

A Drain on Our Neighborhoods: Payday Lending in Washington State

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ACORN Report

The Association of Community Organizations for Reform Now



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Introduction

Ms. N is a 55-year-old Seattle woman who is ill with cancer and has been unable to work. About 3 years ago Ms. N took out a \$300 payday loan. She paid the loan back on the due date and then immediately after the lender gave her another \$300 loan. The lender made it so easy, and she needed the money, so she took out a \$500 loan from another company.

She couldn't afford to pay the whole loan back, and estimates that for two years she just paid the interest on the loans, a total of \$255 per month, but still owed the original loan amounts. Then it got to where she didn't have the money to make the interest payments so she took out additional payday loans from other lenders to pay off the original loans. Then, the fees got to be so much that she couldn't pay her other bills and borrowed more to meet her expenses.

By the spring of 2006 she was drowning in payday loan debt – she was paying \$700 just in fees each month without decreasing the loan balance -- and the only way out of the debt trap was to file bankruptcy.

The entire payday lending industry is built on the simple truth that lower income families don't have a lot of money. In minority and low-income neighborhoods, payday lenders beckon customers with promises of "Easy Cash", "Quick Cash," and "Cash Now." And the signs don't lie. If someone has an ID, a bank account, and a job, they can get a payday loan, typically of about \$300, and all they have to do is write a \$345 check post-dated until their next payday.

The problem comes when, as more often than not, the customer cannot afford to have the payday lender deposit their check. There are only two ways to avoid this: they can either just pay the interest, \$45 in the above example, and roll the loan over until their next payday, or they can take out a new payday loan to pay off the old one.

This is precisely what payday lenders want, which is why there are no credit checks and no reviews of a customer's ability to pay the loan back. As one ACORN member said, **"Payday loans are easy to get, but hard to pay back."**

While payday lenders defend their product as providing needed help for families in a one-time emergency, in reality payday loans sink families deeper into debt and make their financial situations worse.

The Center for Responsible Lending conducted an analysis of quantitative data from the payday lending industry and calculated that predatory payday loan fees cost families in the U.S. \$3.4 billion a year¹. In their examination, they did not consider all payday loan fees to be predatory. Instead they counted only

¹ Center for Responsible Lending, *Quantifying the Economic Cost of Payday Lending*, December 18, 2003, revised February 24, 2004.



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the fees associated with payday loans that were made to borrowers who had gotten caught in a debt trap of repeated loans.

We have used the methodology they developed and expanded upon it to calculate both the extent and cost of predatory payday lending in King and Pierce Counties. Based on data recently released by the Washington Department of Financial Institutions (DFI), we found that:

- Predatory payday loans cost King County residents \$40 million in fees and interest each year.
- In Pierce County, payday lenders charged customers \$23.4 million a year in predatory fees and interest.

In addition, we examined the geographic locations of payday loan stores in King County and found that they were disproportionately in lower income working class neighborhoods.

- Whereas low and moderate income neighborhoods make up just 22% of King County, 58% of the payday loan stores in the county are located in these neighborhoods.
- There is one payday loan store for every 2,800 residents in low-income neighborhoods, and one store for every 4,270 residents in moderate income neighborhoods, compared to just one for every 50,822 residents in upper-income neighborhoods.





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The Growth of Payday Lending and the Predatory Economy

“We believe that, as the working class population segment increases, and as trends within the retail banking industry make banking less accessible or more costly to these consumers, the industry in which we operate will see a significant increase in demand for our products and services.”

(Dollar Financial Corporation, Annual Report, filed 9/22/05)

Banks have not done a good job of meeting the needs of low and moderate-income families, leaving the market open to predatory practices. There are approximately 28 million people without a bank account, and the concentration of “unbanked” households is greatest in minority communities. A recent study found that 46 percent of African-Americans and 34 percent of Hispanic Americans are unbanked. There are also an estimated 48 million people who are “underbanked” -- people who have a bank account, but who do most of their business through other types of companies².

In response, a “predatory economy” has emerged made up of check-cashing stores, pawnshops, payday lenders and car title lenders, to prey on the unbanked and underbanked. Their predatory practices harm our communities and strip billions of dollars from our neighborhoods and from the working families who need them most.

Ten years ago payday lending was almost unheard of, and even five years ago payday lenders only played a marginal role in the economy. In 2000, there were about 7,000 payday loan stores in the U.S., and these payday lenders made \$10 billion in loans a year. Today, according to the Consumer Federation of America, there are approximately 25,000 payday loan stores that make \$40 billion a year in loans³. The number of payday loan stores now is more than the number of McDonalds and Burger Kings combined⁴.

