An Experimental Analysis of the Demand for Payday Loans

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Abstract

The payday loan industry is one of the fastest growing segments of the consumer financial services market in the United States. The purpose of our study is to design an environment similar to the one that payday loan customers face. We then conduct a laboratory experiment to examine what effect, if any, the existence of payday loans has on individuals' abilities to manage and to survive financial setbacks. Our primary objective is to examine whether access to payday loans improves or worsens the likelihood of financial survival in our experiment. We also test the degree to which people's use of payday loans affects their ability to survive financially. We find that payday loans help the subjects to absorb expenditure shocks and, therefore, survive financially. However, subjects whose demand for payday loans exceeds a certain threshold level are at a greater risk than a corresponding subject in the treatment in which payday loans do not exist.

JEL Classifications: D14 (Personal Finance), C9 (Design of Experiments)

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I. INTRODUCTION

The payday loan industry is one of the fastest growing segments of the consumer financial services market in the United States. It sprung up in the early 1990's when commercial check cashing stores began offering customers the option of taking out a short-term loan to help them meet unplanned expenses until their next payday. Payday loans are short-term loans of $100 to $500 that typically must be paid back within two weeks or by the borrower's next payday. The fees for these loans vary from $10 to $25 per $100 borrowed. Although the loan is unsecured, the borrower must be employed, provide personal identification, and have a checking account. While some payday lenders conduct cursory credit checks using services provided by, for example, Teletrack, payday loans are generally provided without any formal credit check. One of the appeals of these loans, as documented in a number of studies (see, for example, Elliehausen and Lawrence (2001)), is the speed with which individuals can obtain these loans.[1] While relatively easy to obtain, payday loans are expensive when compared to the interest rates charged on other consumer loans.

The typical payday loan customer is relatively young with a high school education but little or no college education. They have little money in their checking account and few, if any, alternative sources of credit because they are at (or have exceeded) their credit limit, or previously have been turned down for more conventional consumer loans. Payday loan customers' most frequently cited reason for using the loans is to meet unplanned expenses. Rapid growth of the payday loan industry suggests that this industry evolved to fill a gap in the consumer credit market not being served by more traditional lending institutions.

Two aspects of payday loans draw significant attention in the policy arena: (1) interest rates charged for these loans; and (2) the potential effect of these loans on the "cycle of debt" faced by some consumers.[2] Interest rates on the majority of payday loans exceed 300% on an annual percentage rate (APR) basis, causing some to claim that payday lending is predatory. For example, Stegman and Faris (2003, p. 20) note that "if repeated, chronic borrowing is as commonplace as it appears, then the triple-digit APRs charged by most payday lenders may go beyond what is fair and become abusive and predatory." Because of these high interest rates, some critics suggest that interest rate ceilings should be implemented or propose that the industry be banned altogether. There is also

[1] One of us took out a payday loan in less than 25 minutes.

[2] For a more detailed discussion of these and other criticisms of the payday loan industry, see www.responsiblelending.org. The Center for Responsible Lending, as stated on this website, serves as "a resource for predatory lending opponents."

evidence suggesting that a number of consumers rely frequently on these loans and, therefore, potentially become caught in what critics call a "cycle of debt." In these situations, borrowers can find themselves paying fees for a loan that exceed the initial loan amount.

Despite these and other criticisms, supporters of the industry contend that payday lenders are simply providing credit to individuals who otherwise would not be able to obtain it in the more formal financial sector. Supporters further argue that the credit obtained in this industry allows individuals to weather short-term financial disruptions caused by, for example, unexpected expenditures. Additionally, a comparison of the costs of payday loans with, for example, the costs of bounced checks indicates that payday loans may not be the most expensive choice individuals face.[3]

The objective of our study is to design an environment similar to the one that payday loan customers face and conduct a laboratory experiment to examine what effect, if any, the existence of payday loans has on individuals' abilities to manage and to survive financial setbacks. In our experiment, we control a number of features that allow us to examine the effect of payday loans in different treatments. Each participant faces the same payday loan fee, the same distribution of anticipated monthly expenditures, and the same distribution of unanticipated shocks. The supply of payday loans is also exogenously imposed so as to focus solely on the demand-side of the equation.

In contrast to field studies that cannot directly measure the welfare of individuals, all individuals start off on the exact same footing and thus we can directly measure how well different sets of subjects manage their induced financial circumstances. By randomly assigning participants to different treatment conditions, our results allow us to comment on how payday loans affect an individual's ability to adjust financially to unexpected expenditures.[4] Our analysis also allows us to comment on the extent to which individuals' consumption decisions result in a demand for payday loans that potentially creates and/or compounds financial difficulties.

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[3] In the May 2005 issue of *Consumer Reports*, a comparison of the implicit APR on bounced checks, overdraft protection, and several other forms of overdraft protection were compared. Depending on the total cost assumed, the APR for overdraft protection ranged from 608% to 791% and the APR for bounced check fees ranged from 487% to 730%.

[4] There is no random assignment of people to conditions with and without payday loans in field studies.

The paper is organized as follows: the next section, Section II briefly summarizes the literature on payday loans. Section III describes the experimental design and procedures. Then in the next section we present hypotheses and the semi-parametric model to evaluate them. Section V discusses our results, and the final section summarizes our conclusions.[5]

II. Previous Research

Among the earliest research, Caskey (1994) describes the features of fringe banking and describes those who use fringe banks to obtain financial services.[6] A growing number of studies examine in more detail various aspects of the industry. Several papers focus on the determinants of the location decision of payday lenders (Graves (2003), Burkey and Simkins (2004), Graves and Peterson (2005), Prager (2009), and Damar (2009)). The results of several of these papers are consistent with claims that payday lenders may fill a void created by the departure of more traditional lending institutions. These results would also partly explain the rapid growth in the demand for payday loans. Several other studies focus on the cost and revenue structure of payday lenders, on payday loan pricing behavior, on the profitability of payday lenders, and on payday lender and borrower behavior (Stegman and Faris (2003), Flannery and Samolyk (2005), Skiba and Tobacman (2007), DeYoung and Phillips (2009), Agarwal, Skiba, and Tobacman (2009), and Bertrand and Morse (2009a, 2009b)). The remainder of the most recent research on payday lending focuses on why individuals might use payday loans and on the effects of payday lending on a variety of economic outcomes.

The evidence concerning whether access to high interest rate loans has a beneficial or adverse effect on economic outcomes is mixed. A number of studies have found that payday lending has a harmful effect on individuals or causes an increase in adverse economic outcomes (Carrell and Zinman (2008), Campbell,

[5] Appendix A provides the instructions for the experiment. Another appendix, available upon request, includes a discussion of three subjects in one of the treatments as examples of how payday loans aided, harmed, or could have aided subjects.

[6] Fringe banks also include, for example, check-cashing establishments and pawn shops. A number of recent studies provide additional descriptive analyses of the growth of payday lending, the characteristics of payday borrowers, and public policy issues related to the industry (Fox (1999/2000), Caskey (2001, 2002, and 2005), Stegman (2001), Barr (2004), Bair (2005), Pyper (2007), Stegman (2007), and Lawrence and Elliehausen (2008)). While Chin (2004), Chessin (2005), Butler and Park (2005), Mann and Hawkins (2007), and Huckstep (2007) also include descriptions of payday lending and further document its growth, these studies focus more on the legal and regulatory aspects of the industry. Skiba and Tobacman (2008) offer several theoretical explanations (e.g., high discount rates) for why individuals use high interest rate loans and conclude (p. 16) that "the naïve and sophisticated quasi-hyperbolic models perform better than the exponential model at explaining payday borrowing, repayment, and default."

Martinez Jerez, and Tufano (2008), Melzer (2009), Melzer and Morgan (2009), Skiba and Tobacman (2009). At the same time, several other studies find that access to higher interest rate loans and payday loans in particular have a beneficial effect or cause a reduction in adverse economic outcomes (Morgan (2007), Morgan and Strain (2008), Morse (2009), Karlan (2010), and Karlan and Zinman (2010)).

The results of two studies on the effect of payday loans on personal bankruptcy are also mixed. Skiba and Tobacman (2009) find that payday loans increase the incidence of personal bankruptcy, while Lefgren and McIntyre (2009) find that the existence of payday loans has no effect on bankruptcy rates.

III. Experimental Design and Procedures

In this paper, we use a laboratory experiment to examine the extent to which the existence and use of payday loans affect an individual's ability to manage and survive financial setbacks with uncertain and unforeseeable expenditures and a certain fixed income.[7] We consider two economic treatments: the *Loan* (*L*) treatment, in which payday loans are a financing option; and (2) the *No Loan* (*NL*) treatment, in which payday loans do not exist. This second treatment is motivated by our interest in examining whether the existence of payday loans alters subject welfare. Given that we did not know ex ante the extent to which subjects would put themselves into financially tight circumstances, we conducted our first sessions with a liberal maximum number of overdraft checks, eight. This maximum kicked in after the first experimental month in a session of 30 months, so as to not penalize the subjects too harshly for poor decisions in their first month. After observing 45 subjects in this treatment, we then introduced a treatment that could increase the demand for payday loans by reducing the availability of the alternative, namely we limited each subject to a maximum of two instead of eight overdraft checks after the first month.

An additional treatment variable is whether or not each participant loses utility from writing a check when there are insufficient funds in the participant's account. In the *Overdraft Protection* treatment, the participant is charged a fee and, implicitly, the bank covers the check so that the participant does not incur any negative consequences from the payee for writing a check with insufficient funds in her account. In this paper, we refer to these types of checks as overdrafts. 111 participants faced this treatment condition, 54 without access to

[7] See Smith (1994) for an excellent discussion of using experimental economics to evaluate policy prescriptions in general and Wilson (2007) for a discussion on the use of experimental economics to examine issues in antitrust.

loans and 57 with access to loans. We subsequently conducted a harsher treatment, the *No Overdraft Protection* treatment, which penalizes participants who "bounce checks" on bills. The penalty, however, is delayed until the next month as it takes time for the check to fail to clear.[8] In the treatment without overdraft protection, we refer to checks written without sufficient funds and, therefore, checks that incur *both* a fee and a subsequent penalty as bounced checks. 162 participants faced this treatment, half without access to payday loans and half with access to payday loans. The 2^3 design is summarized in Table 1.

Table 1. Experimental Design
(Number of Subjects)

Overdraft Protection Treatment

	No Loan	*Loan*	Total
8 Overdrafts	*NL8* (23)	*L8* (22)	45
2 Overdrafts	*NL2* (54)	*L2* (57)	111
Total	77	79	156

No Overdraft Protection Treatment

	No Loan	*Loan*	Total
8 Bounced Checks	*NL8* (41)	*L8* (41)	82
2 Bounced Checks	*NL2* (40)	*L2* (40)	80
Total	81	81	162

Each subject earns cash based on a series of financial and consumption decisions over thirty 28-day months, or 840 periods. Each day lasts four seconds. Participants are seated at visually-isolated carrels, with each subject using a computer to access information, such as the instructions (see Appendix A) and their financial situation (e.g., historical payments, current balance, bills due), and to enter their decisions (e.g., which bills to pay). Subjects earn US dollars by consuming goods for which they have bills to pay in experimental dollars. Each bill appears 28 days before it is due. When a bill appears, a subject receives "consumption points", or "utility" in the vernacular of economics, for a good or service. Each consumption point equals one US cent in earnings for the subject.

[8] The penalties associated with bouncing a check represent any costs imposed on individuals by merchants. In addition to charging individuals for bounced checks, merchants may post the individual's name and/or refuse to conduct business with that individual in the future.

Failure to pay bills on time leads to penalties in the form of deductions from a subject's accumulated consumption points.

Each subject is endowed with a starting balance of 50 experimental dollars (E$) and collects biweekly paychecks of 475 experimental dollars. The final balance of experimental dollars is converted into US dollars at the rate of E$400 = US$1. For ease of discussion, $ will denote experimental dollars, except for any reference to actual payouts of cash to the subjects at the end of each session.

We chose bill and income parameters to place subjects in tight financial situations so that failure to survive financially results in the termination of the ability to earn money during the session. Each month a subject must accrue a minimum of 100 consumption points. If a subject fails to meet the monthly minimum of 100, the subject may no longer participate in the session. We chose this monthly minimum to induce a reason for the subjects to pay bills. We also chose it to create an incentive for subjects to continue to participate in the experiment to increase their earnings. This minimum threshold, therefore, conveniently serves as the primary means for us to measure how loans affect the ability of subjects to extend their participation and, as we discuss later, to survive financially.

A bar graph at the bottom portion of the screen continuously updates the number of consumption points that a subject has accumulated in a month (see Figure 1 for a screenshot for a subject in the *Loan* treatment). Once a subject is eliminated, he or she can no longer make decisions or earn money in the remaining periods. However, in an effort to not disrupt those subjects who continue to participate, these subjects remain at their computer terminals until all subjects in the laboratory complete the session. Eliminated subjects may surf the Internet or participate in a quiet activity, such as reading, without leaving their carrel.

The series of monthly bills faced by each subject is given in Table 2. Over time, subjects become familiar with these basic monthly bills, as they appear each month 28 days before their due date. As mentioned in the introduction, meeting unplanned expenses is the most frequently cited reason for why payday loan customers' take out payday loans. To capture this feature in the experiment we implemented large bill shocks that yield no consumption points but carry hefty penalties if they are not paid. These additional bills are more irregular and infrequent, and are not known to the subjects until the bills appear on each subject's computer screen 28 days before they are due. Table 3 lists these bill shocks.

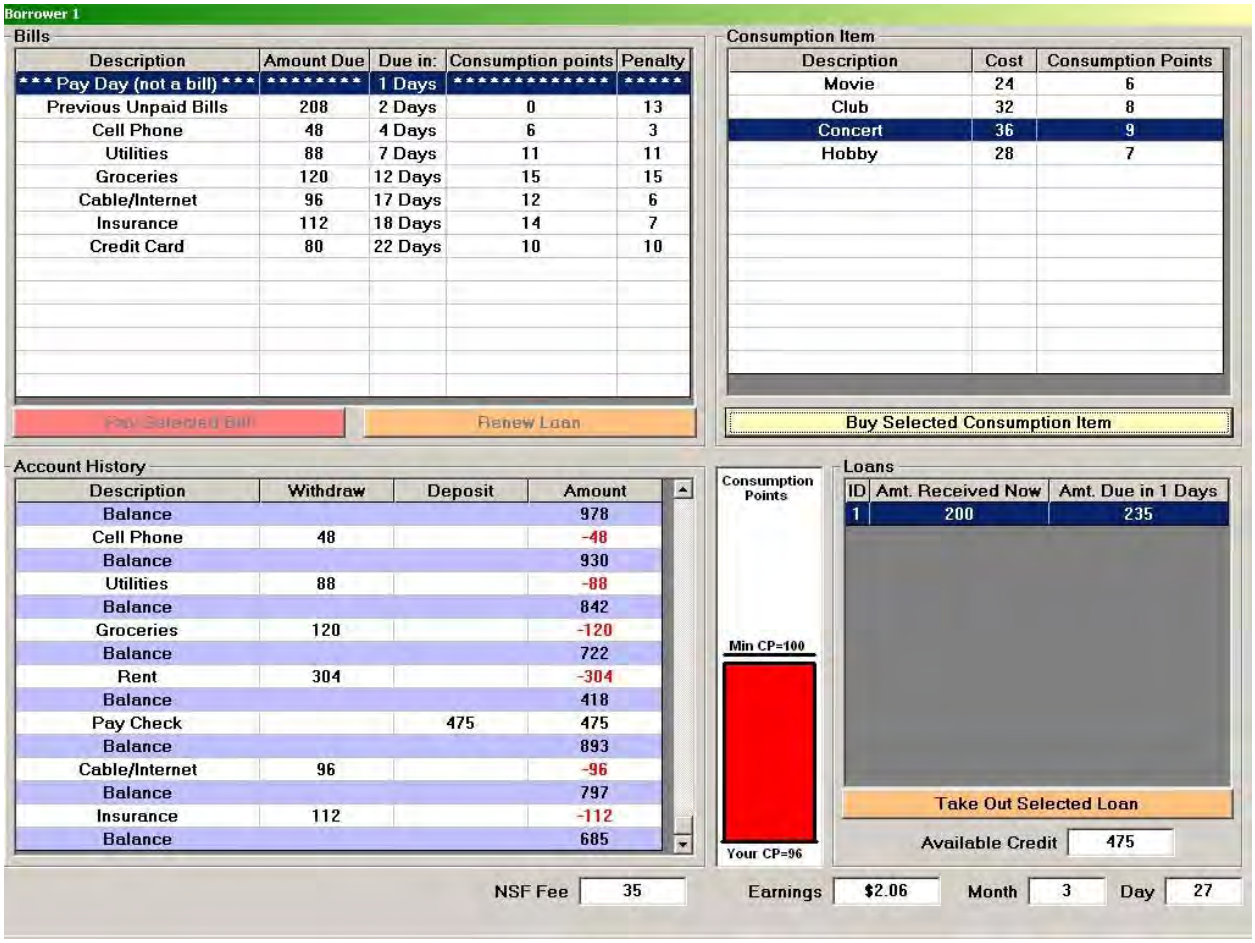

Figure 1. Screenshot for Subject in the *Loan* Treatment

*N.B. The only difference for subjects in the *No Loan* treatment is that they did not have the loan frame in the bottom right corner. The consumption point counter in the bottom middle portion of the screen turned from red to green when the subject met the minimum threshold of 100 consumption points to continue on to the next month.

Table 2. Monthly Bills

Day	Description	Amount	Days until due	Consumption Points	Penalty
2	Rent	304	28	38	38
3	Cell Phone	48	28	6	5
6	Utilities	88	28	11	11
11	Groceries	120	28	15	15
16	Cable/Internet	96	28	12	6
17	Insurance	112	28	14	7
21	Credit Card	80	28	10	10

Table 3. Other Unexpected Bills (or Shocks)

Month/Day	Description	Amount	Days until due	Consumption Points	Penalty
4/7 and 21/7	Vet Visit	180	28	0	45
10/7 and 26/7	Dentist Appointment	190	28	0	48
15/7	Car Repair	200	28	0	50
18/7	Taxes	212	28	0	53
23/7	Appliance Repair	148	28	0	37
24/7	Car Repair	152	28	0	38
26/7	Driving Violation	200	28	0	50

An individual decides which bills to pay and when to pay them. The total amount of bills to be paid over the course of the experiment is $26,244 and the total amount of income (plus the starting balance) is $28,075.[9] Thus bills comprise 93.5% of a subject's income, leaving just 6.5% for discretionary spending. As presented in Table 4, subjects also can choose to purchase optional consumption items at a take-it-or-leave-it price when they become available. Subjects are not informed of the frequency or type of consumption items offered in advance. Purchase of consumption items provide consumption points, which accrue to each subject's earnings. If a (frugal) subject refrains from buying any optional consumption items (and pays all bills on time), he or she will survive until the end of the experiment without taking out a payday loan, bouncing a check, or relying on overdraft protection.

Payment for consumption items is due at the time of purchase. Notice that optional consumption items generate consumption points at twice the rate that bills do. This is meant to capture the more hedonistic pleasure of leisure activities relative to the mundane consumption of utilities, for example. We assume that a vendor has no recourse if a participant bounces a check on an optional consumption item. However, the treatment conditions limit the total number of bounced checks (or overdrafts) to two or eight, so that bouncing checks (or writing overdrafts) eventually catches up with a participant.

Bounced checks or overdrafts are permitted in all of the experimental sessions, though as described at the onset of this section, the maximum number permitted varies with the treatment. Each bounced check or overdraft leads to a

[9] Since the experiment ends after 30 experimental months, this calculation omits the last paycheck on day 28 of month 30 which could not be used to pay bills, nor the last month's set of bills to appear which would come due the following month.

fee of $35, regardless of the amount of the check. When a participant bounces a check on a bill in the *No Overdraft Protection* treatment, he avoids the consumption point penalty in the current month, but this is only temporary as the penalty then hits the participant on day 23 of the following month. The bill also remains unpaid. The *Overdraft Protection* treatment differs in that the participant avoids the consumption point penalty in the next month. The bill, however, remains unpaid and the participant is still assessed the $35 fee for the overdraft.[10]

Table 4. Consumption Item Purchase Opportunities

Month/Day Introduced	Frequency Item is Offered	Description	Price	Consumption Points
1/7	Monthly	Movie	24	6
1/17	Monthly	Club	32	8
2/22	Monthly	Hobby	28	7
3/19	Monthly	Concert	36	9
5/9	Bi-Monthly	Sporting Event	80	20
6/2	Tri-Monthly	Vacation	200	50

All unpaid bills for the month appear as a lump sum item, "Previous Unpaid Bills", on the first day of the following month and are due 28 days later. If a participant fails to pay the previously unpaid bills, he or she incurs the associated consumption point penalty (in the case of utilities, 11 points) and the amount is rolled over to the next month until it is paid.

The computer serves as the payday loan lender in this experiment. The payday loans offered in this experiment are always $200 at a fee of $35, which is typical of the rate found in naturally occurring markets. No subject may take out a loan more than twice ($470) per biweekly pay period (recall the $475 paycheck). Note that the fee for bouncing a check or writing an overdraft is the same as the fee for taking out a $200 loan. All loans automatically are repaid on the next payday. All sessions begin without loans available and then on day 27 in month 2, the subjects in the *Loan* treatment receive the additional instructions on the availability of loans and how they work. Loans always are referred to in the experiment as "loans" and not "payday loans."

A total of 318 subjects participated in the experiment conducted at a large state university in the spring and fall of 2006 and the spring of 2007. Subjects were undergraduate students recruited from the university at large, many from a

[10] In the *Overdraft Protection* treatment, the "unpaid" bill represents the sum the individual must implicitly pay the bank which has "covered" the check.

table in front of a cafeteria. Participants received $7.00 for showing up on time and additional earnings from the experiment itself. Table 5 reports the summary statistics on the subject earnings by treatment.

Table 5. Summary Statistics on Earnings in US$*

	Overdraft Protection			
	L2	*NL2*	*L8*	*NL8*
Mean	23.59	23.40	20.99	20.58
Median	26.09	24.32	17.94	16.27
Minimum	3.05	2.29	2.69	3.24
Maximum	37.57	37.48	37.30	37.47
	No Overdraft Protection			
	L2	*NL2*	*L8*	*NL8*
Mean	7.38	13.48	17.78	17.71
Median	11.13	6.86	16.61	17.16
Minimum	3.01	2.87	2.86	2.75
Maximum	37.57	37.57	36.74	36.93

* Does not include $7.00 show-up payment.

Each subject was seated at a computer terminal and privately read the self-paced instructions on the screen. The experiment began after every subject had completed reading the instructions. Each session typically lasted approximately 75 minutes and no subject participated in more than one session (though several attempted to do so). The subjects were told that the experiment would not last longer than 90 minutes and so ended well in advance of this limit even if they survived until month 30. Earnings were paid privately at the conclusion of the experiment.

Before discussing the results we briefly comment on what we can learn about payday loans in the laboratory vis-à-vis the field. A natural question might be, how can we compare the consumption in the experiment with the consumption in the naturally occurring economy? The answer to this question lies not in explaining how the benefit of paying a grocery bill in our one hour computer exercise somehow corresponds to the benefit of supermarket purchases by a 30-year old single mother of two in rural Virginia. Our aim is to observe what groups of cash-motivated participants do and do not do when faced with a focused task; and here's the key, when replicated under a common set of initial conditions. The typical consumer of payday loans is scraping by month to month and lives in a world full of financial shocks whose frequency and magnitude cannot be

anticipated. The policy question that is debated is whether payday loans help or hinder these people scrape by. To this end we designed a novel computer exercise in which each subject must also scrape by from period to period to continue earning money.[11] The objectives of the single mother of two and our typical undergraduate participant are clearly different, but how they go about satisfying their objectives involves analogous trade-offs. Both can indulge in or forego optional consumption purchases when they are affordable, and both can or cannot take out loans to finance optional purchases when they are not affordable.

The most important feature of our design is that, despite their meager means, our subjects are strongly induced to strive to participate further in the experiment in much the same way that a single mother of two in Virginia strives to make ends meet as a basis for further striving. Furthermore, no data, that we are aware of, has been collected on the number of payday customers that make *good* decisions with payday loans. One benefit of experimental economics is that in the laboratory, the counterfactual, which is unseen in the naturally occurring economy, comes to light. While field data sets may reflect the circumstances of actual payday loan customers, they cannot control for the circumstances under which these customers may need to use them. Nor can they randomly assign people to conditions with and without access to payday loans to assess the efficacy of payday loans. In sum, a laboratory experiment complements field studies with actual payday loan customers by providing data on what cannot be studied in the field.

IV. HYPOTHESES

Our primary objective is to examine whether access to payday loans influences individual welfare and, more specifically, the likelihood of financial survival in our experiment. There are other measures of welfare on which to assess the impact of payday loans in the naturally occurring economy, but the key feature of our design is the necessity of surviving month to month to earn more money in the experiment. By design participants must earn $1 by making ends meet to continue on in the experiment. Hence, the likelihood of survival is the most important determinant of a subject's earnings. All other measures are secondary to this primary determinant of participant earnings.

To examine what effect the existence and use of payday loans have on the likelihood of financial survival, we employ the popular proportional hazards

[11] To our knowledge this is the first economic experiment in the laboratory to employ an endogenous survival mechanism.

model developed by Cox (1972).[12] In the presence of right censoring, this method of analyzing the effect of covariates on the hazard rate assumes that $\lambda(t_i) = e^{\beta' x_i}\lambda_0(t_i)$, where λ is the hazard function for individual *i* at time *t*, **x** is the covariate vector associated with the parameter vector β, and λ_0 is the baseline hazard. For a treatment dummy variable, the Cox model affords a simple interpretation of the "relative risk" for our *No Loan* treatment. Subjects in the *No Loan* treatment are $e^{\beta_{NL}}$ times less likely to survive financially than those in the *Loan* treatment. In other words, we have a measure of the difference in survivability between those who do and those who do not have access to payday loans. For continuous covariates, the exponentiated estimated coefficients are interpreted as the effect of a unit change in the covariate on the relative hazard. For example, $e^{\hat{\beta}_1}$ implies that a one-unit increase in the first covariate changes the hazard by $(e^{\hat{\beta}_1} - 1) \times 100$ percent. An attractive feature of the semi-parametric Cox regression is that it makes no assumption about the parametric distribution of the length of financial survival.

Specifically, we include a number of covariates in our Cox regression. The first covariate, *CIPercent*, measures the expenditures on optional consumption items as a percentage of total income.[13] *NumberLoans* equals the number of loans that subject *i* took out in the *Loan* treatment.[14] *EarlyPenalties* measures the number of consumption point penalties that the subject incurred in the first two months. We also include several dummy variables as covariates. *No Loan* equals 1 if the subject is in the *No Loan* treatment, and equals zero if the subject is in the *Loan* treatment. *2BC* equals 1 if the subject is in either of the

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[12] Kiefer (1988) presents a thorough introduction to the analysis of duration data and subsequent use of hazard models in economics. For a less formal discussion of duration models, see Kennedy (2003).

[13] Because the set of opportunities for optional consumption items is fixed over a six month cycle and is the same cycle for every subject, the danger is minimal that the length of financial survival affects the covariate *CIPercent*, which is measured as a percentage over all months of survival.

[14] If the duration of financial survival definitionally (or involuntarily) determined the *NumberofLoans* that a subject would take out, then we would have the problem of an endogenous covariate and hence a biased interpretation of the hazard ratio for this covariate. For example, a Cox model to assess whether casualties affect the duration of war has the endogeneity problem that war duration also causes deaths. Each subject in our experiment, however, has a choice of whether or not to put themselves into a position to need a payday loan at any time during the experiment: early, middle, or late. In other words, *NumberofLoans* is independent of time. Just because a subject survives longer doesn't mean that the subject is going to put, or not put, him- or herself into a financially precarious position of needing to take out a loan. A scatterplot of *NumberofLoans* against months of survival reveals no uniform relationship across our subjects, and a simple OLS regression of *NumberofLoans* on months of survival (for all the subjects in the *Loan* treatment) confirms this with an R^2 of 0.01 and a $F_{1,158} = 1.95$ (*p*-value of 0.1649).

maximum of two bounced checks or maximum of two overdraft checks treatments. *2BC*, therefore, equals zero if the subject is in a treatment that allows her to bounce up to eight checks or write up to eight overdraft checks. *NoOverdraft* equals 1 if the subject is in the *No Overdraft Protection* treatment, and equals zero if the subject is in the *Overdraft Protection* treatment. And finally, *Female* equals 1 if the subject's gender matches the variable's name.

