, the progression of questions we began with and iterated to end on were:

I. What are the barriers to economic equity for underserved communities in King County?
II. How does access to credit play a role as a barrier to economic equity?
III. Can credit play a better role to remove barriers to economic equity?

Introduction

During the course of our conversations with nonprofit and community based stakeholders, many root causes to economic inequality began to emerge with two recurring themes materializing consistently as most relevant:

I. Lack of access to affordable credit
   a. The most poignant example of this was a conversation with a prominent organization focused on newly arrived refugees and immigrants that had recently surveyed key members of their relevant focus communities on what they considered missing to support their ability to flourish economically. The number one response was 0% interest loans.

II. Lack of connectivity across community networks
   a. Conversations frequently alluded to or explicitly reiterated the detrimental effects to underserved communities of segregated networks across geographic and socioeconomic lines.

Based on the above factors, we continued to explore and analyze these root causes in order to gain a better understanding of economic inequity, not just in King County, but nationally.

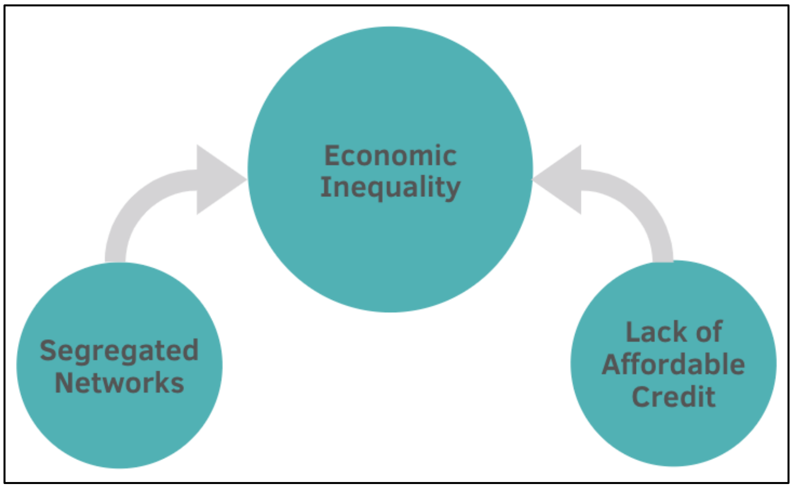

Figure 1: Core Root Causes of Economic Inequality[1]

Problem Analysis

Summary

- People with less resources pay more to access credit
- Network silos decrease the ability to leverage affordable resources and social capital
- In combination, both of the above lead to continuous exacerbation of inequality

Overview

The fact that people with fewer resources pay more to access credit is a major contributing factor to economic inequality. Higher interest rates and increased fees are barriers to economic equity that ultimately lead to increased disparities and a cycle of inability to establish a sound footing on the ladder of economic prosperity. This fact is particularly true for communities that are subject to discrimination or newly arrived in the United States, specifically refugees, immigrants, and minority resident communities including Black, Asian, Native and Latinx communities.

In King County, economic momentum has led to outsized prosperity for many residents and continues to draw top talent to the city's leading corporate employers: Seattle is currently ranked globally as the 12th best positioned city for long term success and only one of two cities globally that are best positioned for long term success with short term momentum.[2] Unfortunately, when viewed from a different lens by racial division, it becomes clear that prosperity is neither a short or long-term opportunity for many community members under existing conditions:

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[1] Source: based on consolidated conversations and research

[2] https://www.visualcapitalist.com/chart-the-30-cities-best-positioned-for-long-term-success/

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Figure 2: King County Median Income by Race[3]

Based on the King County Office of Economic Development's analysis, the only race with a median income above the average is white with average median income of $89,537, otherwise significant economic disparities across racial lines are clear. Based on our conversations and research to date, in addition to core root causes of network segregation and lack of access to affordable credit, root causes for this disparity in King County include discrimination and systemic exclusion from equitable access to employment, housing, healthcare, transit, and other resources.

"When people are grouped or segregated on the basis of a characteristic like social class, race, or religion, it affects the resources and social capital that are available to them."

- *Claude M Steele, Whistling Vivaldi[4]*

Access to resources and affordable capital to remove barriers to economic equity is not easy to come by: historical credit evaluation methodologies and analysis of cost versus benefit when rolling out financial products to serve communities. With respect to accessing credit, historically our financial systems have been predicated on five standards of evaluating credit worthiness (known as the "5 C's of Credit"):

- **Character -> general trustworthiness of the borrower**
  - Those historically responsible for making the determination of trustworthiness have not been individuals from marginalized communities.