Over the last five years, the number of payday loan stores in Washington State has almost doubled. According to the Department of Financial Institutions there were 377 payday lending locations in 2000, and by 2005 there were 716 locations.

During this same period, the number of payday loans made in the state rose from about 1.8 million loans in 2000 to just under 3.6 million loans in 2005. The total dollar amount of payday loans made in the state grew by 138% from \$580 million in 2000 to \$1.4 billion in 2005⁵.

² Sherrie L. Rhine and William H. Greene, "The Determinants of Being Unbanked for U.S. Immigrants," *Journal of Consumer Affairs*, Summer 2006, Vol. 40 Issue 1, p. 21-40

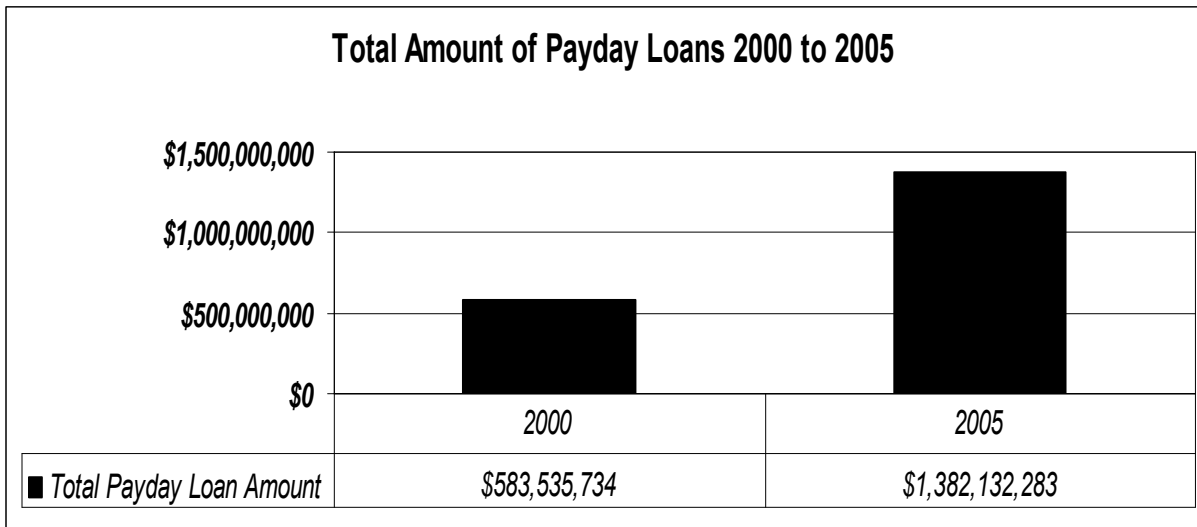
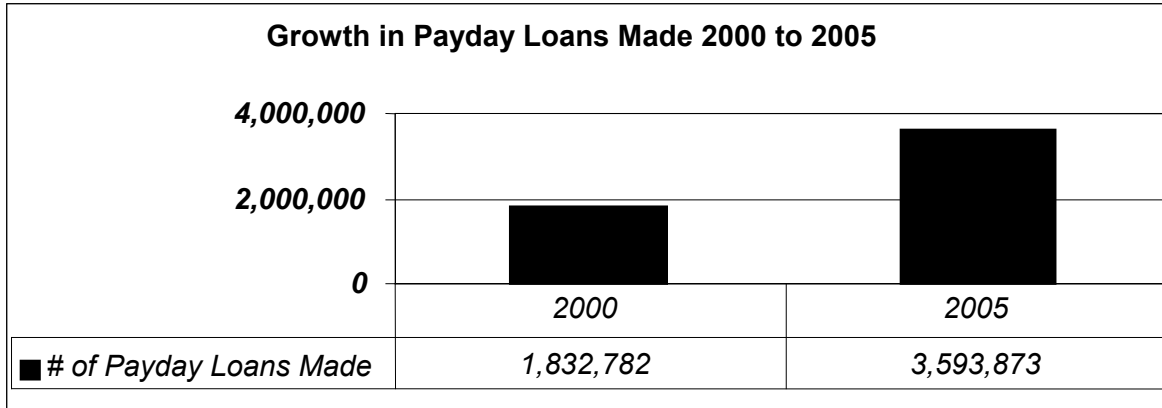
³ www.paydayloaninfor.org/facts.cfm

⁴ ABC News, “Are Predatory Lenders Ripping Off Our Nation’s Finest?” August 22, 2006

⁵ 2005 Payday Lending Report, Washington State Department of Financial Institutions



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Payday Lending: A Primer

What is Payday Lending?

