

Getting Off the Payday Loan Treadmill

Payday loans have gotten a lot of attention recently. They can carry astronomical interest rates. They can saddle people with debt.

But payday loan companies have grown rapidly in lower income communities because they meet people's need for emergency cash. The *Making Connections* Louisville Network is working with local partners to find a better, lower-cost way to meet this need while making Louisville's financial system more responsive to lower-income neighborhoods.



All you need to get a payday loan is a bank account and proof of steady income.

BY LAURA CRAWFORD

“What we learned was that relatively low amounts of very high interest debt was keeping folks from reaching their savings goals. Their credits scores were affected. They didn’t qualify for home mortgages.”

— Jane Walsh

In Louisville, the *Making Connections* Network is working with Republic Bank and Trust Company and the Louisville Urban League on a pilot program called The Affordable Credit and Savings Plan. The goal is to help Network members pay off high cost debt, repair their credit and establish an emergency savings account.

Despite a clear need, very few people enrolled in this program initially. After some critical mid-course corrections, the program is beginning to yield the results the designers anticipated as well as important lessons for taking this model to scale.

It’s an all too common story. Someone working a low-wage job gets hit with unexpected expenses – a car breaks down or a child is sick and needs medication. Cash is low and payday isn’t until next week. Credit cards are non-existent or maxed out, and most friends and family members are in similar situations.

What is *Making Connections*?

Making Connections is a long-term effort in 10 cities to pull residents and institutions together to improve the lives of families living in specific low-income neighborhoods. Established in 1999, this initiative is supported by the Annie E. Casey Foundation along with many local funders.

What’s a person to do? Who can they turn to?

In many-low and middle-income neighborhoods in Louisville, chances are they just have to walk out the door and they will be bombarded with advertising from payday loan operations offering a tantalizingly simple solution.

“Get cash today! No credit check! Simple application!”

And the signs are not lying. All that is needed to get a payday loan is a bank account and proof of steady income. The applicant simply writes a post-dated check plus a “fee” for the amount needed and within hours all problems are solved.... temporarily.

For instance, if someone needs \$100, they write a check for \$115 and receive \$100. In two weeks they must either pay the full amount in cash or the money is taken from their account.

When most people take out a payday loan, they fully anticipate paying it back at the first opportunity. The \$15 fee, while extremely high (a 439% annual interest rate), seems worth it. After all, where else can someone get such fast cash?

But unfortunately, once a person gets behind, it’s hard to catch up. That next paycheck comes and all the money is quickly used. Many people find themselves asking the payday loan company to roll over their loan.

“If you just dived in and started making these loans – without counseling and a methodical way of approaching this – you would have massive losses and you would have to shut your program down.”

— Garry Throckmorton

Republic Bank and Trust’s Garry Throckmorton (here with Sharon Brunck) says every bank sees the challenge of providing bank services that can compete with payday lenders, “but talking about it and coming up with solutions are two different things.”



If the person with a \$100 loan rolls it over three times, they now owe \$60 in fees. Now “fast cash” is simply just “costly cash.”

Helping people find a new financial pathway

With years of experience working in asset development for low-income people, Jane Walsh, Family Economic Success Coach for *Making Connections* Louisville, knows the problem of “costly cash” all too well.

As the former director of the Metropolitan Housing Coalition, she witnessed firsthand the relationship between

high cost debt and housing instability. When she worked at the Center for Women and Families, she was responsible for starting the first IDA program in Louisville in partnership with Republic Bank and Trust Company. (An Individual Development Account – IDA – is a savings account that matches an individual’s contributions. The money can be used to buy a home or to invest in post-secondary education.)

When she joined the *Making Connections* Network, Walsh implemented “Network Listening Circles” to learn more about the financial concerns and realities of Network Members. She heard a familiar refrain.

“These are folks who most likely have poor credit scores so they are already deemed a poor credit risk. With this program, we’re not looking at credit score at all. So we’re not doing traditional underwriting. We’re not looking at risk at all.”

— Garry Throckmorton

“What we learned from talking with both Network Members and Network Partners was that relatively low amounts of very high interest debt – like payday loan debt – was keeping folks from reaching their savings goals and aspirations. Their credit scores were affected. They didn’t qualify for home mortgages. We wanted to find a solution to the problems of high interest debt, low credit scores and lack of savings,” says Walsh.