Our hypotheses are as follows. Our primary hypothesis is that the *No Loan* treatment decreases the likelihood of financial survival because those subjects do not have access to the loans to absorb the bill shocks ($\beta_1 > 0$). Critics of payday loans contend that people subjects may be caught in a "cycle of debt." Thus, an increase in the *NumberLoans* variable is hypothesized to decrease the likelihood of financial survival. Similarly, an increase in the use of loans results in more expenditures on loan fees and, therefore, results in fewer funds available to pay for expected bills and unexpected shocks. Both of these interpretations suggest that increases in the number of loans will reduce the likelihood of financial survival ($\beta_4 > 0$).

We also expect that those subjects who can bounce no more than two checks or write no more than two overdrafts are less likely to survive financially. *2BC*, therefore, decreases the likelihood of financial survival because the subjects have fewer opportunities to use bounced checks or overdrafts as a means to absorb bill shocks ($\beta_2 > 0$). We also expect that *NoOverdraft* will decrease the likelihood of financial survival because, all else fixed, subjects incur additional penalties when bouncing checks (in comparison to overdrafts). We hypothesize that the additional penalties in the *No Overdraft Protection* treatment will make it more difficult to survive ($\beta_3 > 0$).

We also hypothesis that increases in the *CIPercent* variable will decrease the likelihood of financial survival, as purchasing optional consumption items results in fewer funds available to pay for expected bills and unexpected shocks as they arise ($\beta_5 > 0$). Further, an increase in the *EarlyPenalties* variable is expected to decrease the likelihood of financial survival as it difficult to continue in the experiment if one incurs penalties early in the experiment.[15] And finally, we have no reason to predict a gender effect in this experiment.

[15] Because *EarlyPenalties* measures the number of penalties only in the first two months and a subject cannot die until the end of the second month, months of survival cannot affect *EarlyPenalties*. Hence, *EarlyPenalties* is not an endogenous covariate.

Before proceeding further we note that in analyzing the data we found a software bug that differentiated the environmental conditions of a small subset of the subjects (11%) from the others in the *Overdraft Protection* treatment only. Specifically, if a subject attempted to repay his or her "Previous Unpaid Bills" exactly on the first of the month, the software recorded the payment in the accounting ledger of the subject, but this line item for "Previous Unpaid Bills" would appear again in the next month to be repaid a second time. Thus, to survive these subjects would have to pay their unpaid bills twice, making their financial survival that much more difficult.[16] This software problem affected four subjects in the *NL8* treatment, seven in the *L8* treatment, twelve in the *NL2* treatment, and thirteen in the *L2* treatment. Fortunately, we can include these subjects in the Cox regression as "alive" or surviving for the month *before* the software bug affected them. That is, in the month prior to the problem they are in exactly the same circumstances as all the other subjects in the experiment with the observation that they are still surviving in the experiment.[17]

V. RESULTS

The estimates from the Cox regression are reported in Table 6. We report the results of the three primary treatment conditions in two model specifications, with and without the behavioral variables and gender. The estimated hazard ratio for the *No Loan* treatment is 1.31 and is statistically different from one (p-value = 0.0550) in the full model. The estimate in the treatment dummy only model is 1.24 (p-value = 0.0650). The interpretation of this estimate is that the *No Loan* treatment increases the relative hazard of financial survival in our experiment by 31 percent. After controlling for the expenditures on the optional consumption items, the subjects without access to loans are at a nontrivially higher risk. Hence we find that the existence of payday loans, all else fixed, increases the probability of financial survival by 31%. In the specification that only includes the treatment dummy variables, the probability of financial survival by 24%. Payday loans,

[16] Amazingly some subjects did.

[17] Medical studies that utilize this model often have many subjects coded similarly. The Cox survival model explains how long a subject survived since a treatment condition began and takes as an input whether or not the subject is currently alive at the time of monitoring. In a cross section of individuals it is *not* necessary that the individuals all have the same opportunity to survive, which in our case is 30 months, nor furthermore does the model assume that all subjects must have enough time to expire (in medical studies this means actually dying) for there to be useful information for the proportional hazard. Thus, if we "monitor" the subjects before the software bugs hits, they are coded as alive up until this point. We cannot simply drop these subjects without introducing a bias into results as there may be a latent variable that selects these individuals to pay their bills on the first day of the month.

therefore, are a means for the subjects to absorb shocks when, for example, they do not sufficiently save for the unexpected "rainy days".

Taking out the loans, however, does not come without its risk. The estimated coefficient for the *NumberLoans* variable indicates that each additional loan increases the relative hazard by 3 percent and is highly statistically significant (*p*-value = 0.0090).[18] Thus, we find that a sparing use of loans enhances the survivability of the subject relative to the *No Loan* treatment. The model predicts that a subject taking out ten or fewer loans in the *Loan* treatment has a lower hazard rate than a corresponding subject in the *No Loan*. However, taking out more than ten loans puts the subjects at a greater risk than a corresponding subject in the *No Loan* treatment.

Table 6. Estimates of the Cox Proportional Hazard Model for Months Survived

	$\hat{\beta}_j$	$e^{\hat{\beta}_j}$	*z*-stat	*p*-value	$\hat{\beta}_j$	$e^{\hat{\beta}_j}$	*z*-stat	*p*-value
No Loan	0.2137	1.24	1.516	0.0650	0.2666	1.31	1.58	0.0550
2BC	0.0689	1.07	0.468	0.3200	0.2315	1.26	1.55	0.0600
NoOverdraft	0.9343	2.55	6.086	<0.0001	0.3974	1.49	2.37	0.0090
NumberLoans					0.0249	1.03	2.37	0.0090
CIPercent					0.1017	1.11	4.41	<0.0001
EarlyPenalties					0.0844	1.09	14.05	<0.0001
Female					0.0849	1.09	0.58	0.5600
		LR(3) = 42.8 318 Obs.		<0.0001			LR(7) = 230 318 Obs.	<0.0001

The interpretation of the *No Loan* and *NumberLoans* variables provides us with an opportunity to offer some comments about what effect both the existence and use of payday loans has on the subjects' abilities to survive financially in our experiment. In our experiment, 160 subjects had access to payday loans. Of those 160 subjects, 35 of them took out more than ten payday loans. Based on the results of the above hazard model, the predicted probability of survival for these 35 subjects (i.e., 21.9% of the subjects with access to payday loans) was lower than that for otherwise identical subjects in the *No Loan* treatment. At the same time, the predicted probability of financial survival for the remaining 125 subjects for whom payday loans exist was higher than that for otherwise identical subjects in the *No Loan* treatment. In other words, while some subjects' financial survival was adversely affected by their use of payday loans, the majority of subjects in our experiment (i.e., 78.1% of the subjects with access to payday loans) benefited from both the existence of and their subsequent use of payday loans.

[18] The additional covariates of the square of *NumberLoans* and an interaction variable of *NumberLoans* × *CIPercent* are both highly insignificant.

The restriction of the number of bounced checks (and overdrafts) to two has a significant impact on the ability of our subjects to survive financially. Relative to the *8BC* treatment, the *2BC* treatment increases the probability of failure by 26 percent (*p*-value = 0.0600). Even after taking into account the costs associated with bounced checks and overdrafts, this result implies that subjects' abilities to survive financially are greater when the subjects are allowed to bounce more checks or to write more overdraft checks. This result, however, is not robust to the different models. In the streamlined model, *2BC* is not statistically different from 1 (*p*-value = 0.3200).

As hypothesized, the estimated coefficient for the *NoOverdraft* variable is positive and statistically significant (*p*-value = 0.0090) in the full model. This result indicates that those subjects in the *NoOverdraft* treatment are 49% less likely to survive financially. Without the behavioral variables, the *NoOverdraft* variable has an extremely large impact ($e^{\hat{\beta}_3} = 2.55$, *p*-value < 0.0001).

We also find that an increase in the *CIPercent* variable increases the probability of financial failure. Specifically, a one percentage point increase in the share of income used to purchase optional consumption items will increase the probability of financial failure by 11% (*p*-value < 0.0001). Figures 2 and 3 plot the expenditures on optional consumption items as a percentage of income against the number of months of financial survival and reveals a rather clear linear relationship between the two variables for subjects when the *CIPercent* is greater than 6.5% in the *2BC* treatment.[19] This figure clearly shows that the frugal participants who spend less than 6.5% of their income on optional items generally survive until the end of the experiment; the exceptions are the subjects that make early mistakes by failing to pay a bill associated with a large penalty.[20] Furthermore, the more that subjects spend on optional items beyond 6.5% the fewer months they survive.

The estimated coefficient for the *EarlyPenalties* variable is also positive and statistically significant (*p*-value < 0.0001). As expected, increases in the number of penalty points in the first two experimental months cause an increase in the probability of financial failure. Specifically, each additional penalty point

[19] Recall that monthly bills and other shocks represent 93.5% of the subjects' income. The subjects, therefore, can use 6.5% of their income for optional/discretionary spending (or saving).

[20] For example, often if a subject fails to pay the rent bill early in the experiment, there is little that a subject can do in the early months to overcome its associated penalty.

causes the probability of financial failure to increase by 9%.[21] And finally, we find that gender has no effect (*p*-value = 0.5600).

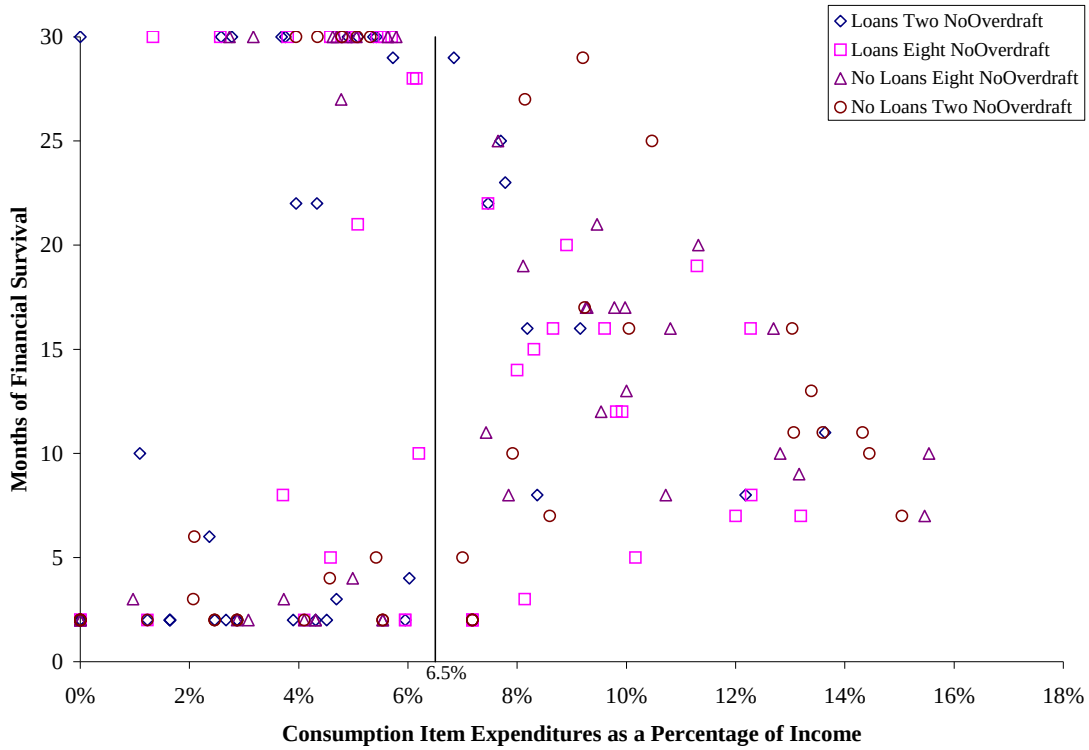

Figure 2. *CIPercent* Plotted Against Months of Financial Survival for *No Overdraft* Treatment

We conclude this section with observations on the spontaneous order plotted in Figures 2 and 3. Notice how uniformly people survive until the end of the experiment (once they make it past the first 5 months), *if they restrain their purchases of optional consumption items to less than 6.5% of income*. Recall that by design a solvent subject can only spend 6.5% of income on discretionary spending over a full 30 months of the experiment. For subjects who more liberally spend their income on the optional consumption items, there is a near linear inverse relationship between the months survived and the percentage of

[21] One possible explanation for this result is that the *EarlyPenalties* variable may capture the effects of the financial skills that each subject brings with her/him to the experiment. We would expect that subjects who know how to pay bills, manage their financial situation, … etc. are less likely to incur penalties early on in the experiment. Hence, the *EarlyPenalties* variable may also serve as proxy for personal finance skills. Regardless of the interpretation, increases in this variable have a negative effect on the probability of financial survival.

income used to purchase optional consumption items. Considering that people whose *CIPercent* < 6.5% take out very few loans, the above analysis indicates that loans are an effective tool to allow people with *CIPercent* > 6.5% to survive longer, as long as they do not overuse them.

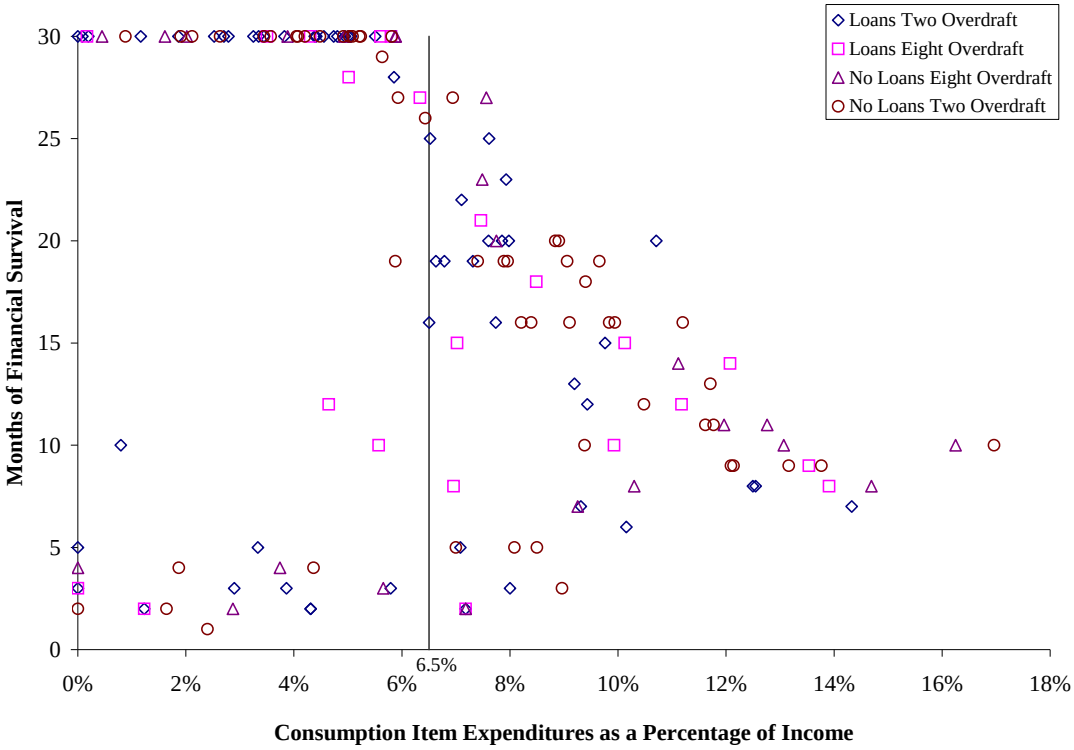

Figure 3. *CIPercent* Plotted Against Months of Financial Survival for the *Overdraft* Treatment

VI. CONCLUSION

The payday loan industry has received intense scrutiny by policy makers and consumer advocacy groups. This is not a surprising development given the industry's growth, the high interest rates charged on payday loans, and the much-publicized news accounts of those individuals whose repeated renewals of just one payday loan resulted in finance charges that far exceed the initial loan. Given both these high interest rates and allegations of excessive borrowing by some payday loan customers, a number of critics conclude that the payday loan industry represents abusive if not predatory lending. Not surprisingly, some of these same

critics have suggested interest rate caps as a remedy while others have argued that the industry should be banned altogether.

In this paper, we design an environment similar to the one that payday loan customers face. We then conduct a laboratory experiment to examine what effect, if any, the existence of payday loans has on individuals' abilities to manage and to survive financial setbacks (as represented by unexpected expenditures). Our primary finding addresses the question as to whether access to payday loans improves or worsens the likelihood of financial survival in our experiment. We also test the degree to which people's use of payday loans affects their ability to survive financially. We find that payday loans are a means for the subjects to absorb expenditure shocks and, therefore, survive financially. Taking out payday loans, however, does not come without its own risks. Subjects whose demand for payday loans exceeds a certain threshold level are at a greater risk than a corresponding subject in the treatment in which payday loans do not exist. While some subjects' financial survival was adversely affected by their use of payday loans, we found that the majority of subjects in our experiment benefited from the existence of and their subsequent use of payday loans.

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APPENDIX A: EXPERIMENT INSTRUCTIONS

<page 1>

Welcome

This is an experiment in the economics of decision-making. The instructions are simple. If you read them carefully and make good decisions, you may earn a

considerable amount of money that will be paid to you in cash at the end of the experiment.

From this point on, all references are in terms of computer dollars. In this experiment you will have a series of bills you must pay over the course of some days and months. Some bills will come on a monthly basis and some will be one time only.

Bills are located in the upper left portion of the screen and will appear throughout the experiment. Each bill will be due in some number of days after it appears. This means it must be paid on or before the due date. To pay a bill, highlight it by clicking on it and press the Pay Selected Bill button.

Each bill will have an amount due. Your account balance is located in the "Account History" frame in the bottom left portion of your screen. This section of your screen records a history of your transactions and your current balance.

<page 2>

Consumption Points

When a bill appears you will earn consumption points. You can think of consumption points as the benefit you receive from consuming the item on the bill. The consumption points you earn from any given bill is located under the "Consumption points" column in the bills frame.

Every consumption point you have at the end of each month will earn you one cent that will paid to you at the end of the experiment. Your monthly consumption point total will be reset to zero at the beginning of the month.

If you do not pay a bill, you may incur a consumption point penalty. The penalty for not paying a bill is located under the "Penalty" column in the Bills section. The penalty will be subtracted from your monthly consumption point total. That bill will then appear next month as "Previous Unpaid Bills" in bill section. You will continue to incur the consumption point penalty each month until you pay it off.

<page 3>

Consumption Points Continued

Each month consumption items will also be available for purchase. These items are located in the top right portion of your screen.

Consumption items are optional purchases; there is no penalty if you do not purchase them. If you do purchase a consumption item, then the cost will be subtracted from your balance and the consumption points will be added to your monthly total.
At the end of each month, which is every 28 days, your consumption points will be added to your earnings. They will then be cleared out.

Each month you must consume a minimum of **100** consumption points. *It is important to note that if you do not reach this minimum by the end of each month, your participation in the experiment will end.*

<page 4>
Bills continued
If you pay a bill that is greater than your account balance, meaning you don't have enough money to pay for it, you will incur a non sufficient fund (NSF) fee. If this occurs, only the NSF fee of 35 dollars will be subtracted from your balance, and you will avoid the consumption penalty. However, the amount of the bill and its associated penalty will appear next month as part of the "Previous Unpaid Bills".

You can only incur 2 NSF fees.

On the 14th and 28th of every month you will receive a paycheck in the amount of **475**. This will be added to your account balance.

<page 5>
At the end of the experiment your balance will be converted to cash at a rate of 4 computer dollars to one US cent. This cash will be added to your "Earnings" from the consumption points, which is displayed at the bottom of your screen.

Important Items for Review

(1) Every consumption point you have at the end of a month will earn you one US cent.
(2) If you do not accumulate the minimum number of consumption points by the end of a month, your participation in this experiment will end.

If you feel you are prepared to proceed with the actual experiment, click on the Start button. The experiment will begin once everyone has clicked on the Start button. If you have a question that you feel was not adequately answered by the instructions, please raise your hand and ask the monitor before proceeding.

<*Loan* treatment instructions on day 27, month 2>

Loans

At any time you can take out a loan from one of the *x* different lenders, located in the bottom right portion of your screen.[22] All of the loans will give you the same amount, 200 computer dollars. But the different lenders may offer different rates for their loans, located in the "Amt. Due in X Days" column.

Suppose the rate in this column is 225, then if you took out that loan you would receive 200 immediately which would be available to spend. Then you would owe 225 on the next payday (the 14th or the 28th).

The loan will be automatically repaid at the price the amount the lender offered at the time of purchase. On the day the loan is due you can choose to renew it by clicking the "Renew Loan" button. This will renew the loan at the current lender's rate. The original loan will also be automatically paid back.

[22] The software has been programmed to implement subjects as lenders. We chose to first implement a robot lender for this initial project. Each lender has a maximum capacity of twelve loans, so depending upon how many subjects were in a session, we included enough computer lenders to accommodate two loans per subject per pay period.

THE REAL COSTS OF CREDIT ACCESS: EVIDENCE FROM THE PAYDAY LENDING MARKET*

BRIAN T. MELZER

Using geographic differences in the availability of payday loans, I estimate the real effects of credit access among low-income households. Payday loans are small, high interest rate loans that constitute the marginal source of credit for many high risk borrowers. I find no evidence that payday loans alleviate economic hardship. To the contrary, loan access leads to increased difficulty paying mortgage, rent and utilities bills. The empirical design isolates variation in loan access that is uninfluenced by lenders' location decisions and state regulatory decisions, two factors that might otherwise correlate with economic hardship measures. Further analysis of differences in loan availability—over time and across income groups—rules out a number of alternative explanations for the estimated effects. Counter to the view that improving credit access facilitates important expenditures, the results suggest that for some low-income households the debt service burden imposed by borrowing inhibits their ability to pay important bills. *JEL* Codes: D14, G2.

I. INTRODUCTION

Historically, consumer lending markets have been highly regulated, subject to state-imposed usury and small loan laws that limit interest rates and principal amounts, among other terms and conditions. Among high credit-risk individuals, interest rate caps can bind and lead to credit rationing. An important question to consider in this context is whether improving access to credit, for example by raising or removing interest rate caps, alleviates economic hardship among borrowers. Economic theory does not offer an unambiguous answer to this question. Improved access to

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credit can ease financial distress by allowing individuals to better smooth income or consumption shocks. Loan access can also exacerbate hardship among individuals with forecasting or self-control problems, who borrow to increase current consumption but suffer in the future due to a large debt service burden (Ausubel 1991; Laibson 1997; Bond, Musto, and Yilmaz 2009).

In this paper I make use of the emergence and development of the payday lending industry, which provides short-term loans at high interest rates, to study this issue empirically. Employing a measure of payday loan availability that varies geographically and over time, I estimate the effect of payday loan access on the following aspects of economic hardship: delay of needed health care due to lack of money; difficulty paying mortgage, rent and utilities bills; household food insecurity; going without telephone service; and moving out of one's home due to financial difficulties. These measures constitute a broad selection of outcomes on which to observe the effects of borrowing. Importantly, the likelihood of these events is also plausibly influenced by a small, short-term loan.

Identifying the effects of payday lending is difficult because loan access is not randomly assigned. Geographic access depends on the location decisions of households and lenders as well as the regulatory decisions of state legislators. The latter two decisions, on the part of store operators and legislators, are likely made in response to the characteristics of potential borrowers. State-level welfare and health care policies that affect economic hardship among poor populations also may not be independent of payday lending regulations.[1] These considerations suggest that straightforward analyses of outcomes relative to store presence or proximity will fail to measure the causal impact of borrowing.

To surmount these issues, the empirical design isolates variation in loan access that is independent of store location decisions and state-level policy decisions. The analysis focuses on households in states that prohibit payday loans, for whom borrowing requires travel to a state that allows payday lending.[2] Households that live close to a payday-allowing state have easy

1. Consistent with the concern that differences in payday lending laws are confounded with other variation across states, Benmelech and Moskowitz (2010) find considerable evidence that state usury laws in the 19th century are influenced by economic conditions (financial crises), as well as political and economic policies.

2. Internet and telephone payday lending, though more extensive today, were limited during the years (1996–2001) covered in my sample. In addition, assuming homogenous effects of loan access across lending channels, internet and telephone

access. In contrast, households within the same state but sufficiently far from the border have limited, or more costly, access. With these circumstances in mind, I use distance to the border of the nearest payday-allowing state to define loan access. Store location decisions and home-state regulations play no role in generating the identifying variation in this measure; access to loans varies entirely due to household location decisions as well as the regulatory decisions of bordering states.[3]

There is considerable anecdotal evidence that people cross into payday-allowing states to get loans.[4] Using geographic data on payday lending locations compiled from state regulators, I offer further proof: conditional on zip code-level observables and a general effect of border proximity, the number of store locations is almost twenty percent higher in zip codes close to payday-prohibiting states. This effect is also stronger in areas where, judging by the income distribution, there are more potential payday loan customers across the border. These facts provide suggestive, if not conclusive, evidence that stores locate at these borders to serve nearby borrowers.

In the main analysis I find no evidence that payday loan access mitigates financial distress. In fact, loan availability leads to important real costs, as reflected in increased likelihood of difficulty paying bills and delaying needed health care. The magnitudes of these effects are considerable. Among families with $15,000 to $50,000 in annual income, loan access increases the incidence of difficulty paying bills by 25%. Among adults in these families, access increases the delay of needed medical care, dental care and prescription drug purchases by a similar proportion. The estimates are robust to the inclusion of extensive individual-level

payday borrowing among those without geographic access would bias the estimated effect of geographic access toward zero.

3. Pence (2006) also studies border areas, using cross-state discontinuities in foreclosure laws within a market to study credit supply. In contrast, my study uses regulatory differences at borders, but compares households within the same state, not across states.

4. See "Georgia Border Residents …" (2007), which cites the claim by the Community Financial Services Association of America—the largest payday loan trade association—that roughly 500,000 loans were made to Georgia residents by stores in surrounding states in 2006. Spiller (2006) discusses Massachusetts residents traveling to New Hampshire to get loans. Appelbaum (2006) discusses the build-up of store locations along South Carolina's border to serve customers from North Carolina.

and county-level control variables as well as a control for border proximity. Two falsification exercises strengthen the case further: proximity to payday lenders has no effect on households that are unlikely payday borrowers judged by income, and counties near future payday-allowing states show little difference in hardship before loans are available across the border.

Results from three additional models offer further confirmation that the measured effects are due to payday loan access and not some other factor. First, a difference-in-difference model that isolates changes in loan availability over time shows that rates of hardship increase when payday loans become available across the border. These results confirm the sign and magnitude of the main findings, albeit with less inferential weight. Second, I identify payday access effects by comparing across income groups. Low-income households, who are largely screened out of the payday loan market, serve as a comparison group for low- to moderate-income households, who represent the vast majority of payday borrowers. Loan access in this case varies within county, so differences in financial safety net and welfare services across counties are not confounding factors. Results from this model support the conclusion that payday loan access increases the likelihood of difficulty paying bills and moving out of one's home, but show little effect of loan access on health-related hardship. Third, I investigate whether the proximity of payday lenders matters more in counties where a greater proportion of workers commute to payday-allowing states and therefore face a lower cost of accessing loans. For difficulty paying bills, cross-border access does indeed have a larger effect in counties with more commuting flow.

In summary, I find robust evidence that payday loan access leads to increased difficulty paying mortgage, rent and utilities bills. While I do not observe actual borrowing, one can view the coefficients on loan access as reduced form estimates of the impact of borrowing, where geographic access serves as an instrumental variable for borrowing. Section VI addresses this issue in more detail.