[3] King County Office of Economic Development (2013-2017 data) & http://livingwage.mit.edu/counties/53033
[4] Steele, C. M. (2010). ''Whistling Vivaldi and Other Clues to How Stereotypes Affect Us''. New York, NY: W. W. Norton & Company.

- As a result, this evaluation method has allowed for and reinforced subjective discrimination based on differences such as physical attributes, language skills and sexual orientation.

- **Capacity -> ability to support debt repayment**
    - Individuals historically deemed untrustworthy by traditional financial systems and institutions were and continue to be pushed to alternative lenders with predatory rates.
    - These extractive rates place immense pressure on individuals that already are in precarious financial positions, causing defaults that impact credit history and cycles of indebtedness that limit the ability to accumulate savings.
    - Without savings and the ability to accumulate wealth, individuals are unable to show that they have the capacity to support debt payments.

- **Capital -> amount of personal investment**
    - Traditional lenders require individuals to show that they have and can put in their own capital to supplement a loan – to have "skin in the game."
    - Without being able to access credit at reasonable rates, it is difficult for individuals to save and build wealth over time and reinvest in themselves, their organizations, their families and friends.

- **Conditions -> economic, regulatory and industry trends that can impact the financial stability of an individual or business**
    - Systemic exclusion from traditional means of obtaining credit have hindered marginalized individuals' and communities' ability to build wealth and savings that could mitigate concerns around weathering economic changes, adapting to shifting regulations and industry trends.
    - Without a safety-net, it is harder to make the case that an individual or an organization will be able to adapt to unexpected changes.

- **Collateral -> assets that can be pledged as security**
    - Without the ability to save and build wealth, individuals that have faced exclusion, discrimination and have been forced to take on obligations with predatory rates do not have collateral that can be pledged to secure loans.

Without additional considerations, the above criteria perpetuate negative cycles for communities: historically marginalized communities have been excluded from traditional means of obtaining affordable credit and as a result are charged a premium in the form of higher interest rates and fees based on perceived risk.[5]

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[5] The Poor Pay More by David Caplovitz

Many financial institutions and other stakeholders are currently working to think differently about what additional considerations would be viable to assess credit and support underserved communities. As a result, alternative evaluations are expanding to include rental and other bill payment analysis, foreign credit analysis in countries of origin, informal lending and repayment analysis using community based lending circles.

Lending strategies are also evolving to accommodate a spectrum of borrowers and recent lending that may seek to support borrowers if implemented with their needs at the core include alternative forms of collateral, revenue-based financing

Without the desire or ability to evaluate or lend using modern techniques, traditional risk versus return analysis often leads to increased interest rates that limit the ability of communities with fewer resources to build wealth in the longer term. When used as standalone evaluation, traditional techniques may lead to negative feedback loops where each factor contributes detrimentally to the next in ongoing cycles of exclusion:

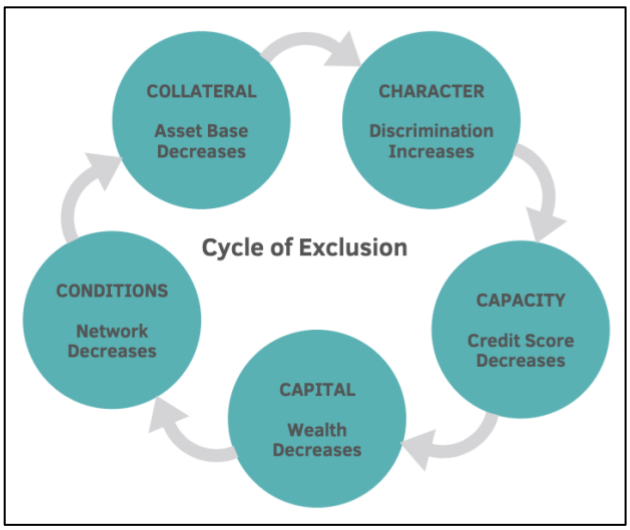

Figure 3: 5 C's of Credit (a.k.a. Cycle of Exclusion)

In practice, this analysis of perceived risk versus financial return leads to required interest yield curves that increase as traditional scoring methods of credit evaluation decrease. Per the chart below, as average FICO Credit scores decrease from 850 to 500, average consumer auto loan interest rates increase in from 3.6% - 15.24%.