With a grant from the Annie E. Casey Foundation through *Making Connections* and technical assistance from the Economic Opportunities Program at the Aspen Institute, Walsh designed a pilot program that offered an affordable alternative credit and savings product to 50 Network Members.

To help execute the program, she called on long-time partners: the Louisville Urban League, known for its financial counseling expertise, and Republic Bank and Trust Company, which has consistently demonstrated its commitment to providing innovative services to low-and moderate-income neighborhoods.

For Garry Throckmorton, Community Reinvestment Act Compliance Officer at Republic Bank, the program was a natural fit. His job is to come up with innovative ways to provide credit to low-and moderate-income neighborhoods – without taking on undue risk.

“Every consumer-oriented financial organization recognizes that there is a huge

challenge in providing standard bank services which are lower cost than what the large percentage of unbanked people are accessing through fringe financial services. But talking about it and coming up with an actual solution are two different things.”



How it works

Network members with high cost debt (30% annual interest or more) apply at the Louisville Urban League. Applicants must live, work or worship in one of the four *Making Connections* neighborhoods – Smoketown, Shelby Park, Phoenix Hill or California. They must have a steady source of income. They meet with a counselor who pulls their credit report, identifies the extent of their debt and discusses their long-term financial aspirations.

“What we try to focus on is whether or not this loan is going to improve their credit – \$2750 is not going to help someone who is \$10,000 in debt,” states Kathryn Mitchell, Director of Housing Services and Neighborhood Revitalization at the Louisville Urban League.

If qualified, applicants are directed to classes which address budgeting and other financial fundamentals. Once approved, their paperwork is sent to Republic Bank and Trust Company and the member takes out a loan of up to \$2750 to be paid back over 36 months. All payments are set up as automatic withdrawals from their checking accounts. At the same time, they borrow an additional

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\$250, which is put into a savings account. *Making Connections* matches that \$250 with an additional gift of \$250 as the loan matures.

When they graduate from the program, their loan is paid off, their credit is repaired so that they can now qualify for lower interest rate loans, and they have \$500 in a savings account.

According to Republic Bank and Trust's Throckmorton, the key to the model's success is the counseling and pre-screening that the Louisville Urban League provides.

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would have massive losses and you would have to shut your program down.”

“These are folks who most likely have poor credit scores so they are already deemed a poor credit risk. With this program, we're not looking at credit score at all. So we're not doing traditional underwriting.

“We're dependent on the counselors at the Louisville Urban League to evaluate the applicant and tell us that this is a person who is seriously interested in this program and we think is a good risk. That's important to us.”

To date, not one person has defaulted on a loan or even fallen behind – a remarkable achievement by any standards.

Louisville Urban League's Kathryn Mitchell (center, with Vickie James and Kenitria Harris) says that once people get training and counseling, “it hits home that this may be the opportunity that they've been looking for to improve their credit.”



“Financial products coming out of community-based organizations are a tough sell. People aren’t accustomed to thinking of these organizations that way.”

—Jane Walsh

“By the time they go through the classes and get the counseling and it’s stressed how paying this loan off will influence their credit report, I think it hits home that this may be the opportunity that they’ve been looking for to improve their credit,” states Mitchell.

A surprisingly slow start

The partners knew it would be challenging to market the product and encourage folks to enroll in the program – they just didn’t *know* how challenging it would be.

“Financial products coming out of community-based organizations are a tough sell. People aren’t accustomed to thinking of these organizations that way. This one places enormous expectations on the part of the recipient, who has to agree to enroll in financial counseling. Plus there is the mind set that if something sounds too good to be true, it usually is. So we knew it would be hard...but this start was much, much slower than we ever imagined it would be,” says Walsh.

The program was underway for many months before even one loan was closed. How could such a clearly valuable product be so under-utilized?

After further analysis, the partners saw that they were getting a significant quantity of inquiries, but most of the callers did not qualify for several reasons:

1. They didn’t have an income.
2. They lived outside the *Making Connections* neighborhoods (initially a requirement).
3. They believed it was a grant, not a loan.
4. They had too much debt.