By offering an empirical analysis of the effects of payday lending, this research addresses a similar topic as other recent studies, but with quite different outcome measures, methodology and results (Carrell and Zinman 2008; Karlan and Zinman 2010; Morgan and Strain 2008; Morse Forthcoming; Skiba and Tobacman 2008; Zinman 2010). This study identifies the effects of loan access for a fairly representative population of low- to moderate-income

households, thereby complementing other research that identifies effects for particular states of nature and for more specific populations.[5] The outcome variables in this study are also quite directly and plausibly linked to loan access, which facilitates more powerful tests (null results are more meaningful) and makes interpretation of the results fairly straightforward. Finally, the existing literature finds mixed results, with some studies suggesting that payday borrowing leads to greater hardship, and others suggesting that loan access provides benefits.[6] Accordingly, additional research is valuable in furthering our understanding.

The following section discusses the basic models of consumer borrowing underlying the hypotheses tested in this paper. Section III highlights relevant background material on payday loan transactions and the regulation and development of the payday lending industry. Sections IV and V cover the data, empirical methodology and results. Finally, sections VI and VII offer further discussion and interpretation of the results along with concluding thoughts.

II. Theories on Consumer Borrowing

II.A. Borrowing to Smooth Current Income or Consumption Shocks

Credit access can alleviate hardship by expanding a household's options when managing consumption over time. If an otherwise credit-constrained household can borrow, even for a short period, it can potentially smooth expenditures around periods of income or consumption shocks, which in the absence of borrowing

5. Morse (Forthcoming) identifies the effect of loan availability after natural disasters. Skiba and Tobacman (2008) and Carrell and Zinman (2008) estimate the effects of payday borrowing for the riskiest borrowers (based on a credit score) and for members of the Air Force, respectively.

6. Two studies detect negative effects: Skiba and Tobacman (2008) find greater rates of Chapter 13 bankruptcy filings among payday borrowers, and Carrell and Zinman (2008) find declines in job performance and readiness among Air Force personnel stationed near payday lenders. Three studies find benefits of payday loan availability: Morse (Forthcoming) finds lower foreclosures following natural disasters; Morgan and Strain (2008) find lower rates of bounced checks in Georgia and North Carolina before payday loan bans; and Zinman (2010) identifies deterioration in subjective assessments of financial well-being after Oregon restricts payday lending. In a field experiment in South Africa, Karlan and Zinman (2010) also find that improved credit access increases rates of employment and improves food security.

can lead to adverse events like delinquency on rent payments, eviction, or forgone health care. Under difficult circumstances, individuals might rationally place a high value on current consumption relative to future consumption, and therefore benefit from borrowing in spite of high interest rates. Competition in credit markets can also benefit consumers. If payday loans offer a clear financial advantage over a consumer's next best borrowing option, then loan access can be beneficial.[7] In light of these considerations, it is natural to test the hypothesis that access to payday loans reduces the likelihood of the negative outcomes under consideration.

II.B. Forecasting and Commitment Problems: Borrowing Costs and Future Distress

While loans provide flexibility in managing consumption over time, they can also impose a substantial debt service burden. When consumers underestimate future interest payments or are unable to commit themselves to a plan of prompt repayment, the future costs of borrowing can outweigh the initial benefits, even from an *ex ante* perspective.

Models of time-inconsistent, hyperbolic preferences have been used to explain consumer borrowing, particularly borrowing at high interest rates (Laibson 1997). Under these preferences, which are often invoked to explain self-control problems (O'Donoghue and Rabin 1999), individuals will sometimes choose to borrow even when doing so makes them worse off. They borrow under the assumption that they will repay the loan in one period, but they cannot commit to this plan. As a result, they end up borrowing and paying interest over many periods. Likewise, under a behavioral model in which individuals systematically underestimate their likelihood of repaying loans in the future, increased loan access can lead to repeated borrowing that is welfare reducing (Ausubel 1991).[8] In both cases, constraining these individuals' consumption in the current period by removing a source of credit can improve their welfare. As discussed subsequently in

7. Payday lending companies cite straightforward examples in which their loans offer borrowers a clear financial benefit, for example when the loan facilitates a bill payment to avoid a delinquency fee that exceeds the loan's interest charge (see Community Financial Services Association of America 2007).

8. Another possibility, put forth in Bond, Musto, and Yilmaz (2009), is that borrowers are misinformed about their ability to repay loans in the future, and consequently underestimate the costs of borrowing.

Section VI, the pattern of repeated borrowing implied by these models is consistent with payday loan usage data.

It is important to note that a model with time-consistent, exponential discounting also predicts borrowing at high interest rates among individuals with very high discount rates. In this formulation, the choice to borrow and bear high future costs, including an increase in expected hardship costs, need not be welfare decreasing; the loan's benefits might exceed the increase in expected hardship costs.

Although I cannot distinguish and test among the particular theories that predict borrowing at high interest rates, I can test their common implication, namely that payday loan access can increase the likelihood of the adverse outcomes under consideration. This test, strictly speaking, will not determine whether payday loans are welfare increasing or decreasing, but rather whether they facilitate important expenditures.

III. Payday Lending Background

Payday advance loans are a short-term source of liquidity used by low- to moderate-income customers. Loans typically have two to four week maturities, principal balances of $200 to $1000 and fees of $15 to $20 per $100 principal balance. The standard underwriting practice in the industry is to require identification, a recent bank account statement, a recent pay stub (or verification of other income), and a personal check that is post-dated to coincide with loan maturity.[9] Renewal and roll-over of loans is common: in practice, payday advances constitute a longer source of liquidity than the two to four week loan duration implies.

Payday borrowers are not destitute, as very poor individuals generally fail to meet the bank account ownership and employment requirements of lenders. In surveys of payday borrowers, the vast majority of respondents report family income between $15,000 and $50,000, while only seven percent of borrowers report family incomes below $15,000.[10]

Since its emergence in the mid-1990s the industry has grown dramatically, reaching 10,000 store locations nationwide by 2000

9. Barr (2004) and Caskey (2005) discuss the basic features of these transactions and the payday loan industry more broadly.

10. See Elliehausen (2006), p. 19, which relies on data from Elliehausen and Lawrence's (2001) survey of payday borrowers.

and 25,000 locations by 2006. Annual loan volume is estimated to have grown in parallel, from about $8 billion in 1999 to between $40 and $50 billion in 2004.[11] High interest rates and rapid industry growth have piqued the attention of consumer advocates, the popular press and state legislators, with considerable changes made to state regulations on loan terms and conditions in recent years.

Regulatory differences across states provide the basis for this study's identification strategy. Key to the empirical design is a focus on states that prohibit payday lending. Of the six states that prohibited payday lending during the time covered by this study, household survey data is available for three of them: Massachusetts, New Jersey, and New York. For the entire sample period, these states forbid both direct payday lending and its facilitation through an agent model.[12] Delaware, New Hampshire, Pennsylvania, and Rhode Island are the payday-allowing states that border Massachusetts, New Jersey, and New York.[13] Payday lending emerged in these areas during the sample period, providing nearby access to loans from New Jersey and New York after 1997, and from Massachusetts after 2000. More thorough discussion of the relevant state regulations is provided in Appendix I.

IV. Data and Outcome Measures

IV.A. Data

The primary outcome and control variables are sourced from the National Survey of America's Families (NSAF), a household survey designed and implemented by the Urban Institute, with data collection performed by Westat. In collecting these data, the Urban Institute aimed to facilitate study of welfare programs targeting the poor, particularly as fiscal responsibility for these programs transferred from federal to state government in 1996.[14]

11. Stegman (2007), p. 169–170.

12. Under the agent model, payday loan stores act as brokers, arranging loans between customers and state- or nationally-chartered banks that are not subject to usury laws.

13. Two other bordering states, Vermont and Connecticut, also prohibited payday lending. The sample includes a small number of New York observations near Canada, where loans were allowed. I assume that international border crossing to get loans is costly and not common; the number of observations affected is small and the results are not sensitive to this assumption.

14. See Abi-Habib, Safir, and Triplett (2004).

In total, the NSAF data constitute a repeated cross-section of roughly 42,000 households per year during 1997, 1999 and 2002.[15] The data are nationally representative, and are also representative at the state level for 13 selected "focal states."[16] The NSAF's coverage of economic hardship among low-income individuals, and its large, state-representative samples within three payday-prohibiting states make it particularly useful in the context of this study. Furthermore, the survey's inclusion of county-level geographic identifiers in focal states facilitates the measurement of household location relative to state borders and payday loan store locations.

The county-level data used to supplement the NSAF include: unemployment data from the Bureau of Labor Statistics, personal income data from the Bureau of Economic Analysis, and economic, demographic and workflow data from the 2000 Census. In testing whether the supply of payday store locations depends on the distance to payday-prohibiting states, I use the addresses of licensed payday lending branch locations collected from banking regulators in 10 states as of July 2007.[17]

IV.B. Outcome Measures

All dependent variables are binary measures, sourced from NSAF questions about events of economic hardship in the 12 months prior to the survey. The underlying survey questions are given in Appendix II. Four health-related measures are taken at the person level: *Medical Care Postponed*, *Dental Care Postponed*, and *Drug Purchase Postponed* are indicators for whether an individual has forgone or postponed needed care due to lack of insurance or money. From these three components, I form a single indicator, *Any Care Postponed*, for the postponement or delay of

15. I refer to the waves of data based on the year in which the survey was conducted. Respondent interviews were conducted between February and September. The median interview occurred in May, so the median respondent in 2002 would be answering questions about the prior year, from May 2001 through May 2002.

16. The 13 focal states are: Alabama, California, Colorado, Florida, Massachusetts, Michigan, Minnesota, Mississippi, New Jersey, New York, Texas, Washington, and Wisconsin.

17. The states for which I collected store location data are Alabama, Delaware, Florida, Kentucky, New Hampshire, Ohio, Rhode Island, South Carolina, Tennessee, and Virginia. Few states maintain historical location data, so the store location analysis is not feasible for the years covered by the NSAF.

any health care. The other hardship measures, taken at the family level, are: difficulty paying mortgage, rent or utilities bills (*Difficulty Paying Bills)*; moving out of one's home or apartment due to financial difficulties (*Moved Out)*; reducing or skipping meals due to lack of money (*Cut Meals*); and going without telephone service for at least one month (*No Phone*). A summary measure, *Any Family Hardship*, indicates whether a family experiences any type of hardship, excluding the health events.[18] Since many of the specific hardship measures depend on other shocks in addition to underlying financial distress, the summary hardship measures should provide additional statistical power in detecting financial distress.

V. Does Access to Payday Loans affect Economic Hardship?

V.A. Defining Payday Loan Access

Among households in payday-prohibiting states, I define access to loans based on the distance from the household's county to the border of the nearest payday-allowing state.[19] *PaydayAccess* is 1 if the center of their county is within 25 miles of a payday-allowing state in that survey year and 0 otherwise. For use in a falsification exercise and a difference-in-difference model, I also define *PaydayBorder*, a purely cross-sectional variable that ignores changes in border-state regulations over time. This variable takes a value of 1 if the household is within 25 miles of a state that ultimately allowed payday lending, regardless of whether it was allowed at the time of the observation. Two alternative measures of geographic access are used in robustness exercises to demonstrate that the binary definition of access and the particular discontinuity at 25 miles are not crucial. *LogDistance*, the natural logarithm of the distance from a household's county to the nearest payday-allowing state, does not assert a discontinuity in geographic access at 25 miles.[20] *Pct Pop* $<$ *15 Miles* refines the

18. Since the NSAF does not report health measures for all individuals within a sampled family, the summary measure of family hardship cannot include health-related hardship.

19. The NSAF reports the county of residence rather than the precise location.

20. *LogDistance* is set to 4.5, the maximum value in the sample, for observations in the period before loans become available across the border. Leaving *LogDistance* missing for these cases has little effect.

PaydayAccess indicator, measuring the percentage of the county's population living within 15 miles of a payday-allowing state, as determined by the location and population of the underlying census tracts.

V.B. *Do Individuals from Payday-Prohibiting States Visit Other States to Borrow?*

To buttress the anecdotal evidence that individuals cross state borders to borrow, I analyze the relationship between the number of payday loan stores within a zip code and the proximity of payday-prohibiting states. I define an indicator for whether a zip code is within 25 miles of a payday-prohibiting state (*Dist. Prohibiting State* $<$ *25 Miles*), and regress the number of payday loan stores in zip code i (*Stores*) on this variable and a set of control variables, including state fixed effects, zip code-level covariates and an indicator for the proximity of any state border (*Dist. Any State* $<$ *25 Miles*).[21]

$$Stores_i = \alpha + \beta Dist.\ Prohibiting\ State < 25\ Miles_i + \gamma Dist.\ Any\ State < 25\ Miles_i + \delta X_i + \varepsilon_i \quad (1)$$

As shown in the first column of Table I, there are roughly 16% more stores (a 0.25 increase over an average of 1.50) in zip codes within 25 miles of payday-prohibiting states. The sizeable response in store locations supports the hypothesis that there is fairly substantial cross-border borrowing. This evidence is only suggestive, however, since the equilibrium number of store locations is both an indirect and an imperfect measure of demand, one that could also reflect supply-related differences at payday borders.

To push the demand hypothesis further I test whether payday border proximity has a stronger effect in zip codes with more potential borrowers across the border. In particular, the model includes an interaction between *Distance Prohibiting State* $<$ *25 Miles* and the proportion of households with $15,000 to $50,000 of annual income in the nearby payday-prohibiting zip codes.[22] As

21. The zip code controls are: cubics in median income, population, and land area; proportions of population in five racial/ethnic categories and five education categories; and the proportions of population in the following categories: foreign born, unemployed, living in an urban area, living in poverty, owning a home, and having a home mortgage.

22. "Nearby" zip codes include the closest zip code plus any others that are within 10 miles of the closest zip code.

TABLE I
EFFECT OF DISTANCE TO PAYDAY-PROHIBITING STATE ON PAYDAY LENDING LOCATIONS

Dependent variable: Mean DV: 1.50	Number of payday loan stores in zip code	
	(1)	(2)
Distance to payday-prohibiting state < 25 miles	0.25	–1.35
	(0.11)	(0.63)
Distance to any state border < 25 miles	–0.03	–0.05
	(0.08)	(0.09)
(Distance to payday-prohibiting state < 25 miles) × (Pct pop below $15,000 income, bordering zip codes)		–0.17
		(1.03)
(Distance to payday-prohibiting state < 25 miles) × (Pct pop $15,000 to $50,000 income, bordering zip codes)		3.54
		(1.39)
Pct pop below $15,000 income, bordering zip codes		0.58
		(0.67)
Pct pop $15,000 to $50,000 income, bordering zip codes		–0.30
		(0.84)
N	5670	5670
R^2	0.53	0.53
State FEs?	Y	Y
Zip code-level controls?	Y	Y

Notes. This table reports OLS estimation results for a regression of the number of payday loan stores in a zip code on a dummy for the proximity of the nearest payday-prohibiting state. The second model includes interaction terms between the payday border dummy and the proportion of bordering zip codes' population in low and moderate income categories. Standard errors are reported in parentheses.

shown in the second column of Table I, the coefficient on this interaction term is indeed positive and statistically significant at the 5% level. That is, the effect of proximity to a payday-prohibiting state is stronger in areas with more potential payday borrowers. While far from conclusive, this examination of store locations provides useful corroboration of anecdotes about cross-border borrowing.

V.C. Regression Sample and Summary Statistics, Economic Hardship Analysis

In the main analysis, the regression sample includes observations from the NSAF's 13 focal states in all three survey years. Three of the 13 focal states—Massachusetts, New Jersey, and New York—prohibited payday lending during this time. Only

observations from these three states contribute directly to the identification of the coefficient on *PaydayAccess*. Observations from the other 10 focal states, in which loans were allowed, are assigned *PaydayAccess* of 1 for all three survey years, and are only included to improve precision in the estimation of county-level and individual-level covariates. The sample excludes observations from counties with populations below 250,000, for which county identifiers are unavailable.[23] The sample also excludes individuals outside the income range of $15,000 to $50,000.[24] Falsification exercises consider individuals outside of this range.

The summary statistics of the regression sample, limited to individuals in payday-prohibiting states and stratified by *PaydayAccess*, are displayed in Table II. Treatment and control groups differ. At the county level, areas with payday loan access are higher income, lower unemployment, more populous and more urban. Individuals with payday loan access have, on average, higher family incomes, higher asset ownership (home and car), and higher rates of health insurance. Demographically, they are more likely to be white, and less likely to be foreign born, African-American or Hispanic. These differences highlight the need to include county-level and individual-level controls in various specifications of the regressions that follow. Two additional points are worth noting. First, if the differences in unobservable characteristics follow the same pattern, in which individuals with payday access are better off, there will be a bias against finding greater hardship in *PaydayAccess* areas. Second, basic county-level observables explain a substantial portion of the individual-level differences. Specifically, conditioning on cubics in county median income, population, and percent urban population dramatically reduces the individual-level differences.

V.D. Identification using Geographic and Temporal Variation in Payday Loan Access

The regression model assumes a linear probability function of the form:

23. To preserve respondent confidentiality, the Urban Institute does not release county identifiers for households living in counties with population less than 250,000.

24. Roughly 70% of payday borrowers report family income between $15,000 and $50,000 (Elliehausen and Lawrence 2001). Although roughly 25% of payday borrowers report income over $50,000, these individuals represent a small proportion of total individuals in that income category, so the average effect of loan access in that group is bound to be small.

TABLE II
REGRESSION SAMPLE SUMMARY STATISTICS, STRATIFIED BY *PAYDAYACCESS*

	PaydayAccess = 0		*PaydayAccess = 1*		Diff.	Adj. diff.	Diff. significant at 5% level
	obs	mean	obs	mean			
PANEL A: County-Level Characteristics							
Median income	27	52,200	10	53,700	1,500	–	
Population	27	824,2t00	10	600,400	–223,800	–	
Percent urban	27	0.96	10	0.91	–0.04	–	
Unemployment rate	95	0.05	15	0.04	–0.01	–	*
Log personal income	95	10.4	15	10.4	0	–	
PANEL B: Individual-Level Characteristics							Adj. Diff. significant at 5% level
Income/assets							
Family income	7821	31,300	1062	32,700	1,400	340	
Home owner	7821	0.42	1062	0.49	0.08	0.02	
Car owner	7802	0.78	1062	0.89	0.11	0.04	*
Employment/insurance							
Collected unemp. last year	7821	0.09	1062	0.09	0.00	–0.01	
Health insurance for past year	7821	0.72	1062	0.78	0.06	0.03	
Education							
No high school degree	7821	0.14	1062	0.12	–0.03	–0.03	
High school degree only	7821	0.37	1062	0.40	0.03	0.01	
Some college	7821	0.27	1062	0.29	0.02	0.02	
College degree	7821	0.15	1062	0.12	–0.03	–0.02	

TABLE II
(CONTINUED)

	PaydayAccess = 0		*PaydayAccess = 1*		Diff.	Adj. diff.	Adj. diff. significant at 5% level
	obs	mean	obs	mean			
Race/ethnicity							
White	7821	0.59	1062	0.71	0.12	0.05	*
Black	7821	0.19	1062	0.13	–0.05	0.02	
Hispanic	7821	0.18	1062	0.11	–0.07	–0.07	*
Asian	7821	0.04	1062	0.04	–0.01	0.00	
Other	7821	0.01	1062	0.01	0.00	0.00	
Other							
Age	7821	39.7	1062	40.3	0.60	0.06	
Family members	7821	3.28	1062	3.30	0.02	–0.02	
Male	7821	0.40	1062	0.40	–0.01	0.01	
Foreign born	7821	0.25	1062	0.18	–0.07	–0.07	*

Notes. This table shows summary statistics, stratified by *PaydayAccess*, for counties and individuals in payday-prohibiting states. The column "Diff." displays the unconditional mean difference across *PaydayAccess* status. For the individual characteristics in Panel B, the column "Adj. Diff" displays differences in conditional means, controlling for state-year fixed effects as well as cubics in the median income, population and percent urban population of individual's county.

TABLE III
MAIN SPECIFICATION

Panel A

Dependent variable:	*Any Family Hardship*	*Difficulty Paying Bills*	*Moved Out*	*Cut Meals*	*No Phone*
Mean:	0.292	0.203	0.012	0.169	0.017
PaydayAccess	0.053	0.050	0.010	0.011	0.006
	(0.019)	(0.016)	(0.006)	(0.014)	(0.007)
Border	–0.032	–0.019	–0.002	–0.017	–0.004
	(0.011)	(0.008)	(0.002)	(0.008)	(0.003)
N	24,641	24,973	24,973	24,835	24,424
R^2	0.08	0.06	0.01	0.05	0.02

Panel B

Dependent variable:	*Any Care Postponed*	*Dental Care Postponed*	*Medical Care Postponed*	*Drug Purchase Postponed*
Mean:	0.179	0.132	0.057	0.066
PaydayAccess	0.045	0.023	0.017	0.018
	(0.016)	(0.017)	(0.007)	(0.008)
Border	–0.012	–0.002	–0.005	–0.010
	(0.012)	(0.012)	(0.005)	(0.006)
N	17,581	17,588	17,587	17,592
R^2	0.08	0.07	0.07	0.04

Notes. This table reports OLS estimates for regressions of each hardship indicator on *PaydayAccess* and a set of controls. Each model includes state-year fixed effects, county-level controls, and either person- or family-level controls. Coefficient estimates are reported for *PaydayAccess* and *Border* but are suppressed for the other independent variables. Standard errors, reported in parentheses, are calculated with observations clustered by county.

$$(2)\quad Y_{icst} = \alpha + \beta PaydayAccess_{ct} + \theta Border_c + \gamma X_{it} + \delta Z_{ct} + \eta_{st} + \varepsilon_{icst}.$$

In each specification the dependent variable is an indicator of hardship for person or family i, in county c, state s and year t. X and Z are vectors containing relevant household-level and county-level controls, respectively.[25] All specifications include state-year fixed effects denoted by η. The dummy variable *Border* is 1 if the individual's county is within 25 miles of any state border, and 0 otherwise. Within this model, the identifying variation in *PaydayAccess* includes a cross-sectional component, determined jointly by variation in household location relative to state borders and variation in border-state regulations, as well as a time-series component, due to changes in border-state regulations over the sample period.

Regression results are reported in Table III. The estimated coefficient on *PaydayAccess* is positive in each family hardship regression, which means that families in payday access areas report more financial problems. *Difficulty Paying Bills* shows the largest difference: a five percentage point increase in likelihood relative to areas without payday credit access. Point estimates also indicate greater likelihood of moving out (1.0 percentage point increase), *Cut Meals* (1.1 percentage point increase), and *No Phone* (0.6 percentage point increase) in *PaydayAccess* areas, but these effects are not statistically significant. For the summary measure, *Any Family Hardship*, the *PaydayAccess* coefficient is 5.3 percentage points (p-value 0.005).

Health-related hardship also occurs more frequently in areas with payday credit access. Individuals in *PaydayAccess* counties are 1.7 and 1.8 percentage points more likely to report postponement of medical care and drug purchases, respectively. Postpone-

25. Z contains two time-varying controls, the average county unemployment rate and the log of county per capita personal income, as well as the following 2000 Census measures at the county level: cubics in county median income, population and percent urban population. X contains: log family income; number of family members; and dummies for home ownership, car ownership, past year family unemployment spell (any adult). For family-level regressions X also contains: age (average for adults); race (all white, all African-American, all Hispanic, all Asian, mixed race), immigrant status (all foreign born) and education (most educated adult: no high school degree, high school degree, some college, college and/or graduate degree). For person-level regressions, X also contains: age and dummies for sex, race (same categories as above), immigrant status, education (same categories as above), and past year spell without health insurance.

ment of dental care rises with *PaydayAccess* as well, by a statistically insignificant 2.3 percentage points. The overall measure, *Any Care Postponed*, increases by 4.5 percentage points (p-value 0.007) due to *PaydayAccess*.

All of these estimates are conditional on the full set of control variables, the most important of which is *Border*. In a model without *Border*, a positive coefficient on *PaydayAccess* might reflect a general border effect, one that is not due to loan access. The regression results confirm that this is not the case: the estimated coefficient on *Border* is negative in each model, meaning that its inclusion increases the estimated *PaydayAccess* effect.[26]

Relative to the average level of hardship within the regression sample, the magnitudes of the estimated *PaydayAccess* effects are substantial. The likelihood of *Difficulty Paying Bills* increases by 25% (5.0 percentage point increase over the 20.3% sample average), as does the incidence of *Any Care Postponed* (4.5 percentage points increase over 17.9% sample average).

V.E. Falsification Exercises

The baseline results indicate that payday credit access is associated with greater hardship among families with $15,000 to $50,000 of annual income. To further explore this finding, I perform two falsification exercises. The first tests whether *PaydayAccess* effects are absent among income groups that use payday loans infrequently. The second tests whether rates of hardship in *PaydayBorder* and non-*PaydayBorder* counties differ even before payday loans become available across the border.

Geographic access to payday loans ought to have no effect on two groups: very low-income individuals who do not qualify for loans, and moderate- to high-income individuals who have access to cheaper sources of credit. The evidence in Table IV supports this hypothesis. When the estimation sample is restricted to families with income less than $15,000 or greater than $50,000, *PaydayAccess* coefficients are small and statistically insignificant for each dependent variable. Standard errors are smaller in magnitude than in the main results, so the null results are primarily due to lower point estimates on *PaydayAccess*.

26. Because the sample includes a number of counties near state borders at which there is no difference in payday loan access, the coefficients on *PaydayAccess* and *Border* can be separately identified.

TABLE IV
FALSIFICATION EXERCISES

Panel A		*Excluded income categories only*	*Before loan avail.*
		(1)	(2)
Any Family Hardship	*PaydayAccess*	–0.011	
		(0.009)	
	PaydayBorder		–0.002
			(0.015)
N		35,863	21,151
R^2		0.23	0.08
Difficulty Paying Bills	*PaydayAccess*	–0.014	
		(0.009)	
	PaydayBorder		0.013
			(0.012)
N		36,295	21,458
R^2		0.12	0.06
Moved Out	*PaydayAccess*	–0.003	
		(0.003)	
	PaydayBorder		–0.002
			(0.003)
N		36,295	21,458
R^2		0.02	0.01

Panel B		*Excluded income categories only*	*Before * loan avail.*
		(1)	(2)
Any Care Postponed	*PaydayAccess*	0.007	
		(0.007)	
	PaydayBorder		0.023
			(0.013)
N		29,650	25,352
R^2		0.09	0.06
Dental Care Postponed	*PaydayAccess*	0.004	
		(0.007)	
	PaydayBorder		0.034
			(0.013)
N		29,655	25,366
R^2		0.06	0.05
Medical Care Postponed	*PaydayAccess*	0.003	
		(0.004)	
	PaydayBorder		0.014
			(0.011)
N		29,662	25,364
R^2		0.07	0.04

TABLE IV
(CONTINUED)

Panel A		*Excluded income categories only*	*Before loan avail.*
		(1)	(2)
Cut Meals	*PaydayAccess*	–0.005	
		(0.010)	
	PaydayBorder		–0.019
			(0.014)
N		36,180	21,325
R^2		0.17	0.05
No Phone	*PaydayAccess*	–0.002	
		(0.003)	
	PaydayBorder		0.004
			(0.005)
N		35,430	20,957
R^2		0.04	0.02

Panel B		*Excluded income categories only*	*Before * loan avail.*
		(1)	(2)
Drug Purchase Postponed	*PaydayAccess*	0.003	
		(0.006)	
	PaydayBorder		–0.001
			(0.008)
N		29,662	25,368
R^2		0.04	0.03

Notes. This table shows OLS estimation results from two falsification excercises. Within each panel, column (1) shows the *PaydayAccess* coefficient estimated on the excluded income sample (family income below $15,000 or above $50,000). Column (2) shows the *PaydayBorder* coefficient estimated on the sample of observations prior to loan availability across the border. Each model includes state-year fixed effects, county-level controls, *Border*, and either person- or family-level controls. Standard errors, reported in parentheses, are calculated with observations clustered by county.
* The "Before Loan Avail." regressions use the amended health variables, for example, *Any Care Postponed*† in place of *Any Care Postponed*.