Payday loans are short-term consumer loans for small amounts. They derive their name from their due date: these loans need to be paid back on the date when the customer receives their next paycheck.

In order to obtain the loan borrowers must agree to “secure” the loan in one of two ways. They can either 1) hand over a check for the loan amount plus interest, post-dated for their next payday or 2) authorize the lender to automatically withdraw the loan amount plus interest on their next payday.

Payday lenders in Washington State are permitted to charge customers a fee of \$15 for every \$100 they borrow. With a typical payday loan of \$300, the customer must agree to repay the lender a total of \$345 – the \$300 loan plus a \$45 fee. This translates to an annual interest rate of 391%, making payday loans an extremely expensive form of credit.

What are the Problems with Payday Lending?

Payday lenders say their loans are meant to help people in a one-time emergency, but in fact payday loans are set up to sink people deeper in debt and trap them in extremely expensive loans.

Payday lenders don’t consider whether the person can pay a loan back before approving it. There are no credit checks and no limits to the percentage of a person’s next paycheck that they can receive in a loan. As long as someone has an ID, bank account, and source of income, they can get a loan. That’s because payday lenders don’t want people to pay the loans back. That’s how they make their profits.

Most customers can’t afford to pay the whole loan back in two weeks, and if the payday lender deposits their check, it will bounce, costing the customer even more in fees. So instead of incurring bounced check fees, the customer agrees to renew the loan, and just pays the interest off or takes out a new loan to pay off the old one, leading to a cycle of debt that can last for months or even years.

There are additional risks associated with payday loans because they are secured with a post-dated check or automatic draft authorization signed by the borrower. This means that if a borrower does not have enough money in their account when the lender debits the account, the customer will end up with a bounced check/ insufficient funds fee every time. Some payday lenders will attempt automatic withdrawal once a day or more until the loan is paid back, and the cost of insufficient funds charges or bounced checks can add up quickly. This can lead to forced account closings and leave a customer’s other bills unpaid, lowering their credit scores and impacting their ability to obtain fair loans for things like mortgages, cars, or even education in the future.

According to the recent DFI report, 87% of all payday loans were made to customers who took out more than four loans during the year.



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The Cost to Washington State Families

Payday loans are very expensive for Washington families. The 2005 Payday Lending Report released by the Department of Financial Institutions shows that payday lenders made almost \$1.4 billion in loans in 2005 and charged over \$173 million in fees.

According to this report, there were over 3.5 million payday loans made in the state in 2005 by 716 licensed payday loan stores. This means that each store made an average of 5,019 loans per year.

The report states that the average loan size was \$385 and the average fees per loan were \$48. Thus, each store made an average of \$1.9 million in loans per year (5,019 number of loans per store x \$385) and charged an average of \$240,912 in fees on these loans (5,019 number of loans per store x \$48).

In the Center for Responsible Lending's report "Quantifying the Economic Cost of Predatory Payday Lending," the group used a figure of five or more loans per year per borrower as the "dividing line above which borrowers should be considered harmed by repeated payday loans."⁶

The Center reasoned that if payday lending were really intended for customers to use in order to help them out of occasional emergencies (rather than being set up to take advantage of customers who are already in a financial hole and for whom the loan will simply dig an even deeper hole), then a customer would need at least a minimum period of 90 days to get back on their feet and pay back the emergency funds. This would mean that customers would not receive more than four legitimate payday loans per year.

For this report, we deemed as "predatory" all loans made to customers who received more than four per year.

The DFI report included data on the frequency with which Washington payday loan customers receive payday loans. According to the report 87% of all payday loans were made to customers who received more than four loans during the year, the level at which we consider the loans to be predatory.

The impact of predatory payday loans is as follows:

- Viewing the average number of loans per store per year in the context of the DFI data means that each store makes an average of 4,367 predatory payday loans per year -- loans that are made to customers who receive more than 4 loans per year and thus contribute to sinking these customers deeper into the debt trap.
- With the average fee of \$48, this means that each store charges about \$209,000 in predatory fees a year (\$209,616).

⁶ Center for Responsible Lending, *Quantifying the Economic Cost of Payday Lending*, December 18, 2003, revised February 24, 2004.



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Payday lenders almost always charge the maximum allowed by state law, and so their fees vary from state to state. Washington has higher rate caps than some other states. Among the states that have legalized payday lending, Florida has the lowest cap on fees, limiting payday lenders to charge a flat upfront fee of \$5 and then \$10 per \$100 borrowed, whereas Washington state allows payday lenders to charge \$15 per \$100 borrowed.