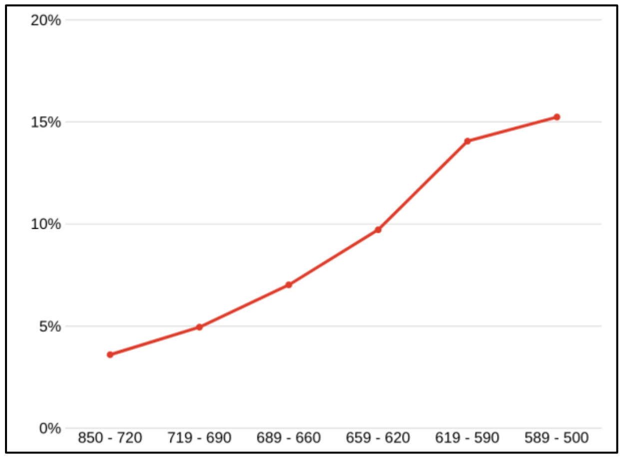

Figure 4: Average Consumer Auto Loan Interest Rates by FICO Credit Score[6]

Credit scores are not solely behavioral – they are inherently linked to a borrowers' cost of borrowing. The higher the cost, the lower the likelihood of timely payments. Therefore, as cost of borrowing goes up, the ability to repay goes down. This negative cycle of credit is particularly exacerbated for marginalized communities: according to the Office of the Inspector General, low-income communities typically pay as much as 10 percent of their total income just on fees for financial services.[7]

Under the assumption that communities with lower median income will also have lower credit scores on average, it's possible to overlay median income with consumer interest rates based on credit score. When viewed in tandem, this analysis represents the core of the problem Community Credit Lab was established to work in collaboration on: communities with lower resources pay more in interest.

[6] Source: Value Penguin - average auto loan interest by FICO scores
[7] United States Postal Service Office of the Inspector General. (2014). Providing Non-Bank Financial Services to the Underserved. Arlington, Virginia: Office of the Inspector General of the United States Postal Service, January 27. https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-14-007_0.pdf

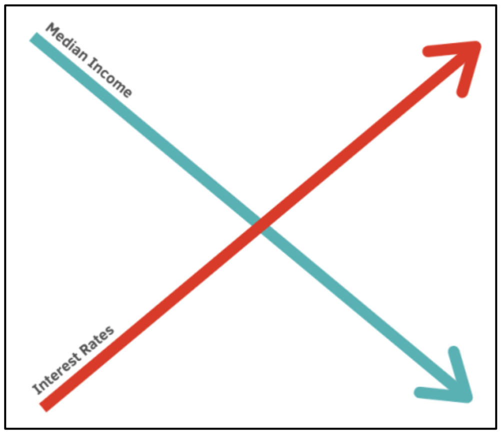

Figure 5: Interest Rates Relative to Income

In addition to excess cost of capital, based on our current understanding segregated networks are the second primary inhibitor to economic equity. Networks provide employment referrals, co-sign on credit applications and mortgages, invest in friends and families, and provide support relevant to economic capacity. As networks become increasingly limited or confined to groups with lower resources, equitable opportunities to access capital decrease as well.

"Opportunity travels along the synapses of social networks."
– Glenn Loury, The Anatomy of Racial Inequality[8]

In King County, divided networks are highly visible purely based on geographic residence. Intuitively, residents are aware that communities are often segregated based on income, race, religion and other socioeconomic factors. In practice, these geographic silos perpetuate social silos, network silos and economic silos: without cross pollination between communities it is difficult to learn from each other, empathize with one another and support each other to achieve economic equity. Per the mapping by foreign born populations below, networks are clearly visible across community lines based on country of origin.

[8]Loury, Glenn (2002). The Anatomy of Racial Inequality. Cambridge, MA: Harvard University Press. *ISBN 978-0-674-00625-6*

Figure 6: Segregated Network Examples in King County[9]

This segregation is not unique to King County: in order to rearrange most U.S. cities so that race played no role in where people lived, you would have to move 85 percent of the black population. People have a physical location in society that correlates directly with socioeconomic opportunity, both historical and present day.[10]

As we continued to understand and reflect on the above situation and core root causes that inhibit economic equity (access to affordable credit and network silos), three primary concepts become embedded in our thought process and ultimately informed the design of our solution:

I. The necessity to keep underserved communities at the center;
II. The necessity to provide affordable credit
III. The necessity to leverage resources across networks

In addition, two primary constraints continue to evolve on an ongoing basis and will continue to inform the concept for Community Credit Lab:

[9] Source: Balk, Gene. A spike in King County foreign-born populations. Seattle Times. October 5, 2015.
[10] Steele, C. M. (2010). ''Whistling Vivaldi and Other Clues to How Stereotypes Affect Us''. New York, NY: W. W. Norton & Company.