Two of the four issues were non-negotiables – participants had to have a steady income and the money was not a gift. It was a loan. But what about the residency requirements and the debt amount? Could those criteria be re-worked in order to increase participation?

Initially, the program offered loans of up to \$1500. This figure was selected because of existing data about the average debt load provided by the Louisville Urban League. But the data apparently no longer reflected reality. After consulting with the advisors at the Aspen Institute, the partners decided to increase the loan amount from \$1500 to \$2750. They also decided to increase the length of the loan period from 18 to 36 months and decrease the total number of participants from 50 to 37.

More importantly, they chose to open eligibility to anyone who was currently a *Making Connections* Network member and not just a resident of a *Making Connections* neighborhood – an important distinction. A Network member is defined more broadly than a resident: a member can be someone who “lives, works or worships”

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— Sharon Brunck

in one of the four *Making Connections* neighborhoods.

This product was intended to be a “value proposition” for *Making Connections* Network members – a unique benefit of membership. The team realized they needed to focus more on this as a “membership perk” in their marketing as well.

These two changes in eligibility had a significant impact on the number of people who qualified for the product, particularly when two local churches heavily promoted the program to their members.

To date, 13 Network members have closed on their loans, one loan has been paid

off, five applicants are in the pipeline and 22 members are enrolled in financial counseling even though they don’t currently qualify for the product.

“I’m here and I’ve brought my banker!”

On May 1, 2007, the first loan was closed at Republic Bank and Trust Company. The participant was a woman from the California neighborhood who owed money at three payday loan establishments. It was an exciting moment for everyone connected with the pilot.



“I thought there was a catch. There was a catch to the payday loan I got with all that interest, so I thought there must be a catch to this too.”

— Bobby Compton

“I thought there had to be a catch.”

When Bobby Compton first heard about the Affordable Credit Product, he didn't believe it could be true.

Compton had gotten himself into a jam with a payday loan and was caught on the treadmill of debt and spiraling interest payments. “I would pay and pay and still owe. It was taking my breath away.”

Despite his predicament, he was skeptical about the Affordable Credit Product. “I thought there was a catch. There was a catch to the payday loan I got with all that interest, so I thought there must be a catch to this too.”

He applied anyway at the Louisville Urban League and discovered he was eligible. He received a loan from Republic Bank and paid off his payday loan as well as some other outstanding medical debt. Now Compton has one monthly payment that feels very manageable.

“Once they decided I was eligible, everything else was easy,” says Compton.

“I didn't believe it at first, but it made a believer out of me.”

Compton estimates he has another year of payments. When asked how he will feel when he pays it off and has \$500 in the bank, he says, “That's something to look forward to – not owing anybody any money and having that account to myself.”

Yet excitement quickly turned to consternation when the client reported that the payday loan establishments would not accept the checks written to them from Republic Bank.

Throckmorton remembers, “We didn't calculate on the payday lenders not being willing to accept our checks – bank-issued checks. But they operate on a cash basis – they write a check and they get cash. The payday lender requires them to buy back that check with cash.”

“We had to void the checks...and all of this is a process internally. It's not like you or me just ripping up a check – there are all kinds of systems and other departments involved. We had to backtrack on the loan disbursement and get the checks replaced with cash.”

To be certain that the cash got in the right hands to pay off the loans, Throckmorton and his assistant, Sharon Brunck, did something unprecedented – something above and beyond what anyone would expect of them. They drove the cash directly to the payday loan companies and paid them in person.

Throckmorton laughs as he recalled the scenario. “We would pull up to a payday lender or pawnshop. I would park outside and wait for Brunck, who had the cash. She would go in with the client and they would do the transaction.”

“And here I am in front of a payday lender or pawn shop just sitting in a car not doing anything. We raised the eyebrows of

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some of the merchants there thinking that something might be up. They’re sensitive to robberies – they deal in cash. I had one guy look me up and down for several minutes. It seemed like it took forever for them to get this done.”

Throckmorton’s and Brunck’s willingness to stretch the boundaries of protocol on behalf of this first loan is a testimony to their commitment to the project.

Throckmorton states frankly, “Banks don’t disburse loan funds in cash and we don’t drive around and pay vendors in cash. We had to do it somehow. We were committed to doing a loan.”