Similarly, geographic access to states that eventually allow payday loans should have no effect before loans become available. I test this hypothesis by restricting the sample to observations from all three payday-prohibiting states in 1997 and Massachusetts in 1999, and regressing hardship indicators on *PaydayBorder*, the cross-sectional measure of access to payday-allowing states.[27] For this model the health variables are altered slightly: the 1997 survey does not assess the reason for postponement of care, so the amended variables measure postponement for any reason (adding † to the name). Results from this exercise are also given in Table IV. Among the family hardship measures, each specification has a small and insignificant coefficient on *PaydayBorder*, consistent with the hypothesized null effect. As in the prior falsification exercise, the null findings are driven mainly by lower point estimates. For the health variables there are positive *PaydayBorder* coefficients, particularly for dental and medical care, raising the concern that some difference in health services in these areas, unrelated to loan access, causes postponement of care.

In summary, the two falsification tests strengthen the case that the *PaydayAccess* coefficients measure a causal effect of loan access, particularly for the non-health measures of hardship. Neither exercise reveals a broad set of positive coefficients, as one would expect if there were some characteristic common to *PaydayAccess* areas—e.g., gambling access, economic weakness or lack of welfare services for low-income groups—that also causes economic hardship.

V.F. Differences in Payday Loan Access over Time

The analysis in this section uses a difference-in-difference model to test more formally whether financial distress in *PaydayBorder* counties increases after the emergence of payday lending across the border:

$$Y_{icst} = \alpha + \beta PaydayBorder_c * Post_{st} + \theta PaydayBorder_c + \varphi Post_{st} + \gamma X_{it} + \delta Z_{ct} + \eta_{st} + \varepsilon_{icst}. \quad (3)$$

27. Payday loans became available in the relevant borders of New Jersey and New York after 1997 and in the relevant borders of Massachusetts after 1999 (see Appendix I). As in the main specification, the sample includes observations from payday-allowing states to add precision in the estimation of covariates.

Post is a dummy variable that takes on a value of one if payday lenders operate in the relevant bordering states in the year under consideration.[28] In this model, the interaction term *PaydayBorder*Post* is the independent variable of interest.[29] Its coefficient, β, measures the effect of payday credit access, relying on the assumption that economic hardship in *PaydayBorder* areas would have trended similarly to non-*PaydayBorder* areas absent the emergence of payday lending. To rule out general economic trends as confounding factors, all specifications include two time-varying controls: county unemployment rates and the log of county-level personal income.

Regression results are given in Table V. The first specification, reported in column (1) of each panel, includes *PaydayBorder* and the full vector of county variables as controls. Estimates for β are positive for eight of the nine dependent variables, suggesting that improved access to payday loans over time is associated with a greater frequency of hardship. Among the family-level measures, *Any Family Hardship* (5.7 percentage points), *Difficulty Paying Bills* (3.7 percentage points) and *Moved Out* (1.2 percentage point) show statistically significant increases with magnitudes similar to the baseline results. The estimates of β for *Any Care Postponed†* (3.2 percentage points, p-value 0.14) and *Drug Purchase Postponed*† (1.9 percentage points, p-value 0.07) are similar in magnitude to the effects found in the main specification. Postponement of medical care and dental care show no relationship with changes in payday loan access.

In the second specification, county fixed effects replace the time-constant county controls. Estimates of β for family hardship remain positive, at somewhat reduced statistical significance, for all variables except *No Phone*. The effects of loan access on *Any Family Hardship* and *Moved Out* are 3.6 and 1.1 percentage points, respectively. The 1.7 percentage point effect on *Difficulty Paying Bills* is somewhat smaller than in the first specification. Among the health variables, *Any Care Postponed*† and *Drug Purchase Postponed*† show respective increases of 4.3 percentage points (p-value 0.04) and 1.6 percentage points (*p*-value 0.11) after payday loans become available across the border.

28. *Post* is zero for Massachusetts observations in 1997 and 1999, and New York and New Jersey observations in 1997, and is one otherwise.

29. *PaydayBorder*Post* is identical to *PaydayAccess*, but I use the former to make transparent the difference-in-difference structure of the model.

TABLE V
DIFFERENCES OVER TIME

Panel A

		County controls (1)	County FEs (2)
Any Family Hardship	*PaydayBorder* Post*	0.057	0.036
		(0.023)	(0.024)
N		24,641	24,641
R^2		0.08	0.09
Difficulty Paying Bills	*PaydayBorder* Post*	0.037	0.017
		(0.018)	(0.018)
N		24,973	24,973
R^2		0.06	0.07
Moved Out	*PaydayBorder* Post*	0.012	0.011
		(0.007)	(0.006)
N		24,973	24,973
R^2		0.01	0.02

Panel B

		County controls (1)	County FEs (2)
Any Care Postponed†	*PaydayBorder* Post*	0.032	0.043
		(0.022)	(0.021)
N		29,502	29,502
R^2		0.06	0.06
Dental Care Postponed†	*PaydayBorder* Post*	0.012	0.022
		(0.025)	(0.024)
N		29,516	29,516
R^2		0.05	0.05
Medical Care Postponed†	*PaydayBorder* Post*	–0.002	–0.003
		(0.013)	(0.016)
N		29,514	29,514
R^2		0.04	0.05

TABLE V
(CONTINUED)

Panel A				Panel B			
		County controls (1)	County FEs (2)			County controls (1)	County FEs (2)
Cut Meals	*PaydayBorder* Post*	0.028 (0.019)	0.024 (0.022)	*Drug Purchase Postponed†*	*PaydayBorder* Post*	0.019 (0.010)	0.016 (0.010)
N		24,835	24,835	N		29,518	29,518
R^2		0.05	0.05	R^2		0.03	0.03
No Phone	*PaydayBorder* Post*	0.003 (0.007)	−0.002 (0.009)				
N		24,424	24,424				
R^2		0.02	0.03				

Notes. This table reports OLS estimation results for the difference-in-difference model that identifies the effect of changes in loan access over time, as captured by the coefficient on *PaydayBorder*Post*. Column (1) specifications include county-level census controls, while column (2) specifications include county fixed effects. All specifications include state-year fixed effects, time-varying county-level controls, and person- or family-level controls. Standard errors, reported in parentheses, are calculated with observations clustered by county.

Because temporal variation in payday loan access is fairly limited, inferences are weaker compared to the baseline results. Overall, though, the results provide confirmation that payday loan access increases the likelihood of financial distress, as found in the main specification.

V.G. Differences in Payday Loan Access across Income Groups

The following model exploits another source of within-county variation in payday loan access: the difference in access between those with incomes of $15,000 to $50,000 and those with incomes below $15,000.

$$Y_{icst} = \alpha + \beta PaydayAccess_{ct} * Income15to50_{it} + \theta PaydayAccess_{ct} + \varphi Income15to50_{it} + \gamma X_{it} + \delta Z_{ct} + \eta_{st} + \varepsilon_{icst} \quad (4)$$

The regression sample includes all families with less than $50,000 of income. *Income15to50* is a dummy for the $15,000 to $50,000 family income category. The parameter of interest is β, the coefficient on *PaydayAccess*Income15to50*, which isolates the difference in *PaydayAccess* coefficients across the two income categories.

The premise underlying this model is that the lower income group lacks access to payday loans but otherwise provides an appropriate comparison group for the higher income group after controlling for observable differences. An attractive feature of this model is that the financial safety net and welfare services that might influence the dependent variables of interest would likely have larger effects on poorer populations. To the extent that *PaydayAccess* areas show greater hardship because they lack these services, isolating variation in loan access *across* income groups should correct for this bias and, if anything, overcompensate.

Estimation results for this model are given in Table VI. Estimates of β are broadly positive for the non-health outcomes. The first specification includes county fixed effects, while the second specification includes county-year fixed effects. This change has little effect on the results, so I focus on the results from the version with county fixed effects, reported in the first column. The effect of loan access is positive, but not quite statistically significant, for *Any Family Hardship* (5.9 percentage points, p-value 0.13) and *Difficulty Paying Bills* (4.6 percentage points, p-value 0.11). Both effects are quite close in magnitude to the estimates from the baseline model and differences over time. *Moved Out* and *Cut Meals*

TABLE VI
DIFFERENCES ACROSS INCOME CATEGORIES

Panel A

		County FEs (1)	County-year FEs (2)
Any Family Hardship	*PaydayAccess* Income15to50*	0.059	0.059
		(0.038)	(0.040)
N		33,795	33,795
R^2		0.09	0.10
Difficulty Paying Bills	*PaydayAccess* Income15to50*	0.046	0.045
		(0.029)	(0.029)
N		34,464	34,464
R^2		0.06	0.07
Moved Out	*PaydayAccess* Income15to50*	0.025	0.024
		(0.008)	(0.009)
N		34,464	34,464
R^2		0.02	0.02

Panel B

		County FEs (1)	County-year FEs (2)
Any Care Postponed	*PaydayAccess* Income15to50*	–0.002	–0.002
		(0.040)	(0.040)
N		23,201	23,201
R^2		0.09	0.09
Dental Care Postponed	*PaydayAccess* Income15to50*	–0.0016	–0.015
		(0.033)	(0.033)
N		23,210	23,210
R^2		0.07	0.07
Medical Care Postponed	*PaydayAccess* Income15to50*	0.008	0.008
		(0.019)	(0.019)
N		23,209	23,209
R^2		0.07	0.08

TABLE VI
(CONTINUED)

Panel A

		County FEs (1)	County-year FEs (2)
Cut Meals	*PaydayAccess* Income15to50*	0.043 (0.044)	0.048 (0.044)
N		34,259	34,259
R^2		0.06	0.07
No Phone	*PaydayAccess* Income15to50*	–0.004 (0.011)	–0.004 (0.011)
N		33,142	33,142
R^2		0.03	0.04

Panel B

		County FEs (1)	County-year FEs (2)
Drug Purchase Postponed	*PaydayAccess* Income15to50*	0.007 (0.019)	0.008 (0.019)
N		23,214	23,214
R^2		0.04	0.04

Notes. This table shows OLS estimation results for the difference-in-difference model that identifies the effect of payday loan access by comparing across income groups. Coefficient estimates are reported for *PaydayAccess*Income15to50*. Column (1) specifications include county fixed effects and time-varying county-level controls, and column (2) specifications include county-year fixed effects. All specifications include state-year fixed effects, and person- or family-level controls. Standard errors, reported in parentheses, are calculated with observations clustered by county.

show *PaydayAccess*Income15to50* coefficients of 2.5 percentage points (p-value 0.004) and 4.3 percentage points (p-value 0.33). These results indicate that even after differencing out the effect of *PaydayAccess* on the lower-income group, loan access increases the incidence of non-health hardship.

Results for the health outcomes, which are given in Panel B, show smaller effects of loan access than in the main specification. The implied effects on *Any Care Postponed* (-0.2 percentage points) and *Dental Care Postponed* (-1.6 percentage points) change signs and are smaller than in the main specification. The point estimates for the effects on *Medical Care Postponed* (0.8 percentage points) and *Drug Purchase Postponed* (0.7 percentage points) are only slightly below the estimates from the main specification. Notably, all the coefficient estimates for the health variables have wide confidence intervals.

V.H. County Work Flow Interactions

Since individuals that regularly commute to work in a payday-allowing area face a lower cost of accessing loans, loan availability ought to have a larger effect in counties with a larger proportion of such commuters, even after conditioning on proximity to a payday-allowing area. *Pct Workflow* is the proportion of workers in a county that commute to a payday-allowing state, defined using Census data on county-to-county workflow. The following model tests whether *PaydayAccess* effects depend on *Pct Workflow*:

$$Y_{icst} = \alpha + \beta PaydayAccess_{ct} * PctWorkflow_c + \theta PaydayAccess_{ct} + \varphi PctWorkflow_c + \gamma X_{it} + \delta Z_{ct} + \eta_{st} + \varepsilon_{icst}. \quad (5)$$

In this specification, the parameter of interest is the coefficient on the interaction term *PaydayAccess*Pct Workflow*. As background for interpreting the coefficients, the average *Pct Workflow* in *PaydayAccess* of prohibiting states is 7.3%.

Estimation results are given in Table VII. Results for the non-health hardship measures indicate that the effect of loan access is indeed stronger in counties with higher *Pct Workflow*. The coefficient on *PaydayAccess*Pct Workflow* is positive for *Any Family Hardship* (β of 0.57, p-value 0.002), implying that *PaydayAccess* areas with the mean workflow have hardship rates 4 percentage points than access areas with no workflow. *Difficulty Paying*

TABLE VII
COUNTY WORKFLOW INTERACTIONS

Panel A			Panel B		
Any Family Hardship	*PaydayAccess * Pct Workflow*	0.57	*Any Care Postponed*	*PaydayAccess * Pct Workflow*	–3.58
		(0.18)			(3.39)
	PaydayAccess	–0.01		*PaydayAccess*	0.07
		(0.03)			(0.03)
N		24,641	N		17,581
R^2		0.08	R^2		0.08
Difficulty Paying Bills	*PaydayAccess * Pct Workflow*	0.30	*Dental Care Postponed*	*PaydayAccess * Pct Workflow*	–6.17
		(0.17)			(3.79)
	PaydayAccess	0.004		*PaydayAccess*	0.08
		(0.03)			(0.03)
N		24,973	N		17,588
R^2		0.06	R^2		0.07
Moved Out	*PaydayAccess * Pct Workflow*	–0.03	*Medical Care Postponed*	*PaydayAccess * Pct Workflow*	0.06
		(0.08)			(1.61)
	PaydayAccess	0.02		*PaydayAccess*	0.01
		(0.01)			(0.01)
N		24,973	N		17,587
R^2		0.01	R^2		0.07
Cut Meals	*PaydayAccess * Pct Workflow*	0.33	*Drug Purchase Postponed*	*PaydayAccess * Pct Workflow*	–1.49
		(0.15)			(1.76)
	PaydayAccess	–0.01		*PaydayAccess*	0.02
		(0.02)			(0.01)
N		24,835	N		17,592
R^2		0.05	R^2		0.04
No Phone	*PaydayAccess * Pct Workflow*	–0.10			
		(0.09)			
	PaydayAccess	0.01			
		(0.01)			
N		24,424			
R^2		0.02			

Notes. This table shows OLS estimation results for regressions that investigate whether the effect of loan access is stronger in counties where a larger proportion of workers commute to a payday-allowing state. Coefficient estimates are reported for *PaydayAccess* and the interaction *PaydayAccess*Pct Workflow*. Each specification includes state-year fixed effects, county-level controls and person- or family-level controls. Standard errors, reported in parentheses, are calculated with observations clustered by county.

Bills (β of 0.30, p-value 0.08) and *Cut Meals* (β of 0.33, p-value 0.03) show the same pattern. These results suggest that improved access to payday loan stores—in this case measured along a dimension other than geographic proximity—leads to increased incidence of hardship.

Estimation results for the health-related measures, shown in Panel B, do not support the hypothesis that *PaydayAccess* effects are stronger in areas with higher *Pct Workflow*. Point estimates of *PaydayAccess*Pct WorkFlow* coefficients are negative for three of the four health measures, but are not statistically significant. The standard errors of these estimates are quite large, which cautions against drawing strong inferences from these results. Nevertheless, the failure to find the hypothesized effect for the health-related measures in this specification and the previous specification (differencing over income categories) is perhaps a sign that there is some health-related omitted variable that is driving positive *PaydayAccess* estimates in the main specification.

V.I. Robustness

The key regression results presented above—those from the baseline model, and the differences across time and income groups—are quite robust, showing little sensitivity to the linear probability assumption and the binary definition of payday credit access.

Online Appendix Table A.1 displays regression output for variations of the baseline model using the two summary measures, *Any Family Hardship* and *Any Care Postponed*, as independent variables. The first specification uses a probit functional form and shows little difference between the estimated marginal effects and the linear probability coefficients. In the second model, observations are weighted based on sampling probability; the *PaydayAccess* coefficient changes little for *Any Family Hardship*, but falls somewhat for *Any Care Postponed*.[30] The next two specifications verify that *PaydayAccess* coefficients change very little when 1997 data is excluded or when a cubic in distance to the nearest border supplements the *Border* control.[31] The final two models use continuous measures of payday access. The coefficients on *LogDistance* are negative and strongly statistically significant, confirming that proximate access implies greater likelihood of negative outcomes. Finally, the coefficient on *Pct Pop < 15 Miles* is

30. To address deliberate oversampling of low-income individuals, and nonrandomness in survey non-response, the Urban Institute constructs sampling weights for the NSAF.

31. This model does not require any assumptions about loan availability for the 1997 data, thereby addressing the worry that loans might have been available in bordering states due to lax regulatory oversight of check cashers in the mid-1990s.

also positive and statistically significant in both cases, consistent with the main findings.

Online Appendix Table A.2 shows robustness analysis for the two difference-in-difference models using *Any Family Hardship* as the independent variable. Probit marginal effects of *PaydayBorder*Post* and *PaydayAccess*Income15to50* are similar in magnitude to the linear probability estimates. When differencing over time the coefficients on *LogDistance* and *Pct Pop < 15 Miles*Border* confirm the main finding, with even greater statistical significance; the emergence of payday lending nearby increases hardship more in areas with proximate access. In the difference across income groups the coefficients on *Pct Pop < 15 Miles*Income15to50* and *LogDistance*Income15to50* concur with the main result. Both point estimates imply greater relative distress among the *Income15to50* group in areas with nearby payday access, and the former is significant at the 5% level.

The final robustness analysis, reported in Online Appendix Table A.3, confirms that sample imbalance between treatment and control groups does not drive the main results. Within subsamples stratified by race and immigrant status, *PaydayAccess* coefficients remain positive and significant for white and native-born individuals, the two largest sub-samples. *PaydayAccess* coefficients are estimated very imprecisely in smaller sub-samples, so the estimates do not support strong conclusions about differential effects across racial categories.

VI. Interpretation of Results

VI.A. Implied Effects of Borrowing

The incremental effects discussed previously represent averages across all individuals in the sample who have proximate access to loans. Average effects on the relevant "treated" population, that is, those who borrow, are also relevant in evaluating the magnitude of the findings. This exercise is necessarily imprecise, owing to lack of data on the proportion of households and adults that borrow in the years and income groups considered in this study. Based on historical estimates of payday borrowing, I assume that roughly 10% of sample households borrow and 6% of sample adults borrow.[32]

32. Fox and Mierzwinski (2001) estimate that 8 to 10 million households borrowed at payday loan stores in 2001, and Elliehausen and Lawrence (2001)

TABLE VIII
TREATMENT ON THE TREATED

Family-level variable: Decomposing effect on *Difficulty Paying Bills*

	Percent of sample	Likelihood	Contribution to average
Non-borrowers	90	20.3%	18.3%
Borrowers	10		
Borrowers already reporting distress	2	100.0%	2.0%
Borrowers not reporting distress	8	62.0%	5.0%
			25.3%

Person-level variable: Decomposing effect on *Drug Purchase Postponed*

	Percent of sample	Likelihood	Contribution to average
Non-borrowers	94	6.6%	6.2%
Borrowers	6		
Borrowers already reporting distress	0.4	100.0%	0.4%
Borrowers not reporting distress	5.6	32.0%	1.8%
			8.4%

Notes. This table provides a hypothetical decomposition of the likelihood of distress in *PaydayAccess* areas into likelihoods among three categories: non-borrowers (no effect of loan access), borrowers who would have already reported distress (no marginal effect of loan access) and borrowers who would not already report distress (the "treated" group for whom payday loan access has a marginal effect). These calculations assume that 10.0% of sampled families borrow, 6.0% of sampled adults borrow, and the proportion of borrowers already reporting distress is the same as the unconditional average—20.3% for *Difficulty Paying Bills* and 6.6% for *Drug Purchase Postponed*.

TABLE IX
FREQUENCY OF PAYDAY BORROWING

	Proportion of borrowers	
Number of loans between 9/05 and 9/06	Florida	Oklahoma
1–3	35.4%	30.9%
4–11	38.0%	38.9%
12–23	23.6%	24.7%
24 or more	3.0%	5.4%

Notes. Source: Veritec Solutions, Inc.

estimate that 70% of borrowers are in the $15,000 to $50,000 income range. Together, these estimates imply that 5.6 to 7 million households borrowed in the time frame and income range considered in the regression sample. As a proportion, this

Table VIII shows the implied effects of borrowing for *Difficulty Paying Bills* and *Drug Purchase Postponed*. These calculations adjust for the fact that some individuals who borrow would report distress even without borrowing, so they should not be considered as contributing to the marginal effect of loan access. An estimated 5.0 percentage point increase in *Difficulty Paying Bills* in *PaydayAccess* areas requires a 62% probability of distress among borrowing households, a substantial increase over the baseline likelihood of 20.3%.

In order for there to be sizable increases in the likelihood of hardship among borrowers, it must be the case that a substantial number of borrowers face large annual interest burdens. Payday loan usage data, displayed in Table IX, attests to this fact. Frequency of usage across borrowers is quite heterogeneous, with a substantial mass (around 25%) of borrowers using 1-2 loans per year, but also 30% of borrowers using *at least* 12 loans over the course of a year. Using an average transaction principal amount of $350 and fee of $50, we can put the annual debt service burden of borrowers in perspective. Around 40% of borrowers face an annual interest burden of at least $500, while 10% of borrowers pay upwards of $1000 in interest annually. This is a substantial allocation of resources for households with other financial commitments and only $15,000 to $50,000 of annual income.

The estimates measure the causal effect of payday loan access, which likely encompasses more than simply the benefits and costs engendered by the initial cash transfer and the future debt service payments. In particular, other financial services providers seem to respond to payday loan availability. For example Melzer and Morgan (2010) find higher fees for bounced checks and overdraft loans in areas with payday loan availability, and Campbell, Jerez, and Tufano (2009) find higher rates of checking account closures when payday loans are available. These changes suggest that households face higher costs and less access to bank account services when payday loans are available. At least a portion of the negative effect of loan access could be caused by these responses.

is 14% to 18% of the 39.4 million households between $15,000 and $50,000 that lived in payday-allowing states in 2000 (U.S. Census). Cross-border access is imperfect, so I assume the proportion of borrowing households is 10%, below the 16% midpoint. Assuming 1.2 borrowing adults per borrowing household and 2 adults per household, the proportion of borrowing adults is 6%.

VII. Conclusion

I utilize a particular financial market development, the advent and growth of the payday loan industry, to investigate whether low- to moderate-income households benefit from increased access to credit. Payday loans are a particularly interesting category of consumer debt, since for many individuals they constitute the marginal source of credit. The effects of borrowing in this form therefore capture the costs or benefits of credit access on the margin, which are quite relevant in evaluating policies that impose or relax constraints on consumer lending.

Measuring the overall welfare contribution of payday loan access is difficult. Instead, I pursue an intermediate target, testing whether loan access facilitates important expenditures on items such as dental and medical care as well as mortgage, rent and utilities bills. I find that payday borrowing has important real costs. Specifically, my findings strongly support the conclusion that loan access increases households' difficulty in paying mortgage, rent and utilities bills. Loan access also appears to increase the likelihood of delaying needed medical care, dental care and prescription drug purchases, though empirical support for these conclusions is somewhat weaker. Contrary to the view that improving credit access facilitates important expenditures, the empirical results suggest that, for some low-income households, the debt service burden imposed by borrowing inhibits their ability to pay important bills.

Appendix I: Payday Loan Regulations

A. Regulations in Massachusetts, New Jersey, and New York

New Jersey and New York forbid payday loans on the basis of check cashing laws that prohibit advancing money on post-dated checks (N.J. Stat. 17:15A-47 and NY CLS Bank 373), and usury laws that limit loan interest rates (N.J. Stat. 2C:21-19 and NY CLS Penal 190.42). Massachusetts banned payday loans through a law limiting interest rates on small loans made or brokered in the state (ALM G.L.c.140 §96 and CMR 209 26.01). For the larger companies that operate 40% of the industry's locations—Ace Cash Express, Advanced America, Cash America, Check into Cash, Check 'N Go, Money Mart and Valued Services—there is no evidence on 10-K filings and company websites of stores operating in these three states.

B. Regulations in States Bordering Massachusetts, New Jersey, and New York

Payday loans were available from Massachusetts (via New Hampshire and Rhode Island) in 2001 and from New York and New Jersey (via Delaware and Pennsylvania) in both 1998 and 2001, the latter two years covered by the NSAF.

New Hampshire's small loan interest rate cap acted as a *de facto* ban on payday loans until it was removed in January, 2000 (1999 NH ALS 248), and payday lenders entered thereafter. The Staff Attorney of the Consumer Credit Division, New Hampshire Department of Banking, confirmed that payday lenders did not operate in the state prior to 2000.

Rhode Island's small loan interest rate cap (R.I. Gen. Laws § 19-14.2-8) acted as a *de facto* prohibition on payday loans until a July 2001 law change that sanctioned deferred deposit transactions (R.I. P.L. 2001, Ch. 371, § 4). However, according to a regulatory supervisor in the Division of Banking, check cashers had begun to offer deferred deposit on check cashing transactions in 2000 and 2001, prior to the law change.

In Pennsylvania, throughout the sample period direct payday lending was prohibited through a cap on small loan interest rates (P.A. 7 P.S. § 6201–6219), but the agent model was permitted through a law that sanctioned loan brokering (P.A. 73 P.S. § 2181–2192). In practice, payday lenders did not build a presence until 1997. Considering the cross-section of payday loan locations in Pennsylvania as of early 2006, I can confirm that 95% of those locations were not making loans in 1996.[33]

Throughout the sample period, Delaware prohibited cash advance loans by check cashers (5 Del. C. § 2744), but allowed lending at any interest rate by licensed non-depository lenders (5 Del. C. § 2201–2244). Licensing records at Delaware's Office of the State Banking Commissioner indicate that payday lending companies first obtained licenses in July of 1998. E Z Cash of Delaware, Inc. was the first entrant.

33. A predecessor of Advance America, National Cash Advance, entered the state in 1997 (Brickley 1999). Money Mart began its payday lending operation in earnest through an agent relationship in 1997 (See Office of the Comptroller of the Currency 1998). Check 'N Go did not operate in the state before mid-1997 (Sekhri 1997). Ace Cash Express entered Pennsylvania in 2000 (Ace Cash Express, Inc. 2000). Finally, Cash Today began operations in mid-1999 (Matheson 2005), and Flexcheck Cash Advance began operations in mid-2001 (O'Donoghue 2003).

Finally, Connecticut and Vermont did not allow payday lending. Connecticut prohibited lending through a combination of a cap on check cashing fees (Conn. Agencies Reg. § 36a-585-1) and small loan interest rates (interest rates capped at 17% *per annum* by Conn. Gen. Stat. 36a-563). Vermont prohibited lending through an interest rate cap of 18% *per annum* (8 V.S.A. § 2230 and 9 V.S.A. § 41a).

Historical store location data from the public filings of the largest national payday lending companies confirm these entry and prohibition dates.

APPENDIX II: DEPENDENT VARIABLES OF INTEREST AND UNDERLYING SURVEY QUESTIONS

Variable	Survey question(s)
Family-level measures	
Difficulty paying bills	– During the last 12 months, was there a time when you and your family were not able to pay your rent, mortgage, or utilities bills?
Moved out	– During the last 12 months, did you or your children move in with other people even for a little while because you could not afford to pay your mortgage, rent, or utilities bills?
Cut meals	– In the last 12 months, did you or other adults in your family ever cut the size of your meals or skip meals because there wasn't enough money for food?
No phone	– During the past 12 months, has your household ever been without telephone service for at least one month? (Do not include temporary loss of service due to storms, damaged wires, or phone company maintenance)
Any family hardship	– Binary variable that takes the value of one if the family experiences any of the four forms of hardship described above, and zero otherwise.
Person-level measures	
Dental care postponed	– During the past 12 months did you not get or postpone getting dental care when you needed it? – Was lack of insurance or money a reason why you did not get the dental care you needed or was it some other reason?