I. The necessity to develop a model that can either return capital or provide financial returns to investors (based on current conversations with investors)
II. The necessity to develop a model that can work towards achieving financial sustainability independent of grant funding on an ongoing basis (based on current conversations with philanthropic funders)

Solution

Vision: economic equity for communities excluded from prosperity in King County
Mission: support underserved communities to access affordable credit in King County

Institution Type	Solution	Interest Rate
Nonprofit Corporation – 501(c)3 status pending	Loans designed in partnership with nonprofits to remove barriers to economic equity	0%

Community Credit Lab aims to partner with nonprofits, community based organizations, corporates, funders and investors to remove barriers to economic equity by providing affordable consumer credit.

Structurally, Community Credit Lab will be a nonprofit entity focused on designing 0% interest consumer credit products that remove barriers to economic for underserved communities in King County. These products will be designed in partnership with nonprofits and community-based organizations and will seek to address specific challenges as identified by these partners across education, healthcare, workforce development, food security, housing security, and socioeconomic stability.

Strategically, Community Credit Lab will adopt a partnership-based model to design consumer credit products based on removing barriers to economic equity for underserved communities with the following inputs, outputs and desired outcome:

1) ***Inputs:*** Community Credit Lab's model will be built upon conceptual inputs from nonprofit partners, investment inputs from impact investors, and philanthropic inputs from grant funders in order to allocate resources in partnership to underserved communities in King County.

2) ***Outputs:*** Community Credit Lab's primary outputs will be identified and developed in partnership with nonprofits and dependent on specific products and barriers to be removed. Secondary outputs will include capital to be returned to impact investors, transparent learnings and credit score improvements for underserved communities to access follow-on, affordable financial products via other financial institutions.

3) ***Outcome:*** Community Credit Lab's ultimate desired outcome is economic equity in King County. This is a long-term goal that cannot be achieved or attributed to a standalone entity and there are many organizations that have been and will continue to seek this outcome in collaboration. Community Credit Lab desires to join this movement of organizations in order to fill systemic gaps and support the removal of barriers to economic equity as identified by existing organizations and partners.

Components:

1) **Lending –** Lending will focus on building new relationships with prospective nonprofit partners, workshopping their existing pathways to understand whether affordable credit can play a role to remove barriers to economic equity, qualifying prospective borrowers, lending funds via affordable consumer loans, and servicing existing loans in collaboration with Counseling.

2) **Counseling –** Counseling will work directly with prospective borrowers to assess existing financial literacy, improve financial literacy (if needed) and package the case for borrowing to Lending. Although Lending will assess readiness of borrowing, Counseling will manage the relationship in perpetuity based on pre-existing trust and personal relationships.

3) **Leverage –** Leverage will work across networks to identify and source resource in partnership with philanthropic funders, investors and other ecosystem stakeholders working to achieve economic equity in King County. Leverage will also manage a grant funded pool of capital available to disburse in order to attract investment partners to participate in products that are traditionally perceived as higher risk via guarantee structures or similar incentive structures.

4) **Operations –** Operations will be the backbone of Community Credit Lab: compliance, accounting and finance will be integral to the success of our organization and our borrowers, especially those without existing credit or with low credit scores. Operations will manage functions related to IT, accounting, reporting of loans to credit bureaus to increase credit scores of borrowers, human resources and administration.