Brunck adds, “We sat for five months with basically no loans and we finally got this one and we had to re-invent the wheel in a couple of days. We weren’t about to let it go.”

For Throckmorton and Brunck, the client’s gratitude went a long way towards justifying the additional effort. “When we went in to the payday loan places, our client would say to the people who had sent her away before, ‘I’m here and I brought my banker!’” Brunck recalls.

“To know that you are doing a transaction for someone that appreciates it and knows that what you are doing is not typical is very gratifying,” Throckmorton says. “But hopefully everyone knows that we’re not going to drive around paying off loans in cash again!”

How the Network approach made a difference: listening to members

Jane Walsh believes that the *Making Connections* Network approach – listening to members and partners and meeting them where they are – was critical to the development and roll-out of this product.

“What I believe is good about the Network is that we went out and asked people, ‘Why do you want payday loans? What do you like about them? What doesn’t work about them?’ Then we said, let’s get rid of the stuff that doesn’t work and find the stuff that does work. That’s how the Network should work. It doesn’t do that every time, but that is the vision of the Network.

“We have to believe that we can make a difference by doing our work in a Network environment and including the residents in every point in the process. And we can’t be saying things like, ‘You need to stop using payday loans or you need an IDA.’ That is part of that old paternal model that says ‘Come over here poor person and let me tell you how this great thing is going to help you.’

“One of the things that really changed for me from the Network Circles is that I gained a whole new respect for all sorts of choices and products that I did not have before. I ended the phase of my life where I thought, ‘Payday loans – bad. Check-cashing – bad. People make bad choices and we can change bad behavior.’ That’s just over for me. I was not much of a behaviorist before and now I’m not a behaviorist at all.”

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—Jane Walsh

Walsh recognized a fundamental truth – payday loan operations and expensive check-cashing services are successful because they fill a need.

“Check-cashing places are open until 9 pm. They’re convenient. Someone can get a lot more business done there than a bank. It’s a business model that works for poor and moderate income people. What we need to figure out is how we make it a business model that’s affordable for people as well as convenient. And if we can figure that out, then I think we’re really responding to our members.”

How the Network approach made a difference: listening to partners

On the partner side, Walsh had to consider the bank’s concerns. “With small loans, you’re pricing for risk – the risk that the borrower is going to default – and you are pricing for the cost of administration. There’s more paperwork with small loans and you’re not making as much money. So if I can take the risk out for you, how much would you need to charge for a loan of this size?”

“So we put a little money in the bank (\$10,000) that just sits there in case someone defaults on those loans. Nobody has defaulted so far and nobody is going



The Louisville Urban League evaluates applicants in ways that don’t involve credit scores, then it trains and coaches those who appear to be good risks.

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to default. The way it is structured, I don’t see it happening. It’s an automatic draw. People don’t have to walk in their payment. Nobody is going to default on that loan unless their account runs dry. They’re working with someone who is looking at their bank accounts with them on a monthly basis.”

In Throckmorton’s eyes, the long history of collaboration and mutual respect he shares with Walsh was essential to the bank’s enthusiasm for this partnership.

“We value our relationship with Jane and the things she’s done. She believes that Republic Bank is a bank that is truly interested in doing these kinds of things, but she’s a realist. She’s been around enough to know that you may want to do something but if it doesn’t make economic sense, it’s not going to succeed. I think the thing that makes our relationship work is that she takes a balanced approach and understands that there are certain hurdles that the bank has to overcome. It’s based on a mutual respect. It’s based on history.”

Pointing the way towards systems change

Ultimately there is something more at stake with this pilot than providing 50 loans. “What makes a difference for families is system change, not services. I have a strong bias towards that because I come from an advocacy background,” states Walsh.

“The potential for Network Organizing and building out our Network is that we

push on systems to change and reform – not that we connect people to services. It’s really important that the Network continue to distinguish itself as not providing services.”

“The Affordable Credit Product is not a social service – it’s a financial product. What’s powerful about that is that it allows *Making Connections* to form a powerful alliance with Republic Bank and Trust Company. And that one product by itself may not change the system, but that as a piece of many other interactions with Republic Bank can push that system to do many other things.” Republic Bank and Trust is already doing a similar lending program involving members of the military.