APPENDIX II (CONTINUED)

Medical care postponed	– During the past 12 months did you not get or postpone getting medical care or surgery when you needed it? – Was lack of insurance or money a reason why you did not get the medical care or surgery you needed or was it some other reason?
Drug purchase postponed	– During the past 12 months did you not fill or postpone filling a prescription for drugs when you needed them? – Was lack of insurance or money a reason why you did not get the drugs you needed or was it some other reason?
Any care postponed	– Binary variable formed from three health-care variables above.

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FROM POVERTY, OPPORTUNITY

Putting the Market to Work for Lower Income Families

The Brookings Institution
Metropolitan Policy Program

Contents

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The responsibility for the contents of this report is ours alone.

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Executive Summary

Public and private leaders have a substantial, and widely overlooked, opportunity today to help lower income families get ahead by bringing down the inflated prices they pay for basic necessities, such as food and housing.

In general, lower income families tend to pay more for the exact same consumer product than families with higher incomes. For instance, 4.2 million lower income homeowners that earn less than $30,000 a year pay higher than average prices for their mortgages. About 4.5 million lower income households pay higher than average prices for auto loans. At least 1.6 million lower income adults pay excessive fees for furniture, appliances, and electronics. And, countless more pay high prices for other necessities, such as basic financial services, groceries, and insurance. Together, these extra costs add up to hundreds, sometimes thousands, of dollars unnecessarily spent by lower income families every year.

Reducing the costs of living for lower income families by just one percent would add up to over $6.5 billion in new spending power for these families. This would enable lower and modest-income families to save for, and invest in, income growing assets, like homes and retirement savings, or to pay for critical expenses for their children, like education and health care.

The policies needed to capture these savings for families will require few taxpayer dollars and true public-private partnership. Together, government, nonprofit, and business leaders can pursue a number of market and regulatory initiatives to bring down the cost of living for lower income families. And unlike most traditional anti-poverty initiatives, limited (strategic) public investments can match or seed innovative market solutions.

This report, analyzing both national data and data from 12 major metropolitan areas across the country, is about this opportunity to put the market to work for lower income families. The report makes the following conclusions:

1. Lower income families tend to pay higher than average prices for a wide array of basic household necessities—often for the exact same items—than higher income households. Depending on where lower income consumers live, and what combinations of necessities are consumed, they can pay up to thousands of dollars more every year for a full range of basic household goods, from financial services to housing to car purchases. For instance:

- ***Check Cashing and Short-Term Loans:*** Lower income consumers are much more likely than higher income consumers to pay high prices to cash checks and take out short-term loans. Most customers of check-cashing businesses earn annual incomes of less than $30,000. To cash a $500 check in one of these businesses, customers would pay an additional $5 to $50 in the selected 12 metro areas. Among the 50 states, the check cashing fee ranges between 1 percent of the face value of a check in West Virginia to no limit (in 19 states).

  Similarly, about 81 percent of the customers that buy high-priced payday loans earn less than $50,000 a year. The fees for short-term loans range from zero (because the industry is banned in some states) to more than 15 percent of a loan's value in Colorado, Delaware, South Dakota, and other states.

- ***Tax Refund Services:*** Lower income consumers are more likely than higher income consumers to pay high fees to get their tax returns quickly. In 2003, lower income tax filers were just as likely as all others to use professional tax preparation services (approximately 60 percent). But, lower income tax filers are nearly three times more likely than higher income households to buy refund anticipation loans. These advance payments on tax refunds are accompanied by interest rates between 70 percent to more than 1,800 percent.
- ***Remittance Services:*** Lower income consumers are likely to pay fees to wire funds to foreign countries, fees less likely to be incurred by high-income households. About 80 percent of remittance clients sending money to Latin America earn an annual income of less than $30,000. To send $200 every other week to Mexico for one year, a customer would be assessed an additional $320 in fees, on average.
- ***Car Prices:*** Nationwide, consumers from lower income neighborhoods pay between $50 and $500 more, on average, to buy the exact same car as a consumer from a higher income neighborhood.
- ***Car Loans:*** Nationwide, 4.5 million lower income consumers pay, on average, two percentage points more in interest for an auto loan than the average, higher income consumer. In 2004, auto-loan customers earning less than $30,000 a year paid an average APR of 9.2 percent for their loan, while the average APR for customers earning $60,000 to $90,000 was 7.2 percent.
- ***Car Insurance:*** Drivers from lower income neighborhoods in the 12 sample metropolitan areas pay between $50 to over $1,000 more per year in higher premiums for auto insurance than those living in higher income neighborhoods. In New York, Hartford, and Baltimore, drivers living in lower income neighborhoods paid $400 more, on average, for 12 months of auto insurance to insure the exact same car and driver risk as those in higher income neighborhoods.
- ***Home Loans:*** Nationwide, 4.2 million lower income homeowners pay, on average, a percentage point more than higher income households in interest for their mortgage. In 2004, the average APR on a first mortgage for lower income households was about 6.9 percent. By contrast, households earning between $60,000 and $90,000 paid an average rate of about 6.0 percent.
- ***Home Insurance:*** Holding other factors constant, homeowners in lower income neighborhoods can pay as much as $300 more for home insurance than those in higher income neighborhoods. For instance, in Chicago, the average quote for a year of home insurance in the city's lowest income neighborhoods was about $1,043, while the quote for households living in neighborhoods with a median income between $30,000 and $60,000, was approximately $755.
- ***Furniture, Appliances, and Electronics:*** Lower income consumers tend to pay more for furniture and appliances because they are much more likely than higher income households to shop at high-priced rent-to-own establishments. Nearly 60 percent of rent-to-own customers earn less than $25,000 a year. In Wisconsin, it is estimated that a $200 television might cost as much as $700 at one of the rent-to-own businesses in the state, after interest.
- ***Grocery Prices:*** Grocery stores in lower income neighborhoods tend to be smaller and more expensive than in higher

income neighborhoods. The average grocery store in our sample of 2,384 lower income neighborhoods is 2.5 times smaller than the average grocery store in a higher income neighborhood. Also, there is about one mid- or large-sized grocer for every 69,055 residents in lower income neighborhoods, half the availability found in other neighborhoods. Access to only small grocery stores results in higher food prices for lower income shoppers. In particular, over 67 percent of the same food products in our sample of 132 different products are more expensive in small grocery stores than in larger grocery stores.

2. A combination of real and perceived market risks, market abuses, and uneven consumer access to market information contribute to these additional costs incurred by lower income consumers.

There a number of market realities and market failures that help drive the costs of consumer products for lower income households.

- ***Companies—from banks to insurance companies— face both real and perceived higher costs of doing business with lower income consumers.*** Lower income borrowers are much more likely than higher income borrowers to fall behind on their payments, declare bankruptcy, and have low credit scores. Within a metropolitan area, they are also more likely to live in urban areas, where car or home insurance is more expensive. Given these risks, businesses will rationally pass on those risks in the form of higher costs to lower income consumers. Importantly, the existence of these higher costs will also drive perceptions of higher costs, even when there may not be data available to support or properly measure perceived risks. This also drives up prices.
- ***The dense concentration of businesses that sell high-priced products and services in lower income neighborhoods can serve to limit the choices of poorer consumers.*** Today, over 23 percent of lower income households do not have a checking account, and another 64 percent do not have a savings account. Certainly, these millions of lower income consumers represent an unmet market demand. However, if the businesses that fill that void are primarily those that that tend to charge high fees or interest rates, then lower income consumers are not being exposed to a broader array of mainstream, competitively-priced products.

  For instance, nearly all of the high-priced, basic financial service companies—alternative check cashers and short-term loan providers, tax preparation firms, and wiring companies—tend to be much more densely concentrated in lower income neighborhoods than higher income neighborhoods. The number of check cashers and short-term loan providers, in particular, is twice as dense in lower income neighborhoods as they are in other neighborhoods. That relative density—with twice as many businesses per capita—in lower income neighborhoods than other neighborhoods is true for remittance services and rent-to-own establishments.
- ***Unscrupulous business practices drive up prices in lower income markets.*** For instance, research on mortgage pricing suggests that between 14 and 20 percent of all borrowers who purchased a high-cost mortgage could have qualified for a better priced mortgage product. Even for those who cannot qualify for prime loans often face unnecessary additional features on mortgage products, such as long-term prepayment penalties and broad insurance plans, all contributing to the higher price. In other cases, the market abuses arise from lax regulatory protections that enable companies to charge APRs of over 400 percent for check-cashing services, short-term loans, and refund anticipation loans in some states.
- ***Finally, lower income consumers lack access to good market information about many goods and services.*** Lower income consumers are generally much less likely than other consumers to compare prices before buying goods and services, making them more susceptible to bad deals. Similarly, they are less likely to

have access to the Internet and its price-comparison tools. Further, studies also show that the lower a consumer's income, the less financial knowledge he or she is likely to have. This would result in limited knowledge about basic financial management, the use and management of credit scores, and the differences in values among key products, such as a checking account versus relying on check cashers. Finally, language barriers, along with cultural obstacles, can steer lower income families toward high-priced financial services.

3. Public and private leaders can reduce the cost of living for lower income consumers by reducing both real and perceived market risks in doing business with such consumers, curbing market abuses that inflate prices, and investing in making lower income consumers the savviest shoppers in the marketplace.

Reducing the additional costs that lower income families pay for standard household goods and services is a powerful and widely underutilized opportunity to help families get ahead. To seize that opportunity, leaders need to connect the competitive, mainstream economy to lower income consumers. There are a number of existing models and emerging initiatives from around the country that federal, state, and local leaders can replicate.

In general, public and private leaders need to embrace three types of reforms:

- ***Public and private leaders need to encourage mainstream businesses to serve lower income markets, where there remains great demand for services and products.*** In concert with community outreach efforts to dispel myths and misperceptions, political and community leaders need to engage the business community to take down the roadblocks to entry into lower income markets. In some cases, businesses have failed to recognize this market opportunity. In other cases, the market opportunity is stunted by real, higher costs of doing business in lower income neighborhoods. To address the particular opportunities that exist in their communities, leaders need to be fact-driven and entrepreneurial. Businesses will respond to profitable opportunities. Already, innovations are underway to encourage businesses to reach out to lower income consumers and produce new low-cost products and services, and in turn, to encourage lower income consumers to turn to mainstream business products.
- ***Public and private leaders need to crack down on alternative, high-priced businesses that have blossomed in lower income neighborhoods.*** At the local level, leaders can use their licensing and zoning authority to curb the development of these businesses in lower income neighborhoods. At the state and federal level, leaders need to enact regulations that limit the fees and interest rates charged by fringe businesses, while funding research that addresses questionable business practices. As always, efforts to create lower-cost alternatives, as mentioned above, will also reduce the demand for alternative, high-priced businesses.
- ***Public and private leaders need to promote consumer responsibility and empower lower income consumers with better market information.*** Ultimately, consumers need to take responsibility to make smart bets on getting ahead, which means knowing which companies to buy from, what goods and services to stay away from, and how to manage day-to-day budget demands. But, the growing complexity of the market makes this difficult for everyone. Among the many choices consumers now have, there are hundreds of different mortgage products, often dozens of mortgage and insurance companies to choose from, new breeds of alternative financial service providers, and growing applications of credit reports and scores. There are a number of examples of market innovations that local and state leaders can embrace that create better electronic tools and information to help lower income consumers navigate today's maze of market choices and price variations. ■


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Introduction

Put aside common perceptions about poverty for a moment and consider this: Together, lower income households in this country are now collectively worth more than $650 billion in buying power every year.[1] That staggering sum is greater than the budgets of Canada and Mexico combined, and equal to more than 25 percent of the entire United States federal budget. To be sure, lower income families need nearly every penny of that total to get by—but not in the way you think. In fact, that $650 billion is potentially one of the most important sources of funding for anti-poverty initiatives today.

Last year, about 4.2 million lower income homeowners paid higher than average prices for their mortgages. About 4.5 million lower income households paid higher than average rates for auto loans. At least 1.6 million lower income adults paid too much for furniture, appliances, and electronics. And countless more paid higher prices for other necessities like basic financial services, food, and insurance than did their wealthier neighbors. Together, these high prices add up to hundreds, sometimes thousands, of dollars needlessly spent by lower income families every year.

But this problem—the evidence that lower income Americans pay more for necessities from groceries to car loans—is also a huge opportunity to push back against poverty. Reducing costs of living by just one percent would amount to over $6.5 billion in new spending for lower income families. What if we could cut these costs by 10 percent? That would add up to over $65 billion newly available for lower income families to save or invest in wealth-building assets from education to homes.

This is today's poverty opportunity: Reduce the higher cost of living that too many lower income families now must pay, and free up billions to help those families build real wealth. Through these savings, market dynamics can be put to work as an important asset, rather than just a liability, for lower income families.

We can accomplish this in three steps.

First, public and private leaders must take measures to bring down higher business costs that drive up prices for poor families. Second, new laws and more rigorous enforcement are needed to curb market abuses that gouge low-income workers. Third and most importantly, the public must invest in making lower income consumers the savviest shoppers in the marketplace, equipped with the know-how to spot and avoid bad deals and find the lowest possible prices. Together, these strategies will give lower income families a powerful tool to lift themselves out of poverty.

WHERE DID THIS OPPORTUNITY COME FROM?

Today's poverty opportunity is not a new one, but it is much greater in scope and importance today than at any time in the past.[2] There are two main reasons for this: demand among lower income consumers for many necessities has expanded dramatically over the last decade, while the supply of those necessities also has substantially changed.

Over the past decade, sweeping economic, market, and policy changes all interacted to create millions of new customers for many basic necessities. The roaring economy of the late 1990s helped contribute to income growth and the decline of concentrated poverty. Additionally, a major wave of new immigration to the U.S. also boosted demand for an array of goods. Those factors, along with sweeping policy reforms in programs that benefit lower income families, sent millions of lower income adults into the labor force in the 1990s.[3]

As demand increased for necessities like basic financial services, housing, cars, and insurance, the financial services market was transforming in ways that increased access to credit among lower income households. The most important of these changes was the burgeoning use of credit scores, which essentially allowed sellers of credit to index prices to reflect lending risks.[4] The advent of indexing helped open up numerous low-income credit markets once eschewed by businesses, and greatly increased lower income consumers' access to a host of credit products, from credit cards to mortgages. These market changes, in turn, expanded the purchasing power of lower income households.

At the same time, jobs were also spreading out in metropolitan areas, following, and sometimes leading, sprawling settlement patterns.[5] As jobs dispersed through metro areas and lower income workers found themselves spatially isolated from available jobs, car ownership among lower income households surged accordingly—from 67 percent in 1993 to 73 percent just ten years later.[6] This increase far outpaced the pace of car purchases among higher income households.[7]

Finally, in the background of all of these policy and market changes, the economy continued to flatten, as the globalization of supply and demand chains of the economy accelerated.[8] One important economic effect of globalization was that wages continued to stagnate, particularly among lower income workers.[9] In turn, this drove up demand among lower income consumers for a variety of short-term loans, along with creatively-priced products, such as mortgages with balloon payments.[10]

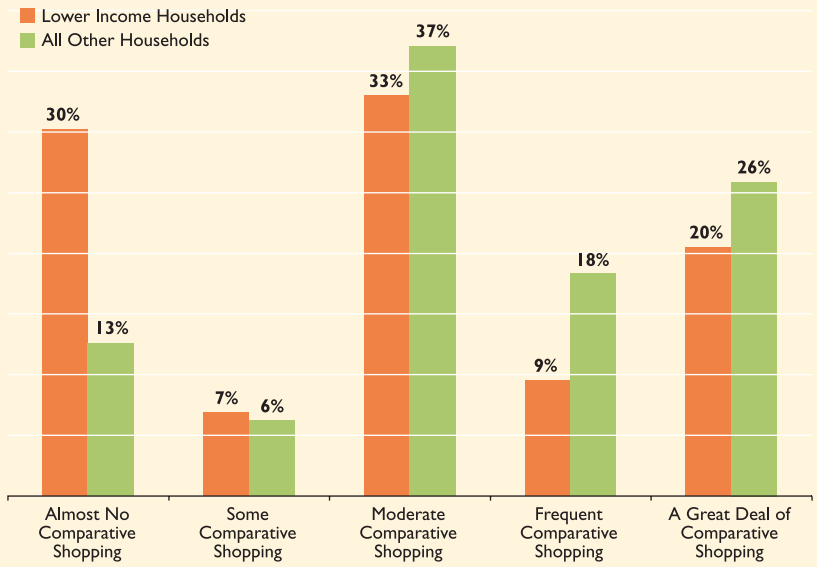
All of these changes worked to bring millions of new lower income consumers into the market for basic necessities.

The supply side of this market too underwent significant change, starting with innovative and entrepreneurial responses in the basic financial services market. Over the past decade, tens of thousands of high-priced, alternative financial services storefronts popped up around the country to meet surging demand in lower income households for check cashing, short-term loans, tax preparation, and money wiring services.[11] The mortgage market responded as well, creating new products for new lower income homebuyers who may have been ignored in the past.[12] Even the grocery market took steps to meet new patterns of demand, most visibly illustrated by Wal-Mart's recent efforts to move into underserved, lower income markets.[13]

For the most part, however, the rising market opportunities presented by lower income consumers went unnoticed. As mainstream

Being lower income is not just about having a lower income; too often, it is also about having to pay high prices for goods and necessities.

Lower income households do less comparative shopping for major credit and borrowing purchases than higher income households



Source: Author's analysis of the 2004 Survey of Consumer Finances

Note: Proportion of consumers in each income category that indicate the extent to which they comparatively shop when making major decisions about credit or borrowing.

businesses missed the moment, high-priced businesses moved to fill the void in the financial services and retail markets especially, leaving these new consumers vulnerable to exploitation.[14]

This vulnerability is not surprising: Survey evidence demonstrates conclusively that consumer savvy and financial literacy both increase with wealth.[15] In other words, low-income families have less understanding about financial services products and their value than do higher income households. This leaves lower income consumers more vulnerable to overcharging, unscrupulous businesses. Between 14 percent and 20 percent of all mortgage borrowers, for instance, are now estimated to pay higher interest rates and fees than indicated by their qualifications.[16]

Similarly, lower income consumers are much less likely than higher income households to shop around when making major decisions about credit or borrowing.[17]

In fact, nearly one in three low-income households reports that they do almost no shopping around; only about one in eight higher income households don't. One might hear such figures and respond, "caveat emptor," but the fact is that many of these consumers are new to many of these markets and may not fully understand their options. That problem has grown worse as many of these markets have become more complicated over the past decade: From insurance plans to mortgage policies, consumers are often beset with large numbers of choices, making it more difficult to make smart decisions.

This paper aims to demonstrate the higher costs lower income households pay for basic goods, costs that high-income households do not pay for what are substantially the same goods.

Overall, the items we examine—financial services, auto-related products, home financing and household goods, and groceries—account for at least 70 percent of a lower income household's budget. Put simply, the evidence is clear: For a wide range of goods and services, poor families pay more.

Thus, the opportunity beckons. Bringing down the costs for these items can create billions of dollars in potential savings, which can be put to work in investments like houses and educations, and in savings for families and retirements. Indeed, as we will describe below, a number of policy and market initiatives to lower prices for lower income families are already underway. Each of these initiatives represents a growing recognition among policymakers that it's time for them to take the other side of low-income families' ledgers more seriously. Being lower income is not just about having a lower income; too often, it is also about having to pay high prices for goods and necessities. As this report illustrates, that's a massive roadblock for working families—but avenues exist to take it down. ■

When we add up all of these higher prices, lower income households can end up paying hundreds, even thousands of dollars more every year to buy the exact same goods or services that higher income households consume.

Methodology

It is exceedingly difficult to measure the prices different individuals pay for the exact same product. Consider, for instance, the price of orange juice, long a staple on Americans' breakfast tables. To help consumers decide among all of the brands and types of orange juice, grocery stores advertise the sticker cost of the product: $2.30 for concentrated orange juice, for instance, and $3.50 for freshly squeezed. Less prominently, grocers also advertise the per-unit price, which is the cost of the same amount of juice across the different brands and types (e.g., $0.44/ounce). This measure controls for a host of factors that can inflate or deflate the sticker cost, from the package size to the thickness of the container that the orange juice is contained in.

The difficulty for this analysis is that most surveys of consumer finances and expenditures measure sticker costs only. As a result, low-income consumers in these surveys appear to spend less on groceries than do higher income households. Lower income households, for instance, more likely buy generic brands instead of more expensive, freshly squeezed juice.[18] Over time, this means that they spend considerably less on orange juice than higher income households.

What this misses, though, is that per-unit price often varies from one community to another based on median household income. The same amount of juice, for instance, often will cost more in a low-income neighborhood than in a higher income neighborhood. When considering orange juice, this difference might not seem significant—but as we demonstrate below, this pattern of price varying by household income holds true for nearly all basic necessities, from small items like a tank of gas or the cost of cashing a check, to much larger items like home mortgages and auto insurance. When we add up all of these higher prices, low-income households can end up paying hundreds, even thousands of dollars more every year to buy the exact same goods or services that higher income households consume. Eliminating this price difference will provide a great opportunity to help lower income families get ahead.

To document that opportunity for public and private leaders throughout the country, we marshal national evidence where it is available, supplemented with local data from 12 metropolitan areas. The breadth of this sample allows us to make a general case about the higher prices lower income families

pay, and to present the most comprehensive picture possible on prices. Data was not always available for individual consumers, so we supplement individual level data with evidence from lower income neighborhoods.

Since most readers will not be familiar with these data sources, and because the availability of data is uneven across the different items measured, we go into detail about each of these dimensions of the analysis below.

ABOUT THE METROPOLITAN AREAS

To supplement and complement the analysis of national data we gathered information about 12 metropolitan areas that together account for about 23 percent of the entire U.S. population.[19]

The 12 metro areas provide geographic diversity but also represent diverse markets. Most importantly, the cost of living varies widely in our sample of metro areas. According to the 2005 ACCRA cost of living index, which measures 364 metropolitan areas, New York and San Francisco are respectively the first and second most expensive metros to live in throughout the entire country.[20] In contrast, Pittsburgh is ranked as the 217th most expensive metro.

The communities in our sample also cover a wide range of economic conditions. Real median wage growth in Indianapolis, Los Angeles, and Pittsburgh stood under 5 percent between 1998 and 2004.[22] On the other hand, San Francisco, New York, and Washington, DC all saw median wages grow by over 15 percent. Similarly, the poverty rate widely varies across our sample of metropolitan areas. Within the cities of Atlanta, Baltimore, Chicago, and Hartford more than one out every five people lives below the poverty line. In contrast, poverty rates in the cities of Indianapolis and San Francisco are both below the national rate. Such uneven opportunity across these metropolitan areas should account for the effects that the economy has on prices for necessities.

This study's 12 metro areas range from being some of the most expensive to the most affordable areas in the U.S.

Metro Area	Cost of Living Rank (of 364)
New York	1
San Francisco	2
Los Angeles	5
Washington, DC	12
Chicago	24
Hartford	30
Seattle	36
Baltimore	40
Denver	88
Indianapolis	110
Atlanta	145
Pittsburgh	217

Note: Cost of living rank is based on quarterly average price data for basic living expenses basis over a one-year period.

Source: ACCRA Cost of Living Index, 2005

ABOUT THE BASIC GOODS AND SERVICES

In this analysis we focus on basic necessities for lower income families, including food, housing, utilities, transportation, and financial services. Together, these items account for about 70 percent of the spending in a typical American household. Other goods and services, like health care, entertainment, apparel, and personal insurance, account for the balance of what households spend; unfortunately, no comparative data is available to assess how prices for these goods and services vary across income categories.

To measure how prices vary across basic necessities, we used a variety of data sources and methods. We summarize this information for each necessity below.

Groceries

For our analysis of per-unit food prices, we needed to measure what households of different incomes pay for the same basket of groceries. In this way we could hold constant all other factors that affect the prices consumers pay for groceries, like different brands or product sizes.[23] To do this, we looked at two types of information.

In total, we analyzed nearly 21,000 grocery stores for this report, using two types of information. The first is a comprehensive database of all grocery stores in each of these markets, from the 500 square foot "mom-and-pop" corner store to the 150,000 square foot Wal-Mart super center. Importantly, this means that there is a substantial range in the a) the quantity of food items, b) the quality of food items, and c) the availability of other services, such as a pharmacy, across our population of grocery stores.[24] From the perspective of the U.S., Canadian, and Mexican officials that jointly created this coding system, the common unifying good sold across all of these establishments is food. But, it is important to keep in mind that this is an otherwise very diverse group of establishments.

This database is maintained by InfoUSA, a private company that mines hundreds of resources to compile a comprehensive index of business establishments in America.[25] This database does not include data about grocery prices, but does contain information about each establishment's location, size and annual revenue. Because store size is strongly correlated with the price of products, we can make inferences about prices based on store size.[26]

Our second source is a database maintained by AC Nielson to look directly at prices in a sample of 3,000 mid- to large-sized grocery stores. This database is not a comprehensive index of grocery stores in the metro areas in our sample, nor is it a random sample of stores: the database only includes grocery store chains that are customers of AC Nielson. Both of these characteristics are important limitations, because the smaller, mom-and-pop stores are the very stores that we find are concentrated in lower income neighborhoods. Also, there is some evidence that suggests lower income neighborhoods have less access to chains.[27] Still, the stores in the AC Nielson sample do vary by size, which allows us to more closely examine the relationship between store size and food prices.

To develop a typical grocery cart of food items, we turned to the ACCRA cost of living index, which includes grocery prices.[28] Using their method as a guide, we examined prices for ground beef, chicken, canned-tuna, milk, eggs, margarine, processed cheese, potatoes, oranges, lettuce, sliced-bread, canned orange juice, coffee, sugar, cereal, frozen dinner, frozen corn, and soft drinks.

Within these food categories, we looked at the average per-unit price of the most popular products sold in these categories during the 12-month period between October 2004 and October 2005. We chose this method of comparison because we needed to compare the price of the exact same product across the 3,000 stores in our sample, and not all products are sold at every grocery store.[29] This yielded a total sample of 132 different food products sold across all of the stores in our analysis.[30] Since each participating store reports data every week, we then took the average price of each food item over the course of the 52 week period. Using this information, we were able to determine how the cost of these products systematically varied across each of the stores in our analysis.

Transportation

More than nine of every 10 American households have access to at least one car, including more than seven out of every 10 lower income households.[31] We focus on three types of automobile costs: the price of purchasing a car, a car loan, and car insurance.[32]

To measure the price of buying a car, we relied on an analysis by Fiona Scott Morton, Florina Zettelmeyer, and Jorge Silva-Risso published by the National Bureau of Economic Research.[33] Using a unique national database of over 650,000 car purchases, these scholars were able to control for over two dozen factors that influence the price that different customers pay for the same automobile. This makes it possible to isolate the independent effect of buyer income on the price of a car, along with the effects of race, gender, and educational attainment. But, to calculate the total effects of income on the price of a car, one would have to add in many of the other effects in this model because these factors also systematically covary with income.[34] Using this model, we can estimate the average mark-up fee lower income drivers typically pay.

To assess what different households pay to borrow the same amount of money for an auto loan, we used the 2004 Survey of Consumer Finances administered by the Federal Reserve. These data provide the only resource that we are aware of to assess how prices for auto loans vary by household income.[35] The Survey of Consumer Finances (SCF) is conducted every three years, and was based in 2004 on interviews with 4,522 families.[36]

Finally, we analyzed the price of insuring the exact same car and driver in each of the metropolitan areas included in this report. Because disclosure laws are so limited in the insurance industry, it is impossible to assess this issue with national data—such data just do not exist. We also cannot measure most of the factors considered by insurance companies in their insurance-rating models, some of which likely vary systematically by income.[37] But, we can look at data from the metro areas in our sample, and we can look at the effects of territories on prices—one important variable used by insurance companies to set prices.