Phase 1: Partnerships to Remove Barriers to Economic Equity

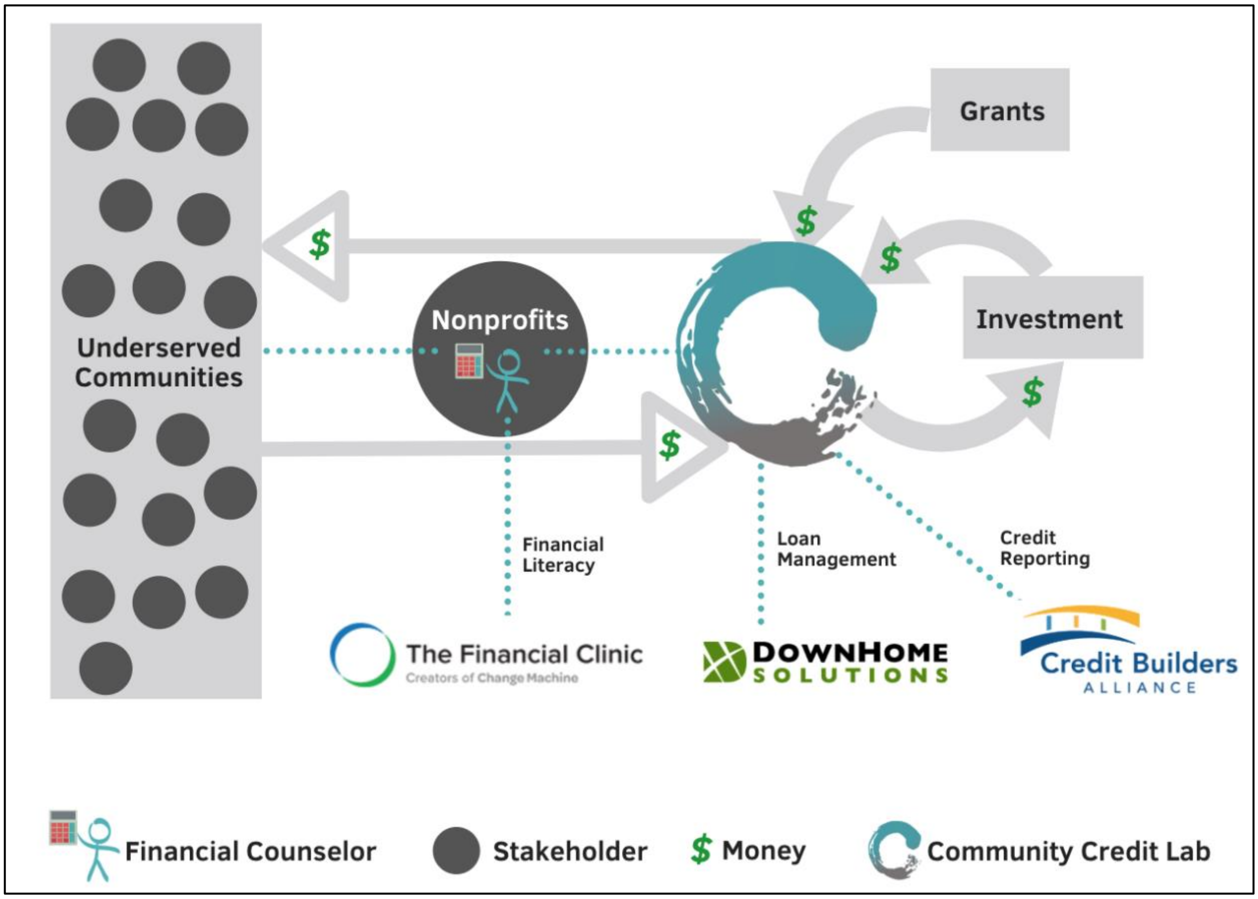

Figure 7: Partnerships to Remove Barriers to Economic Equity

Phase 1 will be focused on identifying partnership opportunities to remove barriers to economic equity using affordable consumer credit. Partnerships will be based on mutual trust and desire to achieve a shared goal for underserved communities. Community Credit Lab will seek to follow up with and identify additional nonprofit partners closely connected to the needs of underserved communities in King County.

If there is potential to remove barriers to economic equity in partnership, Lending will facilitate workshops in order to fully understand the pathways that prospective nonprofits facilitate, where barriers exist and whether affordable consumer credit may be the best intervention to remove those barriers.[11]

If there is alignment around a shared goal and agreement that consumer credit would be a productive goal, Counseling will pilot the concept by imbedding a Financial Counselor on a rotational basis within the nonprofit partner. Financial Counselors will be employed by

[11] Note: Our first workshop was piloted the week of July 12, 2019

Community Credit Lab, but engaged 100% with nonprofit partners and respective underserved communities. Nonprofit partners will facilitate the intervention through:

I. Building applicable and affordable credit based interventions into existing pathways
II. Making light touch referrals to Financial Counselors
III. Sharing insight into the efficacy of partnerships from the perspective of communities

Financial Counselors will have a comprehensive understanding of the pathways of nonprofit partners (from experience during workshops) in order to engage and manage relationships with prospective borrowers productively. Products will be piloted based on removing barriers across these pathways and Financial Counselors will have an inherent responsibility to underserved communities and nonprofit partners.