If this product proves successful at the end of the pilot, it also points the way towards a new role for a national foundation like the Annie E. Casey foundation.

“We’re starting with a small amount of loans, but if we can show that it works, then we can ask for a bigger amount of money from a foundation. We can go to a foundation and say, “If you put x amount of money in a bank as a reserve, then the bank would be willing to do this amount in small loans.”

For Republic Bank and Trust Company, this product can prove that banks can respond to the needs of low-and moderate-income neighborhoods without taking on undue risk – something that is personally important to Throckmorton, who walks that line everyday.

“Everyone wants to do good things for the community, but we have stockholders and we have issues there about being successful. We

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don’t want to be a bank just for the wealthy or the affluent. We want to be a bank for the whole community.”

“It’s not rocket science... but we’re actually doing something as opposed to sitting around wringing our hands about a problem that everyone knows is there. That’s what is cutting edge about this program.”

And for Walsh, the long-time advocate, the “just doing it” part is invaluable. This program represents the opportunity to

tackle an issue that has vexed her and other advocates for many years. *Making Connections* offers a particular brand of investment of technical assistance and strategic capital that she thinks is unique in the field.

“One of the great things about *Making Connections* is that this program is allowing me to figure this whole thing out. My life’s work has been about expanding opportunities for poor people and leveling the playing field but I haven’t had the opportunity to do it like this before.”



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A Reflection on Building Family Economic Success by Working through the *Making Connections* Network and Creating System Change

A core goal of *Making Connections* – a long-term effort to make lower-income neighborhoods in 10 cities more supportive of children and their families – is to increase the income and assets of these families.

In Louisville, this “Family Economic Success” work is staffed by the *Making Connections* Louisville Assets Team. This team is experimenting with several ways of expanding these families income and increasing their savings, all of which involve Louisville’s Network, an ambitious attempt to build a community-wide network that links residents not just to each other but to opportunities and institutions throughout this city.

“We’re organizing to expand income and increase savings,” explains Jane Walsh, Louisville *Making Connections*’ Family Economic Success Coach. “We’re organizing to create a pathway to homeownership and we’re organizing to protect assets.”

And all of this organizing is being done through Louisville’s Network (see “A Different Kind of Network” at www.DiaristProject.org). “What I’m doing is asset building in a Network environment,” explains Walsh.

In addition to developing the affordable credit and savings opportunity with Republic Bank and Trust Company, the Assets Team is working with the Consumer Federation of America and several



Making Connections’ FES Coach Jane Walsh says that the foreclosure crisis, because it affects so many people, provides an opportunity “to build alliances with white suburban neighborhoods.”

local partners to start a pilot program that provides financial coaches for new employees. It is developing “Savers’ Circles” to encourage

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residents to save. And it’s done research on foreclosures in Louisville to help it develop a foreclosure prevention program.

One of the most interesting findings of the foreclosure research is that this problem now transcends *Making Connections*’ mostly lower-income, mostly African American neighborhoods. Walsh says the research showed that foreclosures “moved dramatically into white, suburban neighborhoods.”

In a way, Walsh believes that this provides an opportunity *“to build alliances with white suburban neighborhoods over this issue – to do legislative work, advocacy work and then to use that alliance to work together on other issues. Now is the opportunity for us to do this because it is so earth-shattering.”*

Thinking strategically like this is critical to achieving the kind of system change that Walsh and the Assets Team want.

Part of this system change is reflected in the affordable credit product that the team has developed with Republic Bank and Trust Company. Through this financial product, a bank is responding to a need in the community, Walsh points out. And the intent of the product is not just to meet a short-term need, but to allow residents an opportunity to get out of debt and build their assets.

The Assets Team is building on this idea in 2008, developing a financial planning pilot program with Consumer Federation of America. Its focus will be on “Building Wealth.” Network members will participate in a seminar on how to build wealth,

then get a free half-hour meeting with a financial planner.

The goal, Walsh explains, is to give lower income American access to the kind of planning from which higher income Americans have long benefited. *“Low-income Americans only have access to crisis intervention – credit counseling, bankruptcy counseling, foreclosure counseling. What if low-income people had access to the same tools as middle-income people?”*

To imbed this idea in Louisville, the assets team has convinced the local United Way to *“bring their influence to bear on other organizations that financial coaching is the way to go as opposed to counseling,”* in Walsh’s words.