To do this, we looked at the websites of three large insurance companies—Geico, Allstate, and Progressive—that together account for about 23 percent of the auto insurance market.[38] On each of these sites, we entered a similar profile of a car and driver and obtained auto insurance premium quotes for the minimum amount of legally required insurance.[39] To make the estimate as conservative as possible, we selected an optimal set of characteristics for the driver: 35 years old, married, with a clean driving record, a short (five-mile) daily commute to work, and limited annual mileage (between 10,000–15,000 miles). The car that we used is a five-year-old Ford Taurus, which is approximately equal in value to the median value of automobiles owned by individuals in the lowest income quintile, according to the 2004 Survey of Consumer Finances.

We entered this car and driver profile for each of the ZIP codes in the metropolitan areas in our sample.[40] This research method was designed to yield over 10,000 dif-

ferent price quotes for car insurance, or one premium for every company and ZIP code in the analysis. With this data, we then used the Census 2000 survey to estimate the median income in each of these ZIP codes.[41] In this way, we were able to analyze the relationship between neighborhood income and the price of auto insurance.

While this analysis speaks to the powerful influence of where a driver lives on the price of insurance, it is not without important limitations. For one, it does not account for the credit or insurance score of the driver, and the role that this information can play in shaping auto insurance premiums.[42] The analysis also omits a number of other factors commonly believed to raise the price of auto insurance for lower income drivers, including the driver's occupation and educational attainment of the driver.[43]

Basic Financial Services

We analyzed the four most prominent types of basic financial services: cashing checks, obtaining short-term loans, tax preparation, and wiring money. Together, these four services represent nearly all of the basic financial service products.[44]

Nearly all of the data for this part of the analysis is based on national surveys of consumer behavior and local information about prices. This reflects the gaps that exist in information today: We have very little information about how consumer behavior varies across types of markets, and we have very little information about average prices paid across the country. Still, the available data do provide a powerful set of facts that point to the higher prices lower income families tend to pay for these services.

To determine what consumers typically pay for these services, we used three major sources of data. The first are a series of national surveys, which are covered in each section of the report.

The second data source is information collected from banking regulators in each of the states represented by the metropolitan areas in our analysis. Through an assessment of information collected from both conversations with representatives and information on state-maintained web pages, we were able to assess the maximum interest rates and fees associated with using these products.[45]

Our other major source of information to assess the price of basic financial services was the InfoUSA database, reviewed earlier.[46] In total, we looked at nearly 34,000 providers of basic financial services, from mainstream banks and credit unions to more fringe businesses, like check-cashing establishments and payday lenders. Using these data, we looked at the location and annual revenue of each establishment. We then used the Census 2000 survey to estimate the median income in the neighborhood where each establishment is located. With this information, inferences were made about how the price of basic financial services varies by neighborhood income.

Importantly, the InfoUSA data categorizes establishments by their primary and secondary business

service, but does not capture every type of commodity sold. This means, for instance, that a gas station that derives the largest portion of its revenue from the sale of gas, sells food as its second biggest revenue source, and cashes checks as its third source of revenue, will not be listed in the InfoUSA database as a check-cashing business. For this reason, we systematically undercount the number of businesses in each category.[47]

We supplemented these major sources of data with information about specific companies in our analysis. While not as generalizable as the information collected from the states or InfoUSA, this evidence offers some powerful examples of the higher prices lower income households often must pay for these basic financial service products.

Housing

Our analysis of housing prices includes an assessment of the prices paid for mortgages, home insurance, and furniture and appliances. While this does not exhaust the list of important housing-related costs—such as maintenance, rent, and property taxes—there is no data to suggest that prices for any of these necessities are higher for lower income families than other households.[48]

To examine how mortgage prices vary by household income, we looked at two different datasets. The first is the 2004 Survey of Consumer Finances administered by the Federal Reserve, which we reviewed earlier in this section. These data allow us to compare how the typical amount borrowed and the typical rate charged for mortgages varies across different income categories. The data provide an excellent, national assessment of these higher prices.

We supplemented this analysis with data from the 2004 Home Mortgage Disclosure Act (HMDA), which provides information about a large proportion of the mortgages originated in the 12 metropolitan areas of our geographic sample. These data include a variable that flags whether an originated loan has a high price. The Federal Reserve Board defines high-price loans as those that have an annual percentage rate (APR) three percentage points above comparable Treasury notes for first liens and five percentage points above for junior liens. With this definition, the Board estimated they would capture over 95 percent of the sub-prime market.[49] Although, recent comparisons of the HMDA data with private data suggest that the Board's definition of "high cost" captures a substantially smaller share of the sub-prime market.[50]

To analyze the price of home insurance, we used a method similar to the consideration of auto insurance prices described above. The major difference is that only one of the three selected insurance companies makes home insurance quotes available, and does so for nine of the 12 metropolitan areas. For each of the ZIP codes in these nine metropolitan areas, we entered a similar profile of a house worth approximately $75,000, and requested the minimum amount of insurance required by the state. We then used the 2000 Census to estimate median income in each of these ZIP codes, then analyzed the relationship between neighborhood income and the price of home insurance.

To assess the price of furniture and appliances, we used two different resources. The first is survey data collected by the Federal Trade Commission, which analyzed various characteristics associated with 12,000 customers of rent to own stores.[51] The second resource is the InfoUSA database described in greater detail above. Using these data, we were able to build a profile of rent-to-own customers, while also illustrating where these establishments are geographically concentrated within each of the metropolitan areas studied.

ABOUT OUR DEFINITION OF LOWER INCOME FAMILIES

We used numerous data resources that estimate household income, including Home Mortgage Disclosure Act data, the Survey of Consumer Finances, a Federal Trade Commission Survey, Census Bureau surveys, and J.D. Power and Associates, among others. Because these data are in many different forms, we needed to establish a common definition of "lower income" across each of these different data resources. This was no small challenge, because there is no commonly accepted definition of lower income or poverty.[52] Some analyses use the federal poverty line as the point of demarcation, while others use some percentage above the poverty line. Still others use some measure of a "sufficient income" or receipt of some type of public benefit, like the Earned Income Tax Credit, as a definition.

The results presented in this analysis do not depend on choosing from one of the many available measures of lower income. In general, we find that prices decrease linearly or curvilinearly as household income or neighborhood income increases, where quantitative income information is available.

But, because we needed some way to illustrate these findings, and talk about the differences between lower income borrowers, neighborhoods, and everyone else, we needed to select a measure. Given the lack of agreement about the term "low-income" and "poor" and in light of the diverse measures of income in our datasets (and lack of a poverty measure), we elected to use increments of $30,000 as the common yardstick to assess the relationship between income and prices. We then elected to measure "lower income" as any neighborhood with a median income less than $30,000, or any household that earns less than $30,000—depending on the dataset in use.[53] In current dollars, this represents about half of the estimated value of the median family income in 2006.[54]

But, like any measure of "poverty" or "low-income" it is important to keep in mind the unique limitations of this particular measure. First, cost of living variance among the metro areas means that equal income in two cities does not mean equal purchasing power or quality of life: an annual income of $30,000 goes much farther in Pittsburgh than in San Francisco. Second, not all surveys measure the same units. A family with children making less than $30,000 is certainly less well-off than an individual living alone with the same income. Unfortunately, the data do not allow us to make these distinctions. Similarly, we would have ideally been able to distinguish between individuals, households, and families, but that type of specific data was not available across all of these diverse datasets.

Still, like a lot of these academically minded (unresolved) issues with a measure of "low-income" or "poverty," the importance of these limitations lays at the margins: at worst we are talking about lower income and very moderate-income households, instead of just "low-income" households. For all of these reasons, we refer to "lower income" households, consumers, and neighborhoods throughout the results section of this analysis, and contrast these units to "higher income" households, consumers, and neighborhoods. ■

FINDINGS:

The Higher Prices Facing Lower Income Consumers

I. BASIC FINANCIAL SERVICES

Low- and moderate-income consumers are more likely to buy high-priced basic financial services than higher income households.

Lower income families are more likely than other households to pay high prices for basic financial services like check cashing, short-term loans, tax preparation, and transmitting money. Depending on what products they purchase, the extent of their demand, and where and from what type of establishment they make their purchases, lower income families can pay as much as several thousand dollars every year in extra costs for these services.[55]

Lower income consumers are much more likely than higher income consumers to pay high prices to cash checks and take out short-term loans.[56]

Depending on where lower income families live and the types of services they consume, these costs can range from a few dollars more to over $2,000 every year in extra costs for these basic financial services.[57]

Lower income consumers pay more because of their greater reliance upon alternative, high-priced financial service companies, including check cashers, payday lenders, pawnshops, and auto-title lenders. For instance, survey evidence indicates that most check casher customers earn annual incomes below $30,000. Similarly, most payday-lending customers earn between $15,000 and $60,000 per year, and over 65 percent of pawnshop customers earn under $25,000.[58] All these types of businesses tend to charge a higher price for a comparable service or product sold by a bank or a credit union, thus indicating that the lower income consumers who frequent them are more likely than higher income households to pay high prices for basic financial services.

Exactly how much more lower income consumers pay depends on what products they consume, the extent of their demand, along with where and who they are buying the product from. For instance, cashing a check *generally* costs substantially more every year at a check-cashing establishment than at a bank, but exactly how much more varies across the country.[59]

Prices charged at check cashers range from approximately one percent of the face value of a check in West Virginia to no limit in 19 states.[60] Across the 12 metropolitan areas in our sample, maximum check-cashing fees generally range between 1.6 percent of the face value of a check in New York to up to 10 percent for personal checks cashed in Maryland.[61] Although there is no information about the exact prices charged at establishments in these areas, recent research suggests that fees are generally fixed at the maximum allowed rate.[62]

Thus, a family with a net income of $30,000 a year would pay about $18.46 every two weeks to cash a check in New York, or about $480 over the course of a year. In contrast, that same family would pay $1,500 to cash checks from a private company if they lived and worked in Atlanta.

At least in theory, the family need not pay anything to cash

Exactly how much more lower income consumers pay depends on what products they consume, the extent of their demand, along with where and who they are buying the product from.

The maximum allowable fee for check cashing services varies widely among the states

Select Geographies	Description of maximum fee allowed by state regulations
California (Los Angeles and San Francisco)	For government and payroll checks, fees may not exceed 3% of the value of the check with customer I.D., and 3.5% or $3 (whichever is greater) without I.D. Fees may not exceed $15 for bounced checks. A one-time fee to set up an account may not exceed $10.
Colorado (Denver)	Not regulated
Connecticut (Hartford)	Fees may not exceed 1% of the face value of government and payroll checks, and may not exceed 2% of the face value of all other checks.
District of Columbia (Washington)	Check cashers may not charge an additional fee for verification, handling, and documentation processing totaling more than $5 on a personal check with a face value of up to $250; no more than $10 on a personal check with a face value of $250.01-$500; no more than $15 on a personal check with a face value of $500.01-$750; and no more than $20 on a personal check with a face value of $750.01-$1,000.
Georgia (Atlanta)	Fees may not exceed 3% of the face value of government checks, 10% of personal checks, and 5% of all other checks.
Illinois (Chicago)	Fees may not exceed 1.4% of the face value plus $0.90 for checks under $500, and 1.85% of the face value for checks greater than $500.
Indiana (Indianapolis)	Fees may not exceed 10% of the face value of the check.
Maryland (Baltimore)	Fees may not exceed 3% of the face value of government checks, 5% of payroll checks, and 10% of personal checks.
New York (New York)	Fees may not exceed 1.58% of the face value of the check or $1, whichever is greater.
Pennsylvania (Pittsburgh)	Fees may not exceed 2.5% of the face value of government checks, 3% of payroll checks, and 10% of personal checks. One-time fee to investigate credit of consumer may not exceed $10.
Washington (Seattle)	No limit

Sources: California Department of Financial Institutions; Colorado Department of Regulatory Agencies; State of Connecticut Department of Banking; District of Columbia Department of Insurance, Securities and Banking; Georgia Department of Banking and Finance; State of Illinois Department of Financial and Professional Regulation; Indiana Department of Financial Institutions; Maryland Department of Labor, Licensing, and Regulation; State of New York Banking Department; Pennsylvania Department of Banking; Washington State Department of Financial Institutions

checks, because they could do so through a banking account. Although no inventory exists of banking products offered by every bank and credit union in the metropolitan areas in this analysis, recent industry reports suggest that a growing number of banks have started offering accounts with no maintenance fees, no minimum balance requirements, and no check-cashing fees.[63] Although the banking industry has traditionally lost money on checking accounts (even with monthly maintenance fees), banks and credit unions now widely view these accounts as a gateway to the other, more profitable services they offer.[64] In turn, competition for checking customers means that a growing number of banks are offering accounts that lower income consumers could rationally use as a substitute for paying fees to a check casher.

Lower income consumers also are more likely than higher income consumers to pay higher prices for short-term loans because they rely on alternative, high-priced lenders. As with the premium for cashing checks, just how much more they pay for short-term loans also varies across the country; the amount is also partially dependent upon what type of business sells the lower

The maximum allowable fee for payday lending services varies widely among the states

Select Geographies	Description of Maximum Fee Allowed by State Regulations
California (Los Angeles and San Francisco)	Maximum Charge = 15%; Maximum Loan Amount = $300
Colorado (Denver)	Maximum Charge = May not exceed 20% of the first $300 loaned plus seven and one-half percent of any amount loaned in excess of $300; Maximum Loan Amount = $500
Connecticut (Hartford)	Prohibited
District of Columbia (Washington)	Maximum Charge = 10% of face amount + fee of $5: $0–$250; $10: $251–$500; $15: $501–$750; $20: $751–$1000; Maximum Loan Amount = $1,000
Georgia (Atlanta)	Prohibited
Illinois (Chicago)	Maximum Charge = $15.50 per $100 ; Maximum Loan Amount =$1,000 or 25 percent of a borrower's gross monthly income, whichever is less
Indiana (Indianapolis)	Maximum Charge = 15%: $0–$250; 13%: $251–$400; 10%: $401–$500; Maximum Loan Amount = $500
Maryland (Baltimore)	Prohibited
New York (New York)	Prohibited
Pennsylvania (Pittsburgh)	Prohibited
Washington (Seattle)	Maximum Charge = 15%: first $500; 10%: remaining portion of the loan in excess of $500 up to the $700 maximum; Maximum Loan Amount = n.a.

Source: National Conference of State Legislatures, Consumer Federation of America (www.paydayloaninfo.org)

income consumer an alternative short-term loan.

For the 31 million lower income households that have a checking account, millions of them turn every year to payday lenders for short-term loans.[65] In fact, about 81 percent of the customers that buy high-priced payday loans earn less than $50,000 a year.[66]

Payday lenders typically provide a two-week loan in exchange for a personal check that the lenders will cash on the borrower's payday. State departments of banking regulate rates charged by payday lending businesses, which means that rates vary widely across the country.[67]

Across the country, fees for payday loans range from nothing (because the industry is banned) to higher than 15 percent of a loan's value in Colorado, Delaware, South Dakota, and other states.[68] In Washington, for instance, total fees and interest cannot exceed 15 percent of a loan for $500 or less (a 390 percent APR). Similarly, Illinois allows payday lenders to charge $15.50 for every $100 borrowed (a 403 percent APR).

The 9 million lower income households that don't have a checking account can turn to one of 14,000 pawnshops or one of the growing number of car-title lenders.[69] Prices for pawnshop loans range from no limit (in Arkansas, Iowa, Idaho, Maryland, North Dakota, Nebraska, South Dakota, Utah, and West Virginia) to 2 percent or less in Indiana and Missouri.[70] Across our sample of 12 metropolitan areas, pawnshop loan rates range from a low of 2.5 percent in the California metro areas for loans up to $225, to 20 percent in Chicago for the exact same loan amount. Similarly, recent evidence indicates that auto title loans bear an APR around 400 percent.[71]

There is no information about the prices actually charged at establishments in these areas, but recent research suggests fees are generally set at the maximum allowed rate.[72] Assuming this research is generalizable, a Seattle family in which one salaried worker earns a net income of $30,000 a year would pay about $270 to borrow $300 six times year from a payday lender. In Chicago, that same family would pay about $280 to borrow the same amount of money.

The maximum allowable fee for pawnshop loans varies widely among the states

Geography	Description of Monthly Fees Allowed (Includes Interest and Other Fees)
California (Los Angeles and San Francisco)	2.5% per month on the amount up to $225; 2% on the portion over $225 up to $900; 1.5% on the portion over $900 up to $1,650; 1% on the portion over $1,650. Service charge may range from $1 on any loan for not more than 90 days in amount of less than $15, to $140 on any loan for not more than 90 days in amount of $2,100-$2,500; plus a $3 loan setup fee for loans smaller than $50, or a setup fee of $5 for loans greater than $50; plus a $5 storage fee for items larger than 1 cubic foot, $10 for items larger than 3 cubic feet, $20 for items larger than 6 cubic feet, and $1 for each additional cubic foot of space.
Colorado (Denver)	20% per month for loans smaller than $50; 10% per month for loans greater than $50
Connecticut (Hartford)	5% per month for loans smaller than $15; 3% per month for loans between $14.01 and $50; 2% per month for loans greater than $50
District of Columbia (Washington)	2% per month for loans smaller than $200; 1% per month for loans greater than $200 but less than $1,000; 0.67% per month for loans greater than $1,000
Georgia (Atlanta)	For the first 90 days, 25% per month at a minimum of $10 per month. After 90 days, 12.5% per month at a minimum of $5 per month.
Illinois (Chicago)	20% per month
Indiana (Indianapolis)	2% per month for loans smaller than $960; 1.75% per month for loan amounts between $960 and $3,200; 1.25% per month for amounts greater than $3,200. May charge an additional fee of up to 20% per month for storage, setup fees, etc.
Maryland (Baltimore)	No specified limits
New York (New York)	3% per month
Pennsylvania (Pittsburgh)	3% per month, plus a $1 charge per pledge
Washington (Seattle)	Sliding scale from $1 for loans smaller than $10 to 3% for loans of $100 or more; plus a one-time fee ranging from $0.50 for loans smaller than $5 to $90 for loans of $4,500 or more.

Source: Tenney, Glen. "The Effects of Government Regulation on Competition and Supply in the Pawn Industry: A Quantitative and Qualitative Study." 2004.

As with check-casher fees, lower income families that pay these costs could avoid them by purchasing the same services from mainstream companies in the form of credit cards, home equity loans, and overdraft protection plans, among other products. One 2005 survey measuring 146 different credit card products sold by 47 different companies found that the average APR was 12.6 percent, and industry reports suggest that the typical APR on a home equity loan is even lower.[73] These rates are just a fraction of those charged by payday lenders and other alternative loan vendors.

This does not hold true, however, when consumers overdraw their checking accounts, effectively using them as a source of short-term loans, and incur overdraft fees.[74] Although no industry-wide assess-

ment measures the average rate banks charge for fees, several reports suggest that they can be quite high.[75] For instance, one major company charges $31 per overdraft.[76] Used once per month, six times a year, the Seattle low-income family that pays $270 to borrow $300 six times year from a payday lender would pay about $186 at this bank for that same loan amount.[77] If that family splits that overdraft fee between two bounced checks, however, these fees can quickly outpace charges levied by alternative sources.

Together, lower income consumers rely more on alternative, high-priced check-cashing and short-term loan companies than do higher income households. The annual cost of this reliance can range from a few extra dollars to several thousand dollars for lower income families.

Lower income consumers are also more likely than higher income consumers to pay high fees to get their tax returns quickly.

Lower income consumers are about as likely as higher income consumers to pay for tax preparation services. Nationwide, about 57 percent of lower income tax filers used for-profit tax preparation services in 2003, compared to about 61 percent of non lower income tax filers.[78]

However, when lower income families use for-profit tax preparation firms, they are much more likely than high-income consumers to buy refund anticipation loans (RALs), which are essentially advance payments made to filers based on the refund check from the IRS that they expect to receive. Because the IRS can take several weeks to cut a refund check, these loans have a stronger appeal to lower income families, who, by definition, are on more limited budgets.

Nationwide, about five percent of middle and higher income tax filers take out RALs, compared to about 15 percent of the lower income market.[79] Our sample of metropolitan areas reflects this trend: among middle and higher income households, demand for refund anticipation loans ranged from a low of 3.2 percent of filers in San Francisco to a high of nearly 8 percent in Atlanta. Among lower income filers, however, demand for RALs was much higher in every metropolitan area we sampled, ranging from a low of 6 percent in San Francisco to a high of over 21 percent in Atlanta.

Though no nationwide or metropolitan estimate of the cost of RALs exists, one recent study suggests that a major tax preparation firm typically charges about 250 percent.[80] Other widely cited studies suggest that rates can range from 70 to more than 1,800 percent.[81] This can add up to over $100 in fees for short, two-week loans—a cost, again, that lower income consumers are much more likely than higher income consumers to incur.

Lower income tax filers are much more likely than higher income tax filers to buy refund anticipation loans

	Proportion of Tax Filers That Buy Refund Anticipation Loans (2003)	
Metropolitan Area	Lower Income Households	All Other Households
San Francisco	5.9%	3.2%
Pittsburgh	8.4%	3.4%
Hartford	8.6%	3.3%
Denver	9.7%	4.2%
Seattle	10.3%	5.2%
Los Angeles	10.4%	4.1%
New York	11.0%	4.4%
Washington, DC	12.2%	5.2%
Chicago	14.5%	6.2%
Baltimore	16.2%	5.4%
Indianapolis	18.6%	7.7%
Atlanta	21.2%	8.0%

Source: Unpublished IRS data from Alan Berube and Porsha Cropper, The Brookings Institution

Lower income consumers are likely to pay fees to wire funds to foreign countries, fees less likely to be incurred by higher income households.

Evidence also suggests that lower income consumers are more likely than higher income consumers to buy remittance products. These services allow immigrants to send money back to their country of origin, nearly always for some type of fee. According to a recent analysis by Bendixen and Associates, 80 percent of U.S. buyers who send remittances to Latin America—the most common destination by far—earn annual incomes below $30,000.[82] This points to the much higher demand among lower income households for this basic financial service.[83]

Prices for remittances vary widely across markets, companies, and by the destination for the remittance. According to one recent study, sending a remittance to Mexico costs about 7.32 percent of the amount of money sent.[84] To send $200 every other week over the course of a year, then, would amount to about $320 in fees for that year. Given that 35 percent of immigrants in 2002 earned less than $20,000 a year, and 68 percent earned less than $35,000, hundreds of dollars spent on fees for remittance products can have a significant effect on the budget of a regular, lower income user.[85]

IMPLICATIONS

The dense concentration of businesses that sell high-priced financial services in lower income neighborhoods can serve to limit the choices of poorer consumers.

Nearly all of the high-priced, basic financial service companies we discuss in this section—alternative check cashers and short-term loan providers, tax preparation firms, and wiring companies—tend to be much more densely concentrated in lower income neighborhoods than higher income neighborhoods. Overall, however, the majority of these establishments are located in moderate-income neighborhoods, suggesting that the saturation of lower income markets has provided an incentive for these companies to move into higher income neighborhoods. We review the evidence on each of these types of businesses below.

Check Cashing and Short Term Loans

The highest, per-capita concentration of alternative check cashing and short-term loan providers are found in the lowest income neighborhoods of metropolitan areas.[86] Take Denver, for instance. According to our data, there are approximately 334 core alternative financial service providers in the metro area. In Denver neighborhoods with median incomes below $30,000, there is one of these establishments for every 3,196 residents. As the median income in a Denver neighborhood increases, the number of alternative providers of financial services per person decreases: neighborhoods with

Alternative check cashers and short-term loan providers are densely concentrated in lower income neighborhoods

Population Per Alternative Check Casher and Short-Term Loan Provider, by Neighborhood Income

	Neighborhood Income				
Geography	**$0–29,999**	**$30,000–59,999**	**$60,000–89,999**	**$90,000–119,999**	**$120,000+**
Seattle metro	2,330	6,888	38,244	n.a.	n.a.
Denver metro	3,196	4,755	22,957	27,416	n.a.
Atlanta metro	4,230	5,297	19,019	66,154	33,702
Indianapolis metro	4,357	6,385	20,434	n.a.	n.a.
Baltimore metro	4,901	14,270	68,083	147,356	n.a.
Los Angeles metro	5,873	8,856	28,110	155,864	n.a.
San Francisco metro	5,899	11,938	39,071	74,456	n.a.
Hartford metro	5,985	28,849	55,624	n.a.	n.a.
Washington, DC metro	6,369	7,199	21,994	49,505	218,405
New York metro	9,314	15,303	32,203	116,847	108,350
Pittsburgh metro	10,825	23,392	218,803	n.a.	n.a.
Chicago metro	17,661	16,621	28,845	40,045	40,781
Metro Average	**7,130**	**10,061**	**29,663**	**77,366**	**133,221**
Seattle city	3,560	11,565	62,219	n.a.	n.a.
San Francisco city	3,655	13,179	68,810	n.a.	n.a.
Baltimore city	4,724	12,589	33,918	n.a.	n.a.
Indianapolis city	4,769	5,568	15,355	n.a.	n.a.
Denver city	5,054	7,281	66,690	10,528	n.a.
Atlanta city	6,363	16,804	n.a.	30,879	11,737
Los Angeles city	6,822	11,570	27,902	66,113	n.a.
Oakland city	7,861	12,084	n.a.	n.a.	n.a.
Hartford city	7,919	33,659	n.a.	n.a.	n.a.
Washington, DC city	8,833	8,086	10,156	5,553	n.a.
New York city	9,410	14,271	13,550	19,242	10,050
Pittsburgh city	9,891	132,560	n.a.	n.a.	n.a.
Chicago city	20,781	28,436	8,928	14,731	n.a.
City Average	**7,600**	**10,915**	**15,410**	**26,465**	**32,929**

Source: Author's analysis of 2005 data from InfoUSA, and 2000 Census Bureau Data

Note: Averages are population weighted

Most alternative check cashers and short-term loan providers are located in moderate-income neighborhoods

Distribution of Alternative Check Cashers and Short-Term Loan Providers by Neighborhood Income

	Neighborhood Income				
Geography	**$0–29,999**	**$30,000–59,999**	**$60,000–89,999**	**$90,000–119,999**	**$120,000+**
Washington, DC metro	8%	65%	23%	3%	0%
Chicago metro	11%	67%	19%	2%	1%
Atlanta metro	12%	77%	10%	1%	0%
Denver metro	12%	79%	8%	1%	0%
Seattle metro	16%	77%	7%	0%	0%
Indianapolis metro	18%	75%	8%	0%	0%
San Francisco metro	18%	61%	19%	3%	0%
Los Angeles metro	32%	62%	6%	0%	0%
New York metro	33%	51%	15%	1%	0%
Baltimore metro	43%	49%	7%	1%	0%
Hartford metro	43%	40%	17%	0%	0%
Pittsburgh metro	44%	55%	1%	0%	0%
Metro Average	**22%**	**62%**	**14%**	**1%**	**0%**
Denver city	18%	80%	1%	1%	0%
Indianapolis city	21%	72%	7%	n.a.	0%
Chicago city	25%	54%	20%	1%	0%
Washington, DC city	26%	55%	12%	8%	0%
Seattle city	28%	69%	4%	0%	0%
Oakland city	38%	62%	0%	0%	0%
New York city	42%	45%	12%	1%	0%
San Francisco city	43%	48%	9%	0%	0%
Los Angeles city	53%	43%	4%	0%	0%
Atlanta city	65%	33%	0%	2%	0%
Baltimore city	68%	31%	1%	0%	n.a.
Hartford city	86%	14%	n.a.	n.a.	n.a.
Pittsburgh city	92%	8%	0%	0%	n.a.
City Average	**38%**	**53%**	**8%**	**1%**	**0%**

Source: Author's analysis of 2005 data from InfoUSA, and 2000 Census Bureau Data

Note: Averages are population weighted

median incomes between $30,000 and $60,000 have one store for every 4,755 residents; those with median incomes between $60,000 and $90,000 have one storefront for every 22,957 residents; and so on. This points to the very high relative density of alternative providers of check cashing and short-term loan services in lower income neighborhoods.