Affordable credit-based interventions will not be the only necessary components: prior to disbursement of loans, financial literacy assessment and coaching will be essential components to the role of the Financial Counselors. As underserved communities should remain at the heart of interventions, any disbursement without a comprehensive understanding by the borrower would put them at risk, both financially and reputationally. Careful consideration, assessment and coaching will be taken prior to entering into a loan agreement with prospective borrowers. Assessment and coaching will be managed in partnership with an existing financial literacy content provider, the Financial Clinic, via their financial literacy coaching tool, Change Machine.[12]

Change Machine functionality allows for three core components designed to benefit underserved communities:

I. Bespoke financial literacy content relevant to needs of each potential borrower (over 160 worksheets and tip sheets available);
II. Transparent coaching plans that can be tailored depending on the relevant consumer loan products;
III. Text based communication management to communicate with prospective and existing borrowers in between in person consultations.

Once Counseling signs off on the readiness of a prospective borrower, Lending will assess the readiness of the borrower using the loan application developed by Counseling and other metrics as applicable (to be continuously developed and approved). These metrics may include: existing savings, outstanding debt, financial literacy capacity, credit score (if applicable), payment of rent and bills, and any other relevant factors at the discretion of Lending.

Lending will disburse 0% interest consumer loan funds via ACH transfer (if the borrower has an existing bank account) or via partnerships with Credit Unions (to establish a bank account prior

[12] Subject to ongoing assessment

to disbursement).[13] Once disbursement has occurred, Counseling will continue to maintain the relationship with the borrower to confirm funds have been received and the use of funds. Repayment terms will be designed in collaboration with Counseling to ensure the borrower receives feasible lending terms designed to remove barriers to economic equity rather than add to them.

Operations will manage the tracking and reporting of loans to credit bureaus to ensure borrowers are able to establish or improve credit scores. Tracking will be done in collaboration with Downhome Solutions, a Seattle based provider focused on loan management software for community development with over 200 nonprofit community based lenders.[14]

Based on initial analysis, Downhome Solutions' offering will provide three key benefits:

I. Loan management and portfolio analysis
II. Conversion to Metro II format for reporting purposes to Credit Bureaus
III. Direct integration into QuickBooks for accounting and financial reporting purposes

Credit reporting will be done in partnership with the Credit Builders Alliance[15], a national nonprofit organization with over 500 members focused on supporting underserved communities to build credit and access affordable capital.

Lending will service the loans in collaboration with Operations and Counseling. Borrower relationships will be maintained by Counseling and any repayment issues will be communicated by Lending and Operations to Counseling. Counseling will then recommend the best approach to support the borrower.

Funds will be returned via ACH transfer or other methods based on feedback from nonprofit partners and borrowers. Community Credit Lab is currently exploring partnership opportunities with alternative remittance providers and any remittance partnership opportunities will be assessed in collaboration with community based nonprofits. Community Credit Lab will return funds to investors based on mutually agreed terms.

In order to leverage resources across networks, Leverage will work to collaborate with philanthropic funders and investors. Based on initial conversations, Leverage will plan to include designated funds via a "Leverage Fund" with the following potential strategic components:

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[13] Community Credit Lab is currently exploring partnerships with three regional Credit Unions and will plan to vet any and all partnership decisions with nonprofits and underserved communities
[14] Subject to ongoing assessment
[15] Subject to ongoing assessment

I. *Guarantees:* The ability to disburse guarantees to impact investors that require security on their capital given the perceived risk and untested products that Community Credit Lab seeks to deploy – based on initial discussions, this incentive will be utilized during both the pilot phases and scaling up phases of products;

II. *Working Capital:* The ability to disburse working capital loans to prospective and existing nonprofit partners that receive grants via reimbursement and have limited financial capacity as a result of these funding relationships. Based on initial conversations, working capital 0% interest loans to nonprofits (particularly, smaller community based organizations) may be a productive tool to unlock short term capacity for partnership.