Almost all of the largest payday lending companies in Washington also operate in Florida, including Advance America, ACE Cash Express, Check into Cash, Check N Go, and Money Mart. And although we believe that the rates allowed in Florida are still excessive (a 298% APR to borrow \$350), it is clear that payday lenders can charge lower fees and still stay in business.

- The average payday loan in Washington State of \$385 includes a fee of \$48. In Florida, that same \$385 payday loan would include a fee of \$39.65. Thus for each payday loan made in Washington State there is an excess of \$8.35 in fees relative to the amount charged for the same loan in another state.
- For the 652 loans per store that were made to customers who receive four or fewer loans per year, there is an average excess fee of \$8.35, compared to what payday lenders charge elsewhere.
- This adds an additional \$5,444 average of excess fees charged per store.

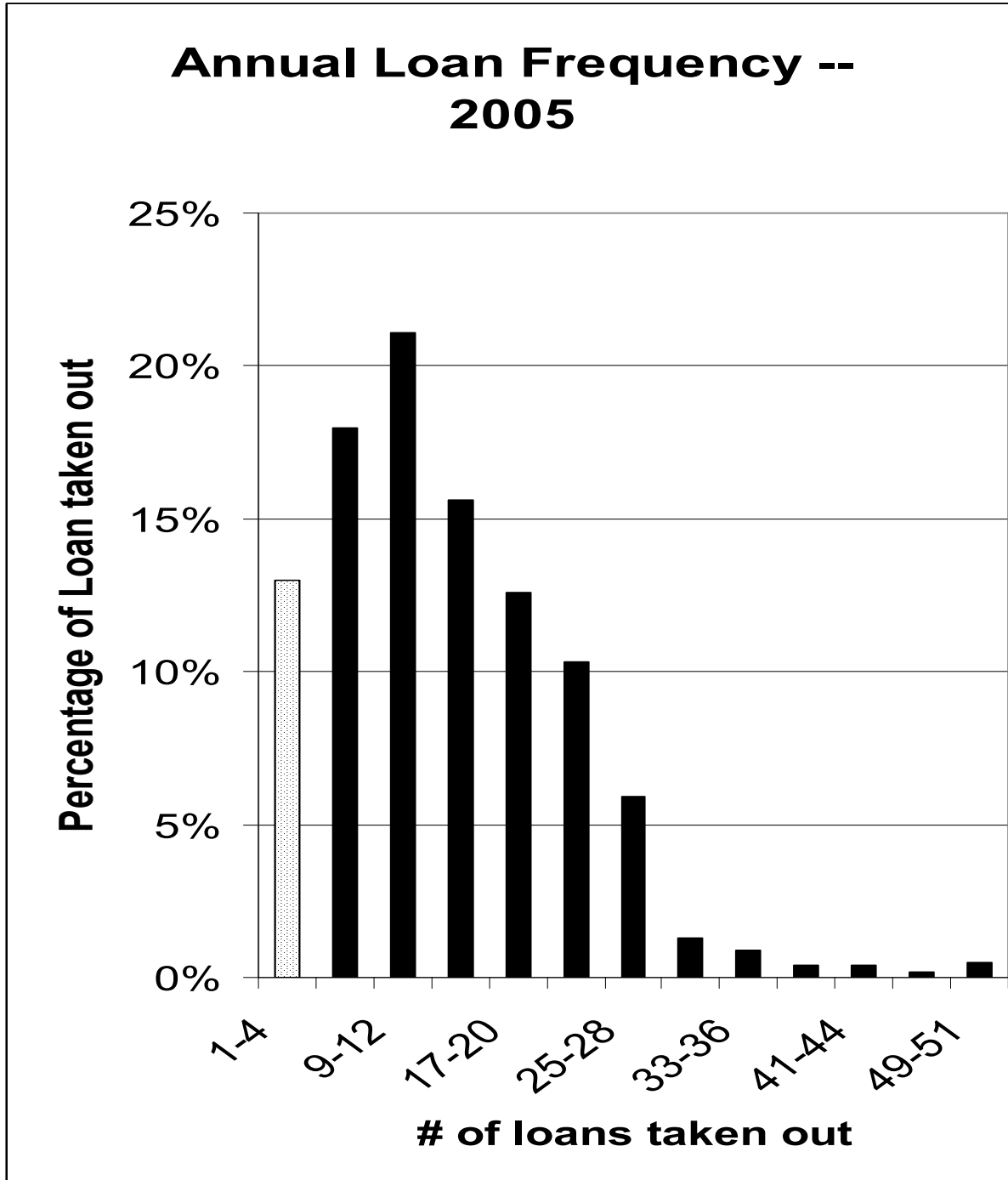
Together, the annual total of excess fees and interest per store is \$215,066.