While concentration is highest in lower income communities, the bulk of alternative financial service sector storefronts are found in moderate-income neighborhoods with median incomes between $30,000 and $60,000. In Chicago, for instance, although the city's lowest-income neighborhoods are home to a much higher per-capita number of vendors of alternative financial services, more than two-thirds of these establishments in the metro area are located in neighborhoods with moderate incomes.

This trend is replicated in nearly every metro area in our sample: While alternative check cashing and short-term loan providers are much more highly concentrated in cities' lowest-income neighborhoods, most of the establishments are located in neighborhoods with more moderate incomes.

Tax Preparation Firms

Tax preparation establishments tend to be the most densely concentrated in moderate-income neighborhoods with median incomes between $30,000 and $60,000, rather than in lower- and higher-income neighborhoods. Moderate-income neighborhoods within the Chicago metropolitan area, for instance, have one tax preparation establishment for every 5,011 residents. That compares to about 8,200 people in a lower income neighborhood, 5,716 people in neighborhoods with median incomes between $60,000 and $90,000, 6,204 people per-establishment in a neighborhood with a median income between $90,000 and $120,000, and so on.

Our sample does include exceptions to this trend, however. Tax preparation firms in Denver, Pittsburgh, San Francisco, and Seattle are most highly concentrated in the lowest-income neighborhoods of those cities. In Seattle, for instance, there is one tax establishment for every 3,035 residents of neighborhoods with median incomes under $30,000. Neighborhoods with median incomes between $30,000 and $60,000, on the other hand, have one establishment for every 4,009 residents, and neighborhoods with median incomes between $60,000 and $90,000 have one tax preparation firm for every 8,172 residents.

For-fee tax preparation firms are densely concentrated in moderate income neighborhoods

Population Per Tax Return Preparation and Filing Establishment, by Neighborhood Income

	Neighborhood Income				
Geography	**$0–29,999**	**$30,000–59,999**	**$60,000–89,999**	**$90,000–119,999**	**$120,000+**
Atlanta metro	5,091	3,331	4,934	12,028	n.a.
Baltimore metro	5,945	4,363	7,360	10,525	n.a.
Chicago metro	8,200	5,011	5,716	6,204	8,739
Denver metro	4,021	5,022	5,483	12,745	5,289
Hartford metro	5,205	4,282	5,115	15,467	n.a.
Indianapolis metro	5,559	4,713	10,547	17,179	n.a.
Los Angeles metro	4,201	3,357	4,240	5,720	6,785
New York metro	8,182	6,557	6,005	7,387	11,405
Pittsburgh metro	3,796	6,440	6,078	5,268	n.a.
San Francisco metro	2,282	2,937	3,688	4,856	3,375
Seattle metro	3,035	4,099	8,172	91,781	n.a.
Washington, DC metro	6,369	3,657	5,206	8,736	12,134
All Metros	**5,434**	**4,367**	**5,357**	**7,057**	**10,336**
Atlanta city	7,635	7,202	7,428	30,879	n.a.
Baltimore city	6,239	7,601	16,959	5,493	n.a.
Chicago city	8,906	6,995	4,310	29,462	n.a.
Denver city	5,686	7,374	16,673	5,264	n.a.
Hartford city	7,309	11,220	n.a.	n.a.	n.a.
Indianapolis city	5,621	5,197	16,890	n.a.	n.a.
Los Angeles city	4,987	4,943	5,131	6,010	16,879
New York city	8,964	8,378	6,606	6,791	30,149
Pittsburgh city	7,253	44,187	21,956	n.a.	n.a.
San Francisco city	2,335	3,533	6,036	2,490	n.a.
Oakland city	2,246	4,711	20,432	8,296	n.a.
Seattle city	3,337	4,755	5,656	n.a.	n.a.
Washington, DC city	9,298	4,299	8,309	4,165	5,791
All Cities	**6,269**	**5,267**	**5,265**	**6,107**	**11,622**

Source: Author's analysis of data from InfoUSA

Wiring Services

Like the tax preparation firms, nearly all of the core providers of remittance services are located in neighborhoods with median incomes of less than $60,000. In 2005, over 84 percent of the establishments were located in these neighborhoods.

Again, however, these services are most densely concentrated in the lowest-income neighborhoods of all but two of the metropolitan areas in our sample. Chicago is typical of this general trend. There is about one business that sells wiring services for every 18,367 residents of Chicago's lowest income neighborhoods. As income rises, the density of these businesses drops. For instance, neighborhoods with a median income between $60,000 and $90,000 have about one wiring service for every 60,505 residents.

What's more, the concentration of these businesses varies systematically with the density of immigrants across our sample of 12 metropolitan areas. In particular, Chicago, Los Angeles, and New York, all with substantially larger numbers of foreign born citizens relative to all of the other areas in our sample, have greater density of these services in their lower income neighborhoods, reflecting higher potential demand among consumers in those communities.[87]

A substantial number of neighborhoods in each of the metros have no financial service establishments and no mainstream establishments in particular.

Banks and credit unions have footholds in place to compete with these higher-priced sellers of basic financial services.

About 29 percent of the lower income neighborhoods in our sample has at least one bank or credit union. Moreover, over 75 percent of the lower income neighborhoods we analyze are adjacent to a neighborhood with a bank or credit union.

This points to another important trend in the data: a majority of these alternative, high-priced check cashing and short-term loan businesses are meeting the demand for these basic financial services among lower income households literally down the street from mainstream banks and credit unions. In fact, of the 3,278 neighborhoods in our sample that included an alternative checking and short-term loan provider, 49 percent of these neighborhoods also had a bank or a credit union, and nearly 80 percent of these neighborhoods were adjacent to a neighborhood with a bank or credit union.

Still, a substantial number of neighborhoods in each of the metros have no financial service establishments and no mainstream establishments in particular.

In Atlanta, for instance, less than half of the lower income neighborhoods in the metro area are home to a bank or a credit union, compared to 100 percent of the neighborhoods with median incomes above $120,000. Clearly, while a large infrastructure for mainstream financial services is already in place, geographic gaps remain.

Wire transfer/remittance firms are densely concentrated in lower income neighborhoods

Population Per Remittance/Wire Transfer Service, by Neighborhood Income

	Neighborhood Income				
Geography	**$0–29,999**	**$30,000–59,999**	**$60,000–89,999**	**$90,000–119,999**	**$120,000+**
Chicago metro	18,367	31,900	60,505	220,249	122,343
Los Angeles metro	19,124	49,629	94,871	311,729	n.a.
Denver metro	31,160	89,318	642,801	109,663	n.a.
Seattle metro	32,625	92,648	956,105	n.a.	n.a.
New York metro	39,901	43,385	105,151	160,664	433,400
Hartford metro	39,902	109,628	n.a.	n.a.	n.a.
Atlanta metro	42,906	37,399	235,838	88,206	n.a.
San Francisco metro	48,376	74,885	117,214	n.a.	n.a.
Pittsburgh metro	83,509	122,360	218,803	n.a.	n.a.
Indianapolis metro	161,206	247,430	n.a.	n.a.	n.a.
Baltimore metro	181,319	93,306	136,166	n.a.	n.a.
Washington, DC metro	203,797	55,192	85,108	198,019	n.a.
Metro Average	**30,422**	**49,517**	**109,663**	**215,809**	**599,495**
Seattle city	13,349	42,791	124,438	n.a.	n.a.
Los Angeles city	17,509	45,543	74,406	132,226	n.a.
Chicago city	17,812	23,544	20,832	n.a.	n.a.
Denver city	22,745	71,895	66,690	n.a.	n.a.
Hartford city	31,674	67,317	n.a.	n.a.	n.a.
Oakland city	36,686	277,936	n.a.	n.a.	n.a.
San Francisco city	42,031	42,833	68,810	n.a.	n.a.
New York city	43,350	47,571	88,077	n.a.	n.a.
Atlanta city	76,353	75,617	74,280	30,879	n.a.
Pittsburgh city	108,799	132,560	n.a.	n.a.	n.a.
Indianapolis city	157,382	207,882	n.a.	n.a.	n.a.
Baltimore city	330,681	204,416	n.a.	n.a.	n.a.
Washington, DC city	n.a.	55,603	30,467	33,319	n.a.
City Average	**30,154**	**44,495**	**66,524**	**158,788**	**n.a.**

Source: Author's analysis of 2005 data from InfoUSA, and 2000 Census Bureau Data

Note: Averages are population weighted

On average, 30 percent of lower income neighborhoods across the 12 selected metro areas have at least one bank or credit union

Proportion of Neighborhoods with a Bank or Credit Union, by Neighborhood Income

	Neighborhood Income				
Geography	**$0–29,999**	**$30,000–59,999**	**$60,000–89,999**	**$90,000–119,999**	**$120,000+**
New York metro	18%	23%	29%	20%	19%
Chicago metro	23%	49%	67%	72%	59%
Los Angeles metro	30%	30%	26%	20%	15%
Baltimore metro	31%	60%	64%	52%	0%
Atlanta metro	41%	58%	73%	56%	88%
Hartford metro	41%	68%	56%	13%	100%
Washington, DC metro	41%	54%	60%	53%	43%
San Francisco metro	43%	44%	46%	42%	23%
Indianapolis metro	44%	65%	76%	80%	100%
Seattle metro	50%	39%	30%	20%	33%
Pittsburgh metro	55%	52%	52%	40%	100%
Denver metro	57%	48%	47%	54%	40%
Metro Average	**29%**	**40%**	**44%**	**36%**	**31%**
New York city	22%	30%	41%	52%	67%
Chicago city	24%	48%	71%	64%	67%
Baltimore city	28%	50%	50%	50%	n.a.
Oakland city	29%	33%	33%	47%	50%
Los Angeles city	32%	38%	48%	33%	12%
Washington, DC city	38%	43%	57%	63%	44%
Atlanta city	39%	56%	57%	67%	100%
Hartford city	41%	59%	n.a.	n.a.	n.a.
Indianapolis city	43%	68%	74%	0%	100%
Pittsburgh city	44%	38%	44%	100%	100%
Denver city	52%	50%	76%	67%	0%
San Francisco city	58%	47%	40%	70%	0%
Seattle city	93%	54%	43%	0%	50%
City Average	**29%**	**40%**	**49%**	**50%**	**39%**

Source: Author's analysis of 2005 data from InfoUSA, and 2000 Census Bureau Data

Note: Averages are population weighted

Why are financial services more costly for lower income consumers?

This section has shown that lower income families are generally much more likely than higher income families to buy costly basic financial services. This is reflected both by survey evidence and by the location of these businesses, which generally tend to be more densely concentrated in lower income neighborhoods than higher income neighborhoods.

To bring down these higher costs, policymakers will have to grapple with the myriad factors that drive lower income consumers to buy these high priced products.

First, banks and credit unions face both real and perceived higher costs of doing business with lower income consumers.

Today, for instance, over 23 percent of lower income households do not have a checking account, and another 64 percent do not have a savings account.[88] To be sure, these millions of lower income consumers represent an unmet market demand. While there is some banking presence in many lower income neighborhoods, many consumers do not use them either because of negative perceptions or lack of products to meet their needs.

Lower income consumers need financial products that make sense for them. That means banks need to offer no, or very low, minimum balance requirements, an affordable overdraft protection plan, and no, or very low, maintenance fees. Not all banks offer these services; those that do not face product development and marketing costs to bring these products into the market. Together, these market dynamics drive both real and perceived higher costs of doing business in lower income neighborhoods.

Second, unscrupulous business practices drive up prices in lower income markets.

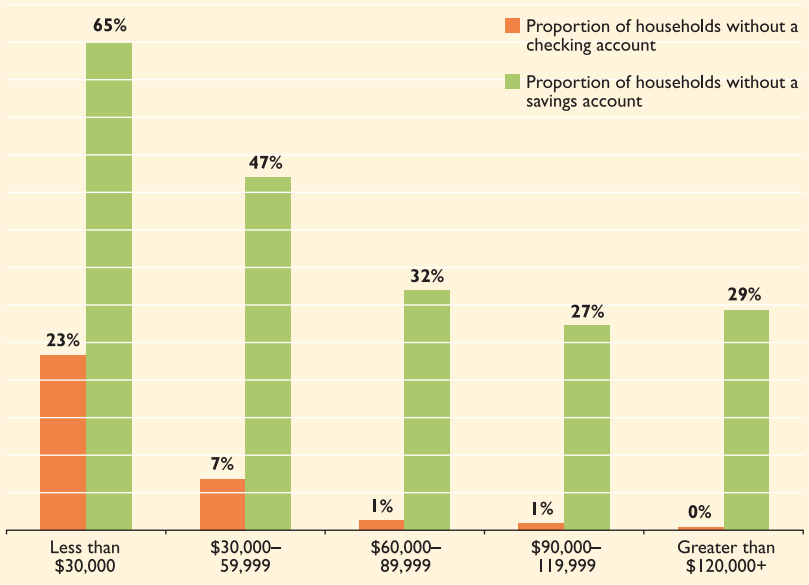
In some cases, this means that regulatory protections are insufficient. As this section has noted, for instance, companies can charge APRs of 400 to 500 percent for check-cashing services, short-term loans, and refund anticipation loans in some of the areas in this analysis. States that pass laws allowing those astronomical rates keep high-priced providers in business.

In other cases, regulatory complacency is reflected by the insufficiency of information given to regulated institutions. For instance, some experts report that there is widespread misunderstanding in the banking community about the paperwork requirements required for opening accounts.[89] Regulators can help banks move into these markets by more widely disseminating information about which specific types of identification are considered acceptable and not acceptable for banks to use when opening up bank accounts.

Finally, consumers lack information about banking services.

Numerous studies point to misperceptions lower income consumers hold about banks, possibly stemming from bad experiences or lack of interaction with banks or credit unions.[90] Studies also show that the lower a consumer's income, the less financial knowledge he or she is likely to have: for instance, some lower income families may not know that a checking account can often be a better financial deal than check cashers.[91] Finally, language barriers, along with cultural obstacles, can steer lower income families toward high-priced financial services.[92]

Lower income households are much less likely than higher income households to own a checking or savings account



Source: Author's analysis of the 2004 Survey of Consumer Finances

II. CARS

Lower- and moderate-income consumers are more likely than higher income households to pay higher prices for car-related products.

Lower income families consistently spend more to purchase cars and take out auto loans than do higher income families. On average, lower income households pay between $50 and $500 more in car prices and an extra two percentage points on an auto loan. Together, these higher prices can add up to over $1,000 every year, depending on the specific combination of products purchased.[93]

There is also evidence suggesting that lower income families tend to pay higher auto insurance prices, although insurance industry disclosure laws are too restrictive to reliably quantify the exact value of that premium. We do find, though, that it is generally much more expensive to insure a car in lower income neighborhoods within metropolitan areas than in higher income neighborhoods.

Consumers from lower income neighborhoods typically pay between $50 and $500 more for the same car as consumers from higher income neighborhoods.

The typical lower income car buyer pays more for a car than a higher income counterpart. While a number of studies have attempted to capture this dynamic, probably the best recent research is by Fiona Scott Morton and her colleagues, who recently analyzed a national sample of 650,000 car purchases.[94] After controlling for a number of factors that influence car prices, including the make and model of cars, the neighborhood income of the car buyer—their proxy for the income of the car buyer—had a significant effect on the final price of a car. They also found that race, and a number of characteristics associated with household income, like educational attainment and renter status, have a strong effect on the price of a car.

What these effects mean is that two customers who buy the exact same car will pay different prices that vary systematically based on certain characteristics. We can see the power of these effects by comparing two hypothetical car buyers.[95] The first is white, has a high school diploma, owns a house, and lives in a neighborhood with a median income of $80,000. The second customer is black, dropped out of high school, rents, and lives in a neighborhood with a median income of $20,000. According to the analysis by Morton and her colleagues, the second customer will pay about $500 more than the first customer for the exact same car.

Income only accounts for a small share of this direct effect because Morton and her colleagues control for a number of other car-buyer characteristics. But, income covaries with many of the other independent variables in this analysis, so the total effect of income adds

up to more than just the direct effect of income. For instance, the much larger effect is race, which accounts for over $300 more, on average, in additional costs, not charged to a white car buyer. Educational attainment and renter status also have significant effects, bringing the total effect to about $500 in extra charges for this hypothetical consumer.

On average, lower income consumers pay two percentage points more for auto loans than higher income consumers.

Every year, about 4.5 million lower income consumers pay a higher than average APR for their auto loans.[96] In 2004, the average annualized rate of interest paid by lower income households was about 9.2 percent. In contrast, households that earned between $30,000 and $60,000 a year paid an average rate of about 8.5 percent; households earning between $60,000 and $90,000 paid an average rate of about 7.2 percent; households earning between $90,000 and $120,000 paid about a 6.3 percent rate; and households that earned more than $120,000 paid about a 5.5 percent rate. Auto loan prices have a nearly perfect, linear relationship with household income.

This relationship has implications that go beyond what a typical household in each income category might pay for an auto loan. To see this, we analyzed the middle 50 percent of all households in each income category—those that fall between the 25th and 75th percentile—in terms of what APRs they paid. This captures a much bigger section of the population than does an analysis of the central tendency.

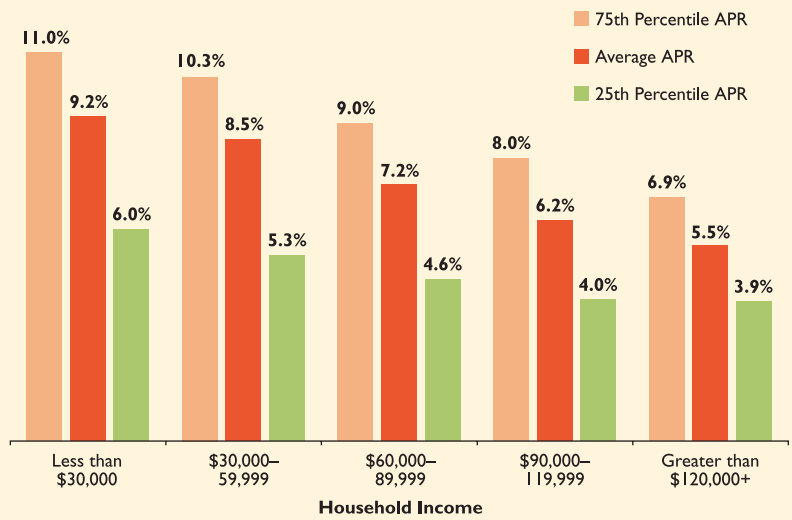
According to this analysis, the middle 50 percent of lower income households pay between 6.0 and 11.0 percent interest for their auto loans. That range systematically falls as household income increases. On the other side of the distribution, for instance, half of the households that earn more than $120,000 a year pay between 3.9 and 5.3 percent interest on their auto loan—both a smaller range and a much less expensive set of rates than those paid by lower income households.

The data also indicate that lower income households are much more likely to pay extremely high interest rates for auto loans, rather than just a higher average price. To see this, we considered the household income of all of the households that paid a higher average APR than 75 percent of all of the other households in 2004. This isolated the households that pay unusually high rates to maintain their auto loans.

Consistent with other results, we found that almost 40 percent of all lower income households with auto loans pay these extremely high rates. In contrast, just 30 percent of households with annual incomes between $30,000 and $60,000 pay these high rates; along with 20 percent of households with annual incomes between $60,000 and $90,000; 13 percent of households that earn between $90,000 and $120,000 annually; and just 6 percent of all households with annual incomes above $120,000.

Taken together, these data demonstrate conclusively that lower

Lower income consumers are more likely to pay higher prices for auto loans than higher income borrowers



Source: Author's analysis of 2004 Survey of Consumer Finances

Note: Dollar amounts are household income

income households tend to pay higher prices for auto loans than do higher income households. Just how much more varies widely across lower income consumers, but we can see how much more the typical lower income consumer pays for an auto loan. In particular, an auto loan of $5,000—about the median value of the typical car owned by a lower income household—would cost $1,256 in interest over the course of five years at a rate of 9.2 percent, the average charged to lower income borrowers. In contrast, a household earning more than $120,000 a year is charged an average rate of 5.5 percent, and thus pays just $730 in interest over five years. That represents a savings of over $500 to the higher income household relative to what the lower income household pays.

Holding other factors constant, drivers from lower income neighborhoods pay between $50 to over $1,000 more per year in higher prices for auto insurance than higher income drivers.

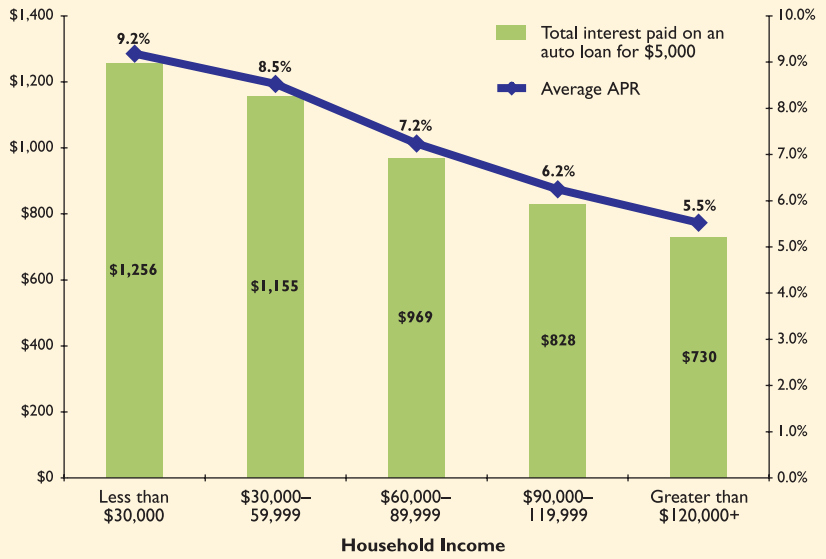
Because disclosure laws in the insurance industry are so limited, it is difficult to reliably quantify the national average prices different drivers pay for the same insurance policy. But we can look at our sample of metropolitan areas–home to nearly a quarter of Americans–to estimate how these price differences vary across neighborhoods.

Across our sample of metropolitan areas, we find that the highest prices for auto insurance are in the lowest income neighborhoods. New York, Hartford, and Baltimore had the highest price differentials across neighborhoods. In these three metros, 12 months of auto insurance in neighborhoods with median incomes of less than $30,000 costs over $400 more, on average, than in neighborhoods with median incomes between $90,000 and $120,000. New York has the highest price differential in our sample: it costs nearly $1,000 more every year, on average, to insure the exact same car and driver in a lower income neighborhood than in a moderate-income neighborhood, with a median income between $30,000 and $60,000.

In lower income neighborhoods within the eight other metros, the price differential was more modest, generally adding up to $50 to $150 extra every year. Chicago, where we found that it costs between $106 and $138 more every year to insure a car in the lowest income neighborhoods of the metropolitan area, was typical of this trend. Similarly, car insurance customers from the lowest income neighborhoods of Indianapolis pay anywhere from a $60 to $90 premium compared to higher income neighborhoods.

Looking only at the central cities of these metropolitan areas, we saw the exact same trend play out in ten of the twelve cities: Purchasers in the lowest income areas paid the highest prices for auto insurance. New York, again, showed the highest price differential across neighborhoods. In neighborhoods where the median income is less than $30,000, average prices for twelve months of insurance were between $210 and $670 more expensive than in higher income neighborhoods within the city. More typical

Higher auto loan prices for lower income households can add up to hundreds of dollars in extra costs



Source: Author's analysis of the 2004 Survey of Consumer Finances

Note: Average APR is taken from the 2004 Survey of Consumer Finances; loan amount is shown for illustrative purposes only

Auto insurance tends to be more expensive in lower income neighborhoods than higher income neighborhoods

Average Price of Car Insurance, by Neighborhood Income

	Neighborhood Income				
Geography	**$0–29,999**	**$30,000–59,999**	**$60,000–89,999**	**$90,000–119,999**	**$120,000+**
Pittsburgh metro	$356	$356	$348	$330	n.a.
Indianapolis metro	458	384	392	366	366
San Francisco metro	604	542	538	508	496
Seattle metro	614	600	564	568	540
Chicago metro	628	522	490	492	500
Atlanta metro	662	554	566	574	n.a.
Denver metro	730	610	610	588	n.a.
Los Angeles metro	802	694	624	644	790
Washington, DC metro	806	594	552	550	566
Baltimore metro	944	616	544	520	n.a.
Hartford metro	1,268	800	720	750	n.a.
New York metro	1,660	1,110	678	854	848
Metro Average	**$831**	**$660**	**$678**	**$680**	**$724**
Pittsburgh city	396	382	n.a.	n.a.	n.a.
Indianapolis city	458	428	426	n.a.	n.a.
Seattle city	596	620	548	n.a.	n.a.
Oakland city	610	594	578	n.a.	n.a.
San Francisco city	652	602	614	588	n.a.
Chicago city	664	612	522	552	n.a.
Atlanta city	726	640	594	602	n.a.
Denver city	730	686	670	n.a.	n.a.
Washington, DC city	822	822	822	822	822
Los Angeles city	826	776	746	798	790
Baltimore city	1,042	818	n.a.	n.a.	n.a.
Hartford city	1,336	1,336	n.a.	n.a.	n.a.
New York city	1,766	1,556	1,214	1,096	n.a.
City Average	**$1,064**	**$927**	**$834**	**$802**	**$790**

Source: Author's analysis of data collected from three major insurance companies

Note: Averages are population weighted

across these ten cities was the gap in San Francisco, where buyers from the lowest income neighborhoods paid between $38 and $64 more for auto insurance than did those from the city's more expensive neighborhoods.

Prices could be even higher for lower income drivers because of a number of driver characteristics that are factored into pricing decisions made by insurance companies. Some of these factors, like credit scores, occupation, and education, are strongly associated with household income.[97] This suggests, though it certainly does not prove, that lower income drivers may systematically pay higher prices for auto insurance. But because there are so few disclosure laws in the insurance industry, there is not sufficient data to analyze the full impact of all of these factors. More than any other issue we discuss in this report, the dearth of good data impairs our understanding of the relationship between income and insurance prices.

Why are these auto and auto-related products more expensive for lower income households?

This section reviewed evidence of the higher prices lower income consumers tend to pay for cars, car loans, and car insurance. Three major causal factors exist for these higher prices.

First, sellers of these auto products face real and perceived risks of doing business in lower income neighborhoods.

Lower income consumers have proven more likely to miss loan payments and to live in areas where it is more expensive to insure drivers.[98] In addition to the real added costs these risks carry, they also foster a perception of higher costs of doing business with lower income consumers, particularly when measurements of these risks are not precise, such as with insurance pricing. Sellers pass on these higher costs—both real and perceived—to lower income consumers by charging them more. As we discuss in the recommendations section, there are both policy and market tools to lower these costs of doing business.

Second, unscrupulous businesses and business practices inflate the prices charged to lower income consumers for car-related necessities.

Some evidence suggests that car dealers may systematically discriminate against black car buyers when setting a sales price.[99] Also, the much higher interest rates lower income drivers pay for auto loans may be due to poor credit or payment histories but also may be due to unscrupulous businesses inflating prices. Because the rate of car ownership among lower income families has been growing at a much faster pace than among higher income families, the sheer volume of new purchasers for cars and related products suggests that a lot of these customers may not

have the experience or knowledge to spot and avoid unscrupulous businesses that overcharge.[100]

Finally, lower income consumers tend to be less well-informed than higher income consumers.

Lower income consumers are generally much less likely to compare prices before buying goods and services, which likely makes them more susceptible to bad deals. At the very least, this weakens the buyer's position when shopping for cars, car loans, and car insurance. Any customer who does not know, for instance, what price a dealer paid for a car, the various strategies dealers use to artificially inflate prices, or even that prices are negotiable, will be at a significant disadvantage when they want to purchase a car.