Phase 2: Partnerships to Provide Access to Affordable Financial Products & Services

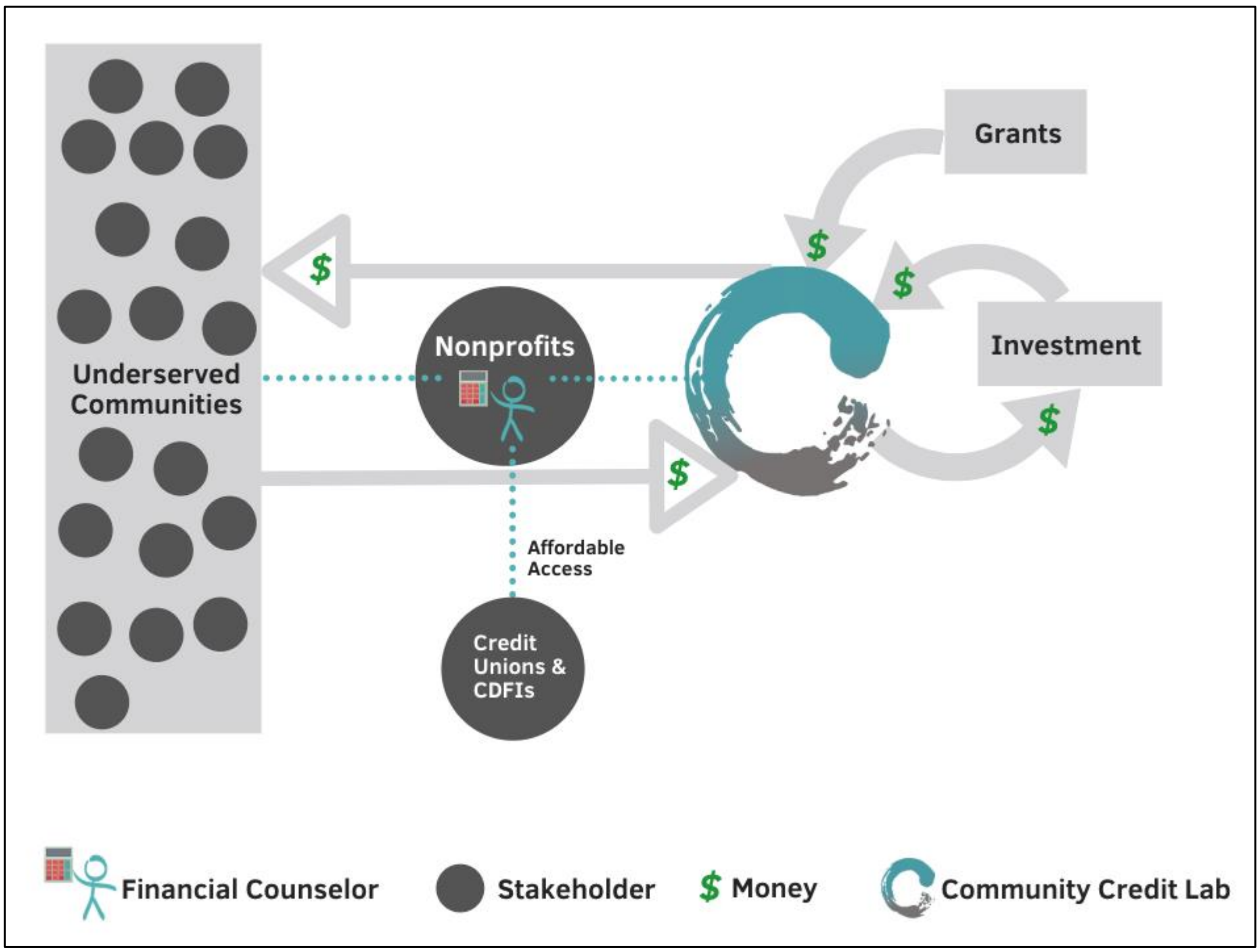

Figure 8: Phase 2 - Partnerships to Provide Access to Affordable Financial Products & Services

In the medium term, Community Credit Lab will seek to establish partnerships with financial institutions (including banks, Community Development Financial Institutions (CDFIs) and Credit Unions) in order to facilitate access to affordable external financial products and services for underserved communities. Rather than replicate existing products or services, Community Credit Lab seeks to facilitate access to existing affordable financial solutions for communities. Conversations with potential CDFI and Credit Union partners are ongoing.