- **There are 186 licensed payday loan stores in King County, meaning that these lenders extract \$40 million in excess fees(\$40,002,276).**
- **There are 109 licensed payday lenders in Pierce County, charging \$23.4 million in excess fees and interest (23,442,194).**

The table below shows the number of loans taken out by each borrower. All of the loans in the black bars are predatory (over the limit of 4 a year).



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Geographic Locations of Payday Loan Stores

Payday loan stores are disproportionately located in lower income and working class neighborhoods.

In King County as a whole, there is one payday loan store for every 10,401 residents. However, in low-income neighborhoods the ratio is almost four times higher – one store for every 2,800 residents. In contrast, in upper income neighborhoods, the ratio is almost five times smaller compared to the average – one store for every 50,822 residents.

Census Tract Median Income	Number of Residents Per Payday Loan Store
Low-Income: (\$0-\$37,500)	2,800
Moderate Income: (\$37,500 - \$59,440)	4,270
Middle Income: (\$59,440-\$89,160)	14,499
Upper Income: (\$89,160+)	50,822

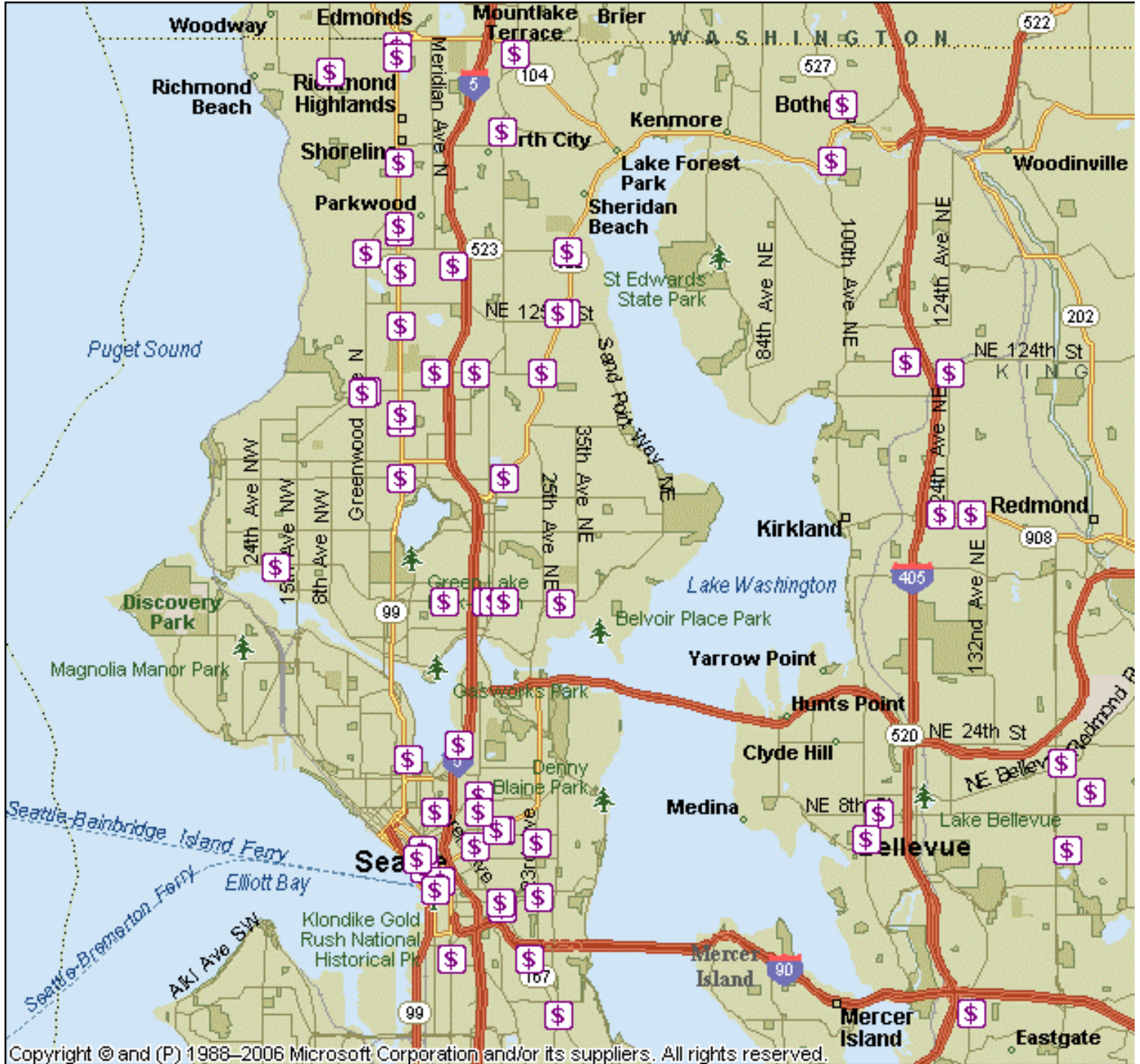
Although low and moderate income neighborhoods make up just 22% of King County, 58% of the payday loan stores in the county are located in these neighborhoods.