Developing an affordable credit product and an opportunity to get financial coaching emerges from a core idea of the Louisville Network, which is the importance of “give/get.” An ambitious, community-wide network like Louisville’s will succeed, Walsh explains, to the extent that its members and partners both get something of value from the Network and give something of value to the Network.

In the case of the affordable credit product, Network members get the chance to get out of debt and build savings. Republic Bank and Trust Company gets new accounts. The Metropolitan Housing Coalition, another partner, gets data with which they can do analysis. *“It’s a perfect example of give/get,”* Walsh says.

One challenge in the future, Walsh believes, will be to keep building value for residents and other partners. *“All of our plans to be better connected*

*“Part of the investment of Annie E. Casey into *Making Connections* that has been very valuable has been into people like me who are going to work in Louisville for the rest of our lives in community development. I have learned a lot about systems changes and program development and policy.”*

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rely on staff other than me.... We’ve talked about bringing in new staff with someone to focus on network partnerships and someone to focus on membership services. We’ve got to build out certain capacities if this whole thing is going to work.

“The point of the Network is member value. If we don’t have it, we don’t have a network. We’ve got to have someone who works all day long to build the value of the Network.”

Similarly, the Network and the Assets Team need to build value into the relationships they’ve developed with Network Partners. *“I think we’ve relied a lot on personal relationships and we need to make connections that rely more on clarity,” explains Walsh. “Here’s what we’re giving you and here’s what you’re giving us.... We need to clarify our relationships on an agency to agency level with clear intent and clear agreements.”*

Doing this work through the Network is interesting, Walsh says, because it involves a very different approach to dealing with the economic challenges faced by lower income

families. She says the public policy or program development work she used to do was a lot easier. *“What we are doing is harder and much less clear.”*

But she believes that working through the Network has tremendous potential. *“The thing that we are doing that is most meaningful in the long run is Network Organizing.”* She thinks that Louisville’s Network has the potential *“to outlast the Making Connections Initiative. It is strong enough to go beyond that.”*

Walsh says she is grateful that *Making Connections* has allowed her and others to think through this new way of working.

*“Part of the investment of Annie E. Casey into *Making Connections* that has been very valuable has been into people like me who are going to work in Louisville for the rest of our lives in some capacity in community development and public policy. I have learned a lot about systems changes and program development and policy. I’ve made a lot of really important relationships on a national level that have influenced the way I work. I think that’s an important part of the investment.”*

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The Diarist Project

This is one of a series of publications about the Annie E. Casey Foundation’s *Making Connections* Initiative put together by The Diarist Project. The project is a new approach the foundation is using to learn from its efforts to strengthen families and transform struggling neighborhoods.

Diarists work to capture strategies and insights of the people who are leading the neighborhood transformation work. In *Making Connections*, the diarist works closely with the staff people who lead the work in each city, the Site Team Leader and Local Site Coordinator.

This story was written by Laura Crawford, the *Making Connections* Louisville diarist. It was edited by Tim Saasta, diarist coordinator. *Published April 2008.*

Making Connections is a Casey Foundation initiative to support work that demonstrates the simple premise that kids thrive when their families are strong and their communities supportive. What began in 1999 as a demonstration project in selected neighborhoods in 22 cities is now an intricate network of people and groups committed to making strong families and neighborhoods their highest priorities.

The **Annie E. Casey Foundation** (AECF.org) works to build better futures for disadvantaged children and their families in the United States. Its primary mission is to foster public policies, human service reforms and community supports that more effectively meet the needs of today’s vulnerable children and families.



Garry Throckmorton

Photos by
Laura Crawford.

For more information about **The Diarist Project**, contact Tim Saasta at Tim@CharityChoices.com. Diarist publication are available at: **www.DiaristProject.org**.

Making Connections Louisville is a ten-year initiative supported in part by the Annie E. Casey Foundation designed to catalyze change to close the gap and improve the life opportunities of families and children in four inner-city neighborhoods: Smoketown, Shelby Park, California and Phoenix Hill.

For more information, contact *Making Connections Louisville*, 334 E. Broadway, Louisville, KY 40202; connect@makechangetogether.org.