Example partnerships to provide access to affordable financial products and services may include:

i. Partnerships to establish bank accounts at Credit Unions for underserved (and unbanked) communities;
ii. Partnerships to facilitate access to affordable consumer financial products offered by Credit Unions designed for underserved communities;
iii. Partnerships to facilitate access to affordable commercial financial products offered by Credit Unions and Community Development Financial Institutions;
iv. Partnerships to design new community oriented products and services with Credit Unions and Community Development Financial Institutions;
v. Partnerships to develop, design and implement financial literacy curriculum and training programs with banks, Credit Unions and Community Development Financial Institutions.

In order to ensure that underserved communities are well prepared to enter the financial system, it will be integral to continually assess (and, if applicable, improve) financial literacy, economic stability and credit. Community Credit Lab will seek to facilitate access to external financial products and services only if and when terms are affordable for underserved communities. Partnerships with financial institutions that seek to provide external financial products and services designed to improve the credit of communities with affordable terms and accessible service offerings will be prioritized.

The role of the Financial Counselor will remain at the core of this ongoing assessment and facilitation to ensure that people do not leverage themselves beyond what they can afford or fall prey to predatory lenders and institutions that do not keep community needs at the center. Prior to establishing partnerships with financial institutions, Community Credit Lab will seek to assess the trust and motivation of financial institutions from the perspective of underserved communities and existing nonprofit partners established during Phase 1.

Community Credit Lab will also seek to facilitate access to other existing financial products and services offered by other nonprofits and community-based organizations, as applicable. Based on research and conversations to date, these partnerships may include facilitating access to 0% interest lending circles, 0% interest immigration loans and affordable commercial loans.

Phase 3: Partnerships for Sustainability

In the longer term, Community Credit Lab may seek to explore strategies that allow for financial sustainability and below market rate investor returns without sacrificing mission. Community Credit Lab will not explore strategies that seek to extract from communities with products that target above market rate returns. At this stage, several conceptual ideas on how to establish financial sustainability and provide minimal returns to investors are in discussion. The potential for these partnerships is to be continually explored and determined at a later date, rather than prioritized in the near term.

Stakeholders

i. **Underserved Communities:** our core stakeholders will be individuals and people from communities that that have been excluded from prosperity in King County;

ii. **Nonprofits:** our most trusted partners will be organizations that work directly with underserved communities;

iii. **Philanthropic Funders:** partners that seek to support initiatives related to economic equity in King County will be essential, particularly in the short term while piloting;

iv. **Impact Investors:** Foundations, values aligned individuals and impact investing groups with a focus on economic equity in King County will ideally be partners to pilot, seed and scale lending products;

v. **Financial Institutions:** Banks, Credit Unions and CDFIs will be prospective partners to collaborate for additional financial products and services;

vi. **Government:** Public sector partners will be integral thought partners for cross learning and enacting structural changes in collaboration with other nonprofits;

vii. **Other:** Other stakeholders include corporates, fiscal sponsors, service providers, financial advisors, coalitions, networks, and King County community members – opportunities for collaboration with these stakeholders are to be continually evaluated and adopted strategically.

Team

Ryan Glasgo (COO): Ryan is the co-founder of Community Credit Lab and most recently the CEO of Tondo Foundation (a private foundation focused on identifying, funding and partnering with organizations that seek to address community socioeconomic needs). He began his career in public accounting with KPMG and continued to work in financial advisory, business management and investment management before transitioning to work in philanthropy, development finance and impact investing across Canada, Southeast Asia, the UK, West Africa, the Middle East and the United States. Ryan is a Certified Public Accountant (CPA) with a Bachelor's of Accounting from McGill University and a Master's of Business Administration (MBA) from the University of Oxford.

Sandhya Nakhasi (CIO)*:* Sandhya is the co-founder of Community Credit Lab and most recently the Investment Manager at Tondo Foundation. In her career to date, she has worked at public, private and non-profit financial institutions including Freddie Mac, Capital One and Coastal Enterprises, Inc. where she developed her expertise in credit analysis, portfolio risk management and portfolio operations. Prior to joining Tondo Foundation, she used her expertise to build out underwriting and portfolio-management systems and processes that enabled data-driven decisions at Lighter Capital, a financial technology start-up focused on small business lending. In 2018, she joined Tondo Foundation to support the design and implementation of both direct and indirect-investing strategies in Southeast Asia.

Sandhya has a Bachelor's of Arts in Economics from New York University and a Master's of Business Administration (MBA) from the University of Michigan.