Census Tract Median Income	Percentage of Payday Loan Stores	Percentage of King County
Low-Income: (\$0-\$37,500)	7.8%	2.4%
Moderate Income: (\$37,500 - \$59,440)	50.3%	19.9%
Middle Income: (\$59,440-\$89,160)	36.5%	50.8%
Upper Income: (\$89,160+)	5.4%	26.9%



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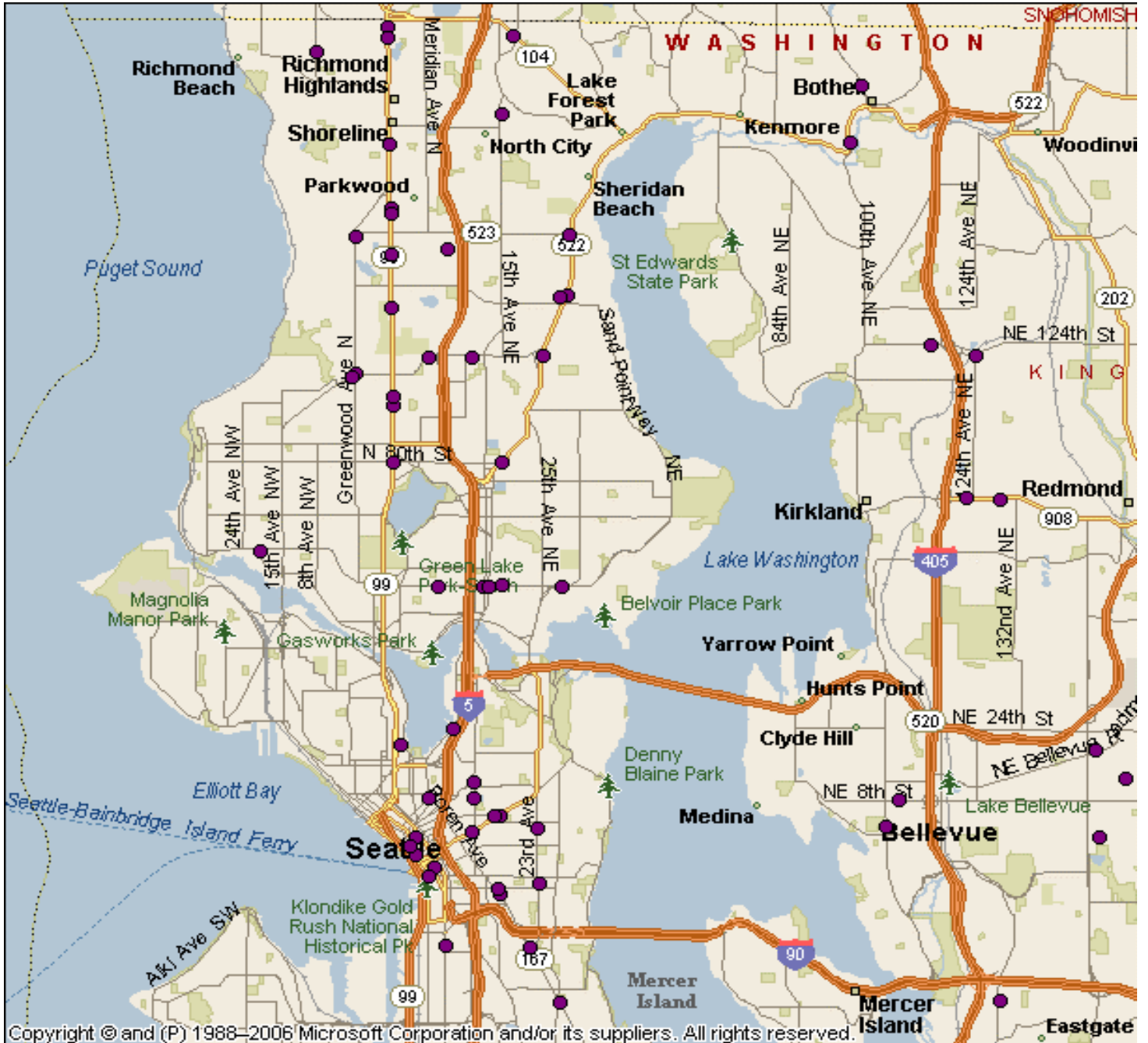
King County





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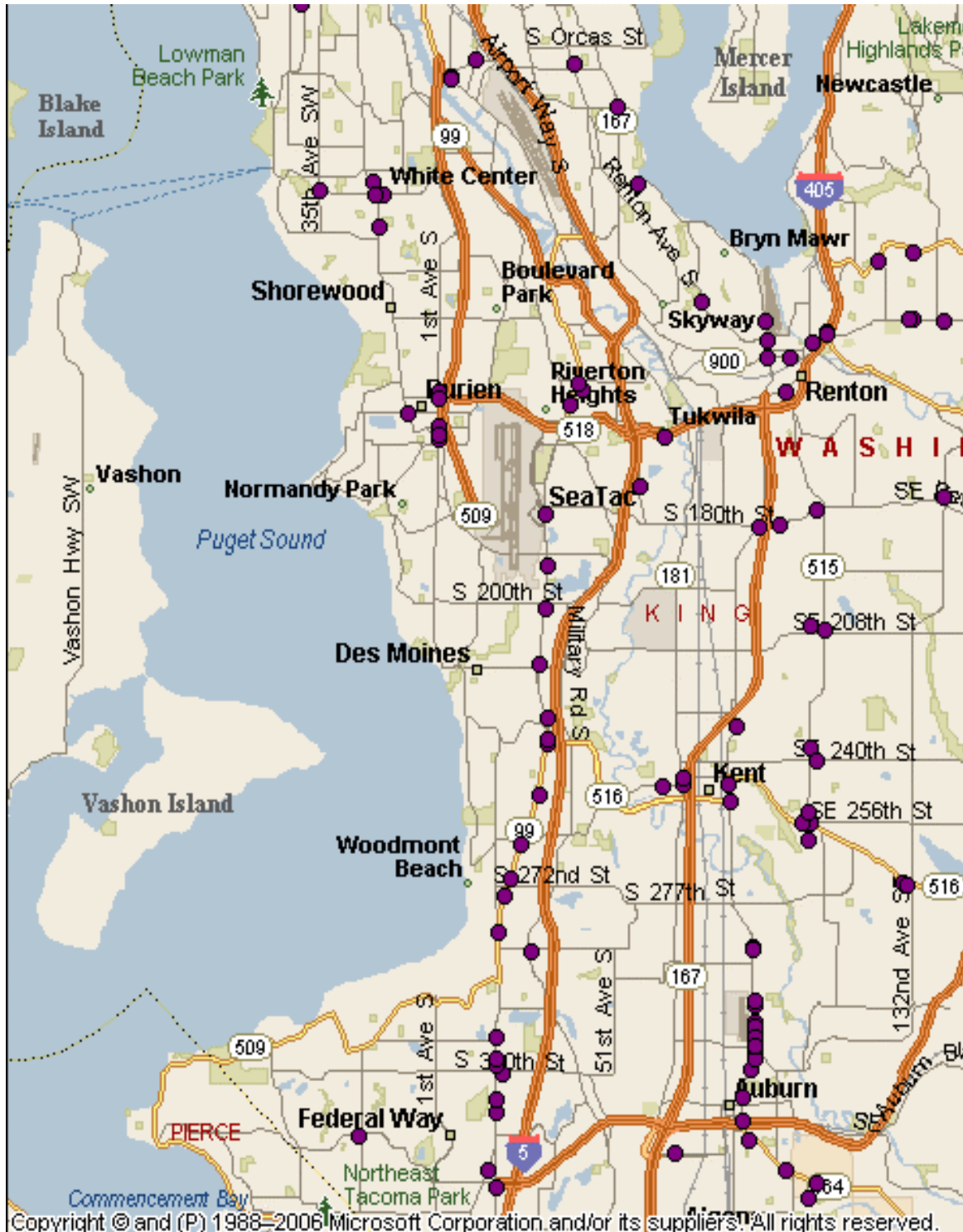
North King County





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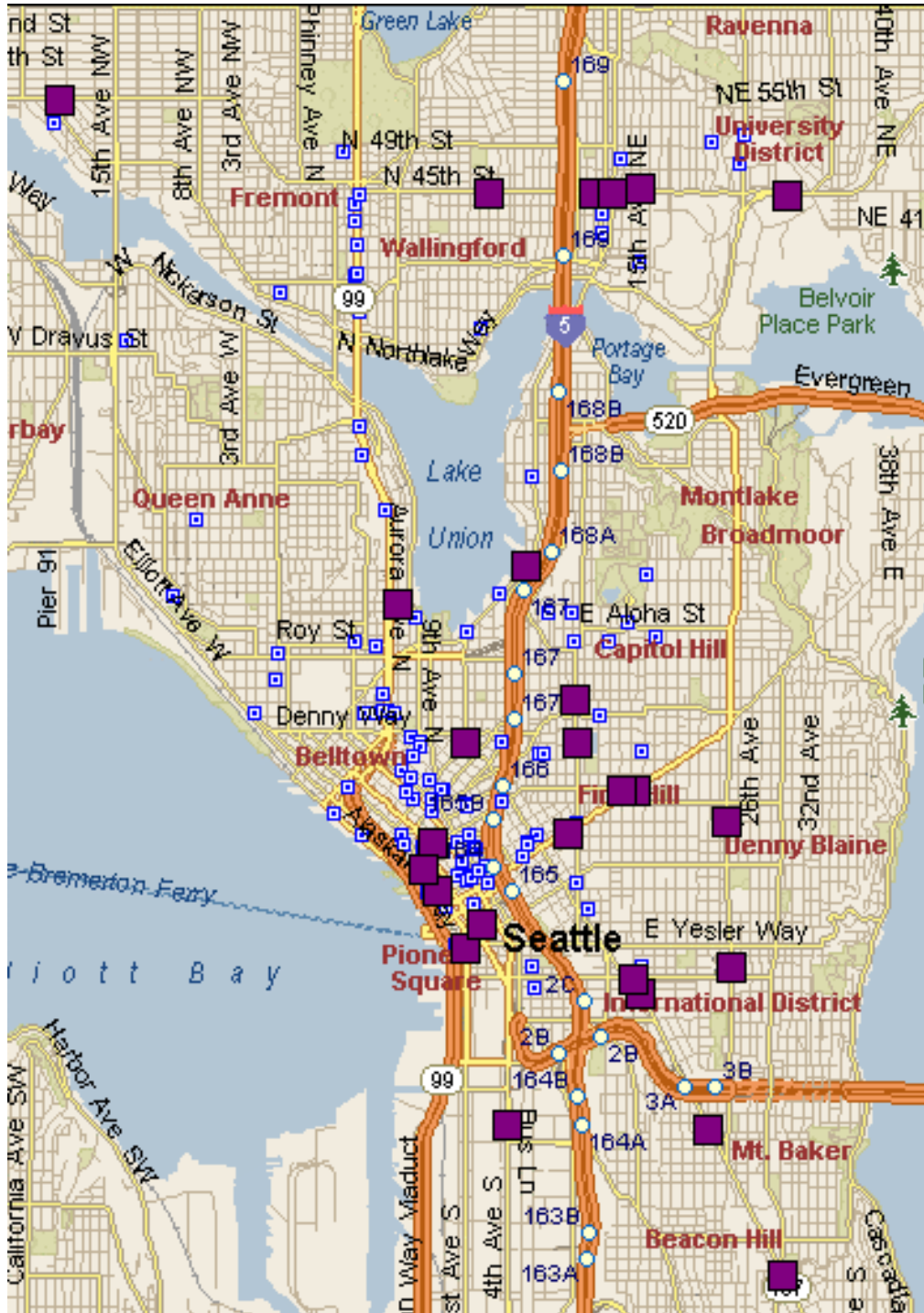
South King County





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Seattle Area





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Recommendations

1. State Legislatures should adopt laws protecting consumers from abusive lending practices. The legislation should set a rate cap of 36% for all loans, not just “payday” loans, so that predators are not able to evade the law through loopholes as they are currently doing in some places.
2. State Attorneys General and financial regulators should aggressively prosecute companies that violate state law, such as internet payday lenders and other unscrupulous businesses.
3. Cities and counties should follow the lead of municipalities in Oregon and pass local ordinances regulating payday lending using the maximum possible authority.
4. Banks should discontinue their financing of payday lenders and other predatory financial institutions. This includes holding stock in the public corporations that engage in these lines of business.
5. Banks should instead seek ways to improve their current services and products to better meet the needs of consumers who use payday lenders.
6. More credit unions should implement the alternative payday loan programs begun by some credit unions and should increase the outreach and promotion of these programs.
7. Payday lenders should immediately change their fee structures, and rather than charge customers in certain states more than those in other states, should drop their fees in all states to the lowest level they currently charge anywhere in the U.S.

ACORN, the Association of Community Organizations for Reform Now, is the nation's largest community organization of low- and moderate-income families, with more than 230,000 member families participating in neighborhood chapters in 103 cities. Learn more at www.acorn.org.

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