Similarly, lower income consumers are less likely to understand credit scores—an important factor in what sellers charge for loans and insurance—which may needlessly drive up the prices these consumers pay. For instance, one recent survey found that only 56 percent of the respondents with a low educational attainment, and 64 percent of respondents with a lower income, indicated that they knew that their credit rating weakened when they missed a credit card payment.[101] Knowing less about this market product may make it more difficult for lower income consumers to bring up their credit scores.

III. HOMES

Lower- and moderate-income consumers are more likely than higher income households to pay higher prices for home-related products.

Lower income consumers are more likely than higher income households to buy higher-priced home furniture and appliances. Together, these extra costs can add up to thousands of dollars for lower income families, depending on what combination of products they consume.

Similarly, evidence suggests that it is generally more expensive to insure a home in a lower income neighborhood than in a higher income neighborhood, and that lower income home insurers may pay an additional premium, above and beyond the premium they pay for the neighborhood they live in.

Lower income homeowners paid, on average, a percentage point more than higher income households in mortgage interest and fees.

Nationwide, more than 4.2 million lower income homeowners pay a higher than average APR for their mortgage.[102] In 2004, the average annualized rate of interest on a first mortgage for lower income households was about 6.9 percent.[103] By contrast, households that earned between $30,000 and $60,000 a year paid an average rate of about 6.5 percent; households earning between $60,000 and $90,000 paid an average rate of about 6.0 percent; households earning between $90,000 and $120,000 paid about a 5.9 percent rate; and households that earn more than $120,000 paid a rate of approximately 5.5 percent. The much smaller second mortgage market shows a nearly identical pattern. Over the course of a loan, these higher annual percentage rates paid by lower income households can add up to tens of thousands of dollars in additional charges.

Higher mortgage prices have implications for more than just the typical household with a mortgage in each income category. To see this, we analyzed the middle 50 percent of all households in each income category—those that fall between the 25th and 75th percentile—in terms of what APRs they paid. This illustrates the rates that the middle 50 percent of each income category pay for mortgages, which captures a much bigger section of the population than an analysis of the central tendency.

According to this analysis, the middle 50 percent of lower income households paid between 5.4 and 7.8 percent interest for their mortgages in 2004. That range systematically shrinks as household income increases. On the other

Lower income households pay higher prices for home loans than higher income households

Typical APR on First Mortgage, by Income Group

	Typical APR on First Mortgage, by Income Group		
Household Income	**25th Percentile**	**Mean**	**75th Percentile**
Less than $30,000	5.4%	6.9%	7.8%
$30,000–59,999	5.5%	6.5%	7.0%
$60,000–89,999	5.3%	6.0%	6.5%
$90,000–119,999	5.1%	5.9%	6.3%
Greater than 120,000+	4.9%	5.5%	6.0%
Total	**5.3%**	**6.2%**	**6.8%**
	Typical APR on Second Mortgage, by Income Group		
Household Income	**25th Percentile**	**Mean**	**75th Percentile**
Less than $30,000	7.0%	9.2%	10.0%
$30,000–59,999	5.8%	7.9%	10.0%
$60,000–89,999	4.5%	7.1%	8.5%
$90,000–119,999	4.5%	6.4%	8.0%
Greater than 120,000+	4.5%	6.0%	6.5%
Total	**4.8%**	**7.2%**	**8.8%**

Source: Author's analysis of the 2004 Survey of Consumer Finances

side of the distribution, for instance, half of the households that earn more than $120,000 a year pay between 4.9 and 6.0 percent interest on their mortgage loans. That range is smaller, and the rate much lower, than that paid by lower income households.

The data also indicate that lower income households are much more likely to pay *extremely* high rates for mortgages. To see this, we analyzed all of the households that pay a higher average APR than 75 percent of all other households in the sample. This isolated the households that pay unusually high rates to maintain their home loans. Consistent with other results, we find that over 54 percent of all lower income households with a mortgage pay these extremely high rates. By contrast, 46 percent of households with an annual income between $30,000 and $60,000 pay extremely high rates; along with about 36 percent of households with an annual income between $60,000 and $90,000; 35 percent of households between $90,000 and $120,000; and just 19 percent of all households with an annual income above $120,000.

Data from our sample of metropolitan areas reflects these nationwide trends. In 2004, among all home mortgage borrowers in nine of the 12 metro areas in our sample, lower income households were more likely than any other income group to purchase a high-cost mortgage.[104] And, in five of our 12 metropolitan areas, households earning less than $30,000 represented the largest market share for high-cost mortgages among all of the income groups. Both statistics point to the much greater likelihood that lower income borrowers will buy a higher priced mortgage product than higher income households.

These overall trends belie important differences across the metropolitan areas in our sample, however. Lower income borrowers in the metro areas of Atlanta, Baltimore, Indianapolis, and Pittsburgh show particularly high demand for high-cost loans: in those four metros, more than one in five mortgage borrowers earning less than $30,000 a year purchased high-cost mortgages. In Atlanta and Indianapolis, more than one in four lower income homeowners purchased a high cost mortgage.

To put that in perspective, consider the other side of the distribution. In high-cost areas like San Francisco and Seattle, for instance, only between 10 and 12 percent of all lower income mortgage borrowers in each area purchased a high-cost mortgage. Lower income borrowers are still among the most likely income group in these two metros to purchase a high-cost mortgage, but that probability was substantially lower than the four areas detailed above.

Although lower income borrowers do tend to be the most likely home buyers to purchase a high-cost loan, it is important to point out that the market for high-cost loans consists of many more middle and higher income households than lower income households. In fact, lower income borrowers comprised

Across the 12 metro areas, lower income households are much more likely than higher income households to buy high-cost mortgages

Proportion of High-Cost Loans, by Household Income and Metro Area

	Household Income						
Metro Area	$0–30,000	$30,000–45,000	$45,000–60,000	$60,000–75,000	$75,000–90,000	$90,000–105,000	$105,000+
San Francisco	11%	8%	8%	9%	10%	9%	6%
Seattle	12%	14%	14%	14%	12%	10%	8%
Los Angeles	12%	13%	14%	15%	14%	13%	9%
New York	12%	13%	14%	16%	16%	15%	10%
Denver	13%	16%	16%	15%	13%	10%	7%
Washington, DC	15%	17%	17%	16%	14%	12%	7%
Hartford	17%	18%	18%	16%	13%	11%	8%
Chicago	20%	21%	21%	19%	16%	14%	9%
Baltimore	23%	21%	19%	16%	14%	12%	8%
Pittsburgh	25%	21%	16%	13%	10%	8%	6%
Atlanta	25%	23%	21%	20%	16%	14%	11%
Indianapolis	25%	22%	19%	15%	13%	11%	9%

Source: Author's Analysis of 2004 Home Mortgage Disclosure Act Data.

Note: High Cost Loans are defined by the Federal Reserve; this table says, for instance, that 25 percent of the loans originated to a household in Atlanta with a median income between $0-30,000 were high cost.

more than a fifth of the high-cost mortgage market in each of the metropolitan areas in our sample. In eight of the 12 metros, borrowers earning less than $30,000 a year accounted for less than five percent of the total high-cost mortgage market in 2004.

Similarly, in nearly all of the metropolitan markets in our sample the largest portion of the high-cost mortgage market in 2004 earned considerably more than $30,000 a year. And, in Los Angeles, New York, and San Francisco, a majority of the high-cost mortgages were sold to borrowers with household incomes more than $105,000.

Because middle- and higher income households account for the majority of the market for high-cost mortgages, we can state that the demand for and supply of these products does not depend on low-income households. In fact, in nearly all of the metropolitan areas in our sample, these borrowers account for a very small portion of this high-cost market.

Holding other factors constant, homeowners in lower income neighborhoods can pay as much as $300 more for home insurance than those in higher income neighborhoods.

Because disclosure laws in the insurance industry are so limited, it is difficult to reliably quantify the national average prices homeowners in different income groups pay for the same insurance policy. But we can estimate these price differences by examining our sample of metropolitan areas—where nearly one out of every fourth person in this country lives.

In seven of the nine metropolitan areas where we could obtain home insurance quotes, homeowners in lower income neighborhoods paid the highest prices for insurance.

Chicago, where the average quote for a year of home insurance in the city's lowest income neighborhoods was about $1,043, had the sharpest price differentials across income groups. The next highest average quote in our sample was for households in neighborhoods with a median income between $30,000 and $60,000, for whom a year of home insurance would cost $755. This trend holds across most of the metropolitan areas in this sample, suggesting that home insurance premiums tend to be more expensive in lower income neighborhoods.

Lower income households represent a small share of the market for high cost loans in these 12 metros

Distribution of Market Demand for High-Cost Loans, by Household Income and Metro Area

	Household Income						
Metro Area	$0–30,000	$30,000–45,000	$45,000–60,000	$60,000–75,000	$75,000–90,000	$90,000–105,000	$105,000+
San Francisco	1%	3%	7%	13%	16%	16%	43%
New York	1%	6%	13%	19%	18%	14%	28%
Los Angeles	2%	7%	15%	19%	16%	13%	29%
Washington, DC	2%	11%	19%	21%	16%	11%	20%
Seattle	2%	14%	21%	21%	14%	9%	17%
Denver	4%	18%	22%	19%	12%	8%	16%
Hartford	4%	19%	25%	20%	12%	8%	11%
Chicago	4%	17%	24%	21%	13%	8%	13%
Baltimore	7%	19%	22%	18%	12%	8%	14%
Atlanta	8%	23%	23%	17%	10%	7%	12%
Indianapolis	15%	27%	21%	14%	8%	5%	9%
Pittsburgh	20%	28%	21%	14%	7%	4%	6%

Source: Author's Analysis of 2004 Home Mortgage Disclosure Act Data.

Note: High Cost Loans are defined by the Federal Reserve; this table says, for instance, that households in Atlanta that earned between $0–30,000 a year accounted for about 8 percent of all households in the Atlanta metropolitan area that purchased a high-cost loan in 2004.

As with auto insurance, home insurance prices could be much higher for lower income drivers because of a number of personal characteristics that insurance companies factor into pricing decisions. Some of these factors, like credit scores, occupation, and education, are closely correlated with household income.[105] But because there are so few disclosure laws in the insurance industry, we lack sufficient data to analyze the full impact of all of these factors.

Lower income consumers tend to pay more for furniture and appliances because they are much more likely than higher income households to shop at rent-to-own establishments.

Lower income consumers are much more likely than higher income consumers to buy furniture and appliances from rent-to-own stores. Depending on specific state regulations and the combination of products they buy, this shopping tendency can cost lower income families hundreds of extra dollars every year in higher prices for furniture and appliances.

A recent analysis by the Federal Trade Commission (FTC) found that 59 percent of rent-to-own customers earn less than $25,000 a year.[106] Renting to own means that consumers pay more for a piece of furniture or electronics than if they simply bought the item outright because of numerous fees these stores charge. For instance, the Wisconsin Department of Financial Institutions estimates that a $200 television might cost as much as $700 at one of the rent-to-own establishments in the state.[107] Similarly, the Maryland attorney general's office estimates that a new $400 washing machine would cost over $1000 if purchased from a rent-to-own business.[108] The myriad additional costs rent-to-own establishments pass on to their customers—including processing fees, delivery fees, installation fees, in-home collection fees, home pick-up fees, product insurance fees, and late payment fees—account for these bloated prices.[109] In contrast, a consumer who bought that same washing machine with a credit card charging a 24 percent interest rate would pay just $480 over an 18 month period.[110]

In the 12 metros, home insurance premiums tend to be higher in lower income neighborhoods than higher income neighborhoods

Home Insurance Premiums, by Area and Neighborhood Income

	Neighborhood Income				
Geography	**$0–29,999**	**$30,000–59,999**	**$60,000–89,999**	**$90,000–119,999**	**$120,000+**
Indianapolis metro	$694	$770	$722	$720	$720
New York metro	798	668	618	600	568
Denver metro	800	838	844	800	n.a.
Baltimore metro	840	812	740	704	n.a.
Atlanta metro	866	820	754	796	n.a.
Hartford metro	916	720	730	700	n.a.
Pittsburgh metro	978	998	976	1120	1082
Chicago metro	1130	748	676	720	704
Los Angeles metro	n.a.	n.a.	n.a.	n.a.	n.a.
San Francisco metro	n.a.	n.a.	n.a.	n.a.	n.a.
Seattle metro	n.a.	n.a.	n.a.	n.a.	n.a.
Washington, DC metro	n.a.	n.a.	n.a.	n.a.	n.a.
Metro Average	**$878**	**$776**	**$734**	**$743**	**$714**
Indianapolis city	694	692	740	n.a.	n.a.
Denver city	800	824	860	n.a.	n.a.
New York city	806	698	846	1,020	n.a.
Atlanta city	874	868	880	880	n.a.
Baltimore city	880	870	n.a.	n.a.	n.a.
Pittsburgh city	926	920	n.a.	n.a.	n.a.
Hartford city	960	960	n.a.	n.a.	n.a.
Chicago city	1,196	884	1,026	1,060	n.a.
Los Angeles city	n.a.	n.a.	n.a.	n.a.	n.a.
San Francisco city	n.a.	n.a.	n.a.	n.a.	n.a.
Oakland city	n.a.	n.a.	n.a.	n.a.	n.a.
Seattle city	n.a.	n.a.	n.a.	n.a.	n.a.
Washington, DC city	n.a.	n.a.	n.a.	n.a.	n.a.
City Average	**$892**	**$840**	**$870**	**$987**	**n.a.**

Source: Author's analysis of data collected from three major insurance companies

Note: Averages are population weighted

Why are home-related purchases more expensive for lower income consumers?

Evidence in this section has shown that lower income consumers are more likely than higher income households to buy higher-priced home loans, furniture, and appliances. Similarly, our analysis indicates that insuring a home in a lower income neighborhood is generally more expensive than in a higher income neighborhood, largely reflecting previous research on the higher costs of insuring urban homeowners. There is also evidence that at least suggests lower income home insurers may pay an additional premium, above and beyond the premium they pay for the neighborhood they live in.

To bring down these prices, leaders will need to grapple with three market dynamics that drive up these prices.

First, businesses do incur some real risks when serving lower income markets, increasing their costs.

Lower income homeowners are much more likely than higher income borrowers to fall behind on their payments, declare bankruptcy, and have low credit scores.[111] Within a metropolitan area, they are also more likely to live in urban areas, where insurance is more expensive. As is the case with all of the higher costs of doing business considered in this report, there are many good reasons for these higher costs. But as long as these higher costs of doing business exist, businesses will rationally pass those higher costs onto lower income consumers. Importantly, the existence of these higher costs will also drive perceptions of higher costs, even when there may not be data available to support those perceptions. This also drives up prices.

Second, rent-to-own establishments are more densely concentrated in lower income neighborhoods than elsewhere, driving and responding to higher demand in those communities for rent-to-own products.

In all but one of the 12 metropolitan areas in our sample, we find that the highest concentration of rent-to-own stores is in lower income neighborhoods. Atlanta is typical of this trend: For the entire metro area, there is about one establishment for every 15,808 lower income neighborhood residents. That compares to one rent-to-own establishment for approximately every 23,067 residents of neighborhoods with median incomes between $30,000 and $60,000, and one establishment for every 147,300 residents of a neighborhood with a median income between $60,000 and $90,000.

Importantly, these trends do not suggest that most rent-to-own stores are located in lower income neighborhoods. In fact, most of the 817 rent-to-own stores within the 12 metropolitan areas in our sample are located in moderate-income neighborhoods with a median income between $30,000 and $60,000, perhaps due to market saturation in lower income neighborhoods.

Third, unscrupulous businesses drive up housing prices for lower income families.

For instance, research on mortgage pricing suggests that between 14 and 20 percent of all borrowers who purchased a high-cost mortgage could have qualified for a better priced mortgage product, saving them hundreds or thousands of dollars in interest charges every year.[112] Even for those who cannot qualify for prime loans, some bad apples in the mortgage market tack on additional features to mortgage products that unnecessarily drive up costs for consumers, like long-term prepayment penalties and

In the 12 metros, rent-to-own businesses are most densely concentrated in lower income neighborhoods

Population Per Rent-to-Own Furniture Establishment, by Neighborhood Income

	Median Neighborhood Income				
Geography	**$0–29,999**	**$30,000–59,999**	**$60,000–89,999**	**$90,000–119,999**	**$120,000+**
Atlanta metro	15,808	23,067	147,399	n.a.	n.a.
Denver metro	17,806	34,735	321,401	n.a.	n.a.
Indianapolis metro	17,912	23,565	326,950	n.a.	n.a.
Hartford metro	19,951	30,452	222,496	n.a.	n.a.
Seattle metro	21,750	44,118	191,221	n.a.	n.a.
Pittsburgh metro	23,382	66,278	218,803	n.a.	n.a.
Washington, DC metro	40,759	50,593	97,874	594,058	218,405
Chicago metro	51,019	64,199	206,724	220,249	61,172
Baltimore metro	60,440	36,757	272,332	n.a.	n.a.
New York metro	97,938	114,878	286,245	642,657	216,700
Los Angeles metro	119,524	123,187	325,273	207,819	n.a.
San Francisco metro	120,940	126,729	182,333	446,734	n.a.
Metro Average	**56,218**	**60,166**	**205,617**	**455,597**	**239,798**
Seattle city	17,799	106,976	n.a.	n.a.	n.a.
Indianapolis city	19,673	23,986	168,904	n.a.	n.a.
Atlanta city	20,824	50,411	n.a.	n.a.	n.a.
Pittsburgh city	21,760	132,560	n.a.	n.a.	n.a.
Denver city	22,745	95,861	n.a.	n.a.	n.a.
Hartford city	31,674	67,317	n.a.	n.a.	n.a.
Baltimore city	55,114	44,759	n.a.	n.a.	n.a.
Chicago city	74,811	121,643	124,994	n.a.	5,071
San Francisco city	84,062	342,662	344,052	n.a.	n.a.
Washington, DC city	88,329	84,904	n.a.	n.a.	n.a.
New York city	125,921	178,391	96,084	n.a.	15,075
Los Angeles city	262,636	164,654	446,436	66,113	n.a.
Oakland city	n.a.	92,645	n.a.	n.a.	n.a.
City Average	**70,795**	**78,437**	**136,375**	**238,183**	**65,857**

Source: Author's analysis of 2005 data from InfoUSA, and 2000 Census Bureau Data

Note: Averages are population weighted

Most rent-to-own businesses are located in moderate income neighborhoods

Distribution of Rent-to-Own Furniture Establishments, by Neighborhood Income

	Neighborhood Income				
Geography	**$0–29,999**	**$30,000–59,999**	**$60,000–89,999**	**$90,000–119,999**	**$120,000+**
San Francisco metro	8%	52%	36%	4%	0%
Washington, DC metro	8%	57%	32%	2%	2%
Seattle metro	11%	79%	9%	0%	0%
Atlanta metro	14%	80%	6%	0%	0%
Baltimore metro	14%	79%	7%	0%	0%
Chicago metro	16%	70%	11%	2%	2%
Denver metro	16%	80%	4%	0%	0%
Indianapolis metro	17%	81%	2%	0%	0%
Hartford metro	23%	69%	8%	0%	0%
Los Angeles metro	23%	65%	8%	3%	0%
New York metro	26%	56%	14%	2%	2%
Pittsburgh metro	50%	48%	2%	0%	0%
Metro Average	**20%**	**68%**	**11%**	**1%**	**1%**
Indianapolis city	23%	74%	3%	0%	0%
Los Angeles city	27%	59%	5%	9%	0%
Chicago city	32%	58%	6%	0%	3%
San Francisco city	33%	33%	33%	0%	0%
Washington, DC city	33%	67%	0%	0%	0%
New York city	36%	41%	19%	0%	3%
Baltimore city	40%	60%	0%	0%	n.a.
Denver city	40%	60%	0%	0%	0%
Seattle city	43%	57%	0%	0%	0%
Atlanta city	65%	35%	0%	0%	0%
Hartford city	75%	25%	0%	n.a.	n.a.
Pittsburgh city	83%	17%	0%	0%	0%
Oakland city	n.a.	n.a.	n.a.	n.a.	n.a.
City Average	**33%**	**57%**	**8%**	**1%**	**1%**

Source: Author's analysis of 2005 data from InfoUSA, and 2000 Census Bureau Data

Note: Averages are population weighted

needlessly broad insurance plans.[113] Similarly, rent-to-own businesses often charge two-to-three times the price of a product to mostly low- and moderate-income consumers.[114]

Finally, lower income consumers tend to be less informed than higher income consumers and have less access to the Internet, a key comparison shopping tool.

We've shown in previous sections, for instance, that lower income consumers generally do not shop around as much as higher income households when buying necessities; they also are less informed about credit reports. This lack of information puts them at a disadvantage when shopping in the housing market.

Additionally, lower income consumers have less access to the Internet.[115] Without this tool at their disposal, lower income families miss out on a world of opportunities to save money. Besides having access to online listings that allow consumers to comparatively shop for houses, several companies now provide online mortgage prices, and others comparatively shop mortgage prices for consumers.[116] Similarly, consumers can now order appliances, furniture, and electronics online, and get lower prices for those goods and services than they would pay in brick and mortar establishments.[117] These resources can save homeowners money—but as long as lower income consumers lack access to these resources, or knowledge about them, they will not be able to use these market tools to get lower prices.

IV. GROCERIES

Lower income consumers may pay more for groceries, either through higher prices or additional travel costs to reach discount grocery stores.

Grocery stores in lower income neighborhoods tend to be smaller and more expensive than in higher income neighborhoods.

Grocery stores are smaller and more expensive in lower income neighborhoods than in higher income neighborhoods. Though this does not necessarily mean that all lower income families pay those higher prices, it does mean that lower income families often have to commute to other neighborhoods to get to cheaper food, which adds to the total costs of food shopping.

The average grocery store in a lower income neighborhood is 2.5 times smaller than the average grocery store in a higher income neighborhood.

Grocery stores tend be much smaller in lower income neighborhoods than those found in higher income neighborhoods.[118] As was the case throughout the country up until at least the 1960s, lower income neighborhoods tend to be still densely clustered with tiny convenience stores rather than the new, supercenter-style grocery store.

In fact, across our sample of 12 metropolitan areas, there is about one mid-sized or large grocery store (greater than 10,000 square feet) in a lower-income neighborhood for every 69,055 residents in those neighborhoods, compared to one mid-sized to large grocery store for every 29,005 residents of a non lower-income neighborhood.

The Atlanta metro area illustrates these general market trends. In particular, there is one mid-sized or large grocery store in one of the metro's lower-income neighborhoods for every 30,034 residents of these neighborhoods, compared to one store for every 23,734 residents of a neighborhood with a median income between $30,000 and $60,000. The density of these mid-sized to large grocery stores continues to increase with household income. In fact, on the other side of the income distribution, there is about one mid-sized to large grocery store in the area's highest income neighborhoods for every 8,426 residents of these neighborhoods.

This reinforces the fact that lower income neighborhoods generally have much less access than higher income neighborhoods to mid- to large-grocery stores, which have the space to sell lower priced goods and a more diverse variety of goods.

In the 12 metros, lower income neighborhoods have fewer mid-sized and large grocery stores than higher income neighborhoods

Population per Mid-Size and Large Grocery Store (Greater than 10,000 square feet), by Store Size and Neighborhood Income

	Neighborhood Income				
Geography	$0–29,999	$30,000–59,999	$60,000–89,999	$90,000–119,999	$120,000+
Denver metro	15,580	22,736	23,807	27,416	19,117
Atlanta metro	30,034	23,734	12,545	14,701	8,426
Pittsburgh metro	30,766	21,209	21,880	n.a.	n.a.
Washington, DC metro	50,949	24,950	23,872	22,848	36,401
Baltimore metro	51,805	25,270	23,343	49,119	n.a.
Los Angeles metro	61,294	49,275	33,484	29,688	56,543
Seattle metro	65,250	21,800	29,878	91,781	n.a.
Chicago metro	83,486	28,854	20,333	25,912	20,391
Hartford metro	119,707	24,915	29,666	n.a.	n.a.
New York metro	134,665	44,088	30,669	31,349	72,233
Indianapolis metro	161,206	19,033	21,797	34,358	12,870
San Francisco metro	241,879	29,954	33,490	37,228	73,327
Metro Average	**69,055**	**31,318**	**25,236**	**28,475**	**38,677**
Denver city	12,997	35,948	n.a.	n.a.	n.a.
Seattle city	26,698	26,744	20,740	n.a.	n.a.
Pittsburgh city	36,266	37,874	n.a.	n.a.	n.a.
Atlanta city	38,177	25,206	18,570	15,440	n.a.
Washington, DC city	44,165	55,603	91,400	16,660	35,454
Baltimore city	55,114	80,566	33,918	n.a.	n.a.
Chicago city	74,811	37,752	24,999	29,462	2,536
Los Angeles city	75,039	71,350	31,888	33,057	42,199
Indianapolis city	157,382	19,704	45,786	n.a.	n.a.
New York city	176,290	101,938	88,077	38,484	30,149
Hartford city	n.a.	n.a.	n.a.	n.a.	n.a.
San Francisco city	n.a.	34,266	28,671	34,859	n.a.
Oakland city	n.a.	138,968	40,863	29,035	n.a.
City Average	**79,429**	**41,061**	**30,994**	**29,773**	**24,697**

Source: Author's analysis of 2005 data from InfoUSA, and 2000 Census Bureau Data

Note: Averages are population weighted

The greater proximity and concentration of smaller grocery stores drives up food prices in lower income neighborhoods.

With groceries available mostly in smaller stores, lower income neighborhoods tend to have higher food prices than higher income neighborhoods. Prices tend to be higher in smaller grocery stores than in larger grocery stores because of the lower economies of scale, the smaller distribution channels, and because their customers tend to be more captive.

To examine this trend, we considered the price of 132 different products sold at over 3,000 grocery stores.[119] The methods section of this report provides an overview of our criteria for selecting both grocery products and stores.

The dearth of big-box, low-cost grocery stores in lower income neighborhoods indicate an unmet market opportunity.

Of the 132 products in our sample, 67 percent were more expensive in stores smaller than 10,000 square feet than in larger stores. For instance, the average price of a dozen eggs in stores less than 10,000 square feet was $3.03. That exact same brand of eggs cost, on average, $2.89 in stores greater than 10,000 square feet. Similarly, the average price of a box of Honey Nut Cheerios, which was one of the best-selling products in the sample, was $4.71 at stores with less than 10,000 square feet of retail space; $4.56 in stores greater than 10,000 square feet. We found this strong relationship between average price and store size in all of the eleven major food categories in our sample.

Multiplied over the course of a year, and added to the premiums for other basic food items, this evidence suggests lower income families shopping at small local grocery stores can end up paying hundreds of dollars extra for food. The typical dense concentration of small stores, and the frequent absence of any grocery stores greater than 10,000 square feet, suggests that many lower income families bear this added cost.

All of this evidence supports the conventional wisdom that smaller stores charge higher prices. Our finding that smaller stores account for almost all grocery stores in lower income neighborhoods leads

to the conclusion that consumers in those neighborhoods pay more for groceries. Even when lower income consumers want to avoid these higher prices, they often have to commute to larger grocery stores found in higher income neighborhoods—and this commute may very well negate much of the savings they find at these larger stores.

Besides the immediate differences in prices across neighborhoods, the absence of modern, large grocery stores in lower income neighborhoods also means that there tends to be a lower a) quantity of food items, b) availability of other services, such as a pharmacy, across our population of grocery stores, and perhaps a lower overall quality as well. An analysis by Philadelphia-based Food Trust found that these important grocery store differences across neighborhoods add up to substantial (and costly) differences in the diets and health of the people in these neighborhoods.[120] Through these ways, examining just the average price difference across stores may significantly underestimate the true, higher cost of buying groceries in lower income neighborhoods.

Why do lower income neighborhoods face higher food costs?
The dearth of big-box, low-cost grocery stores in lower income neighborhoods indicate an unmet market opportunity. The reasons for this include higher costs of doing business, as well as systematic undercounts of demand, or perceived high crime rates in these neighborhoods that lead to false perceptions of high costs.

Recent evidence suggests, however, that this is generally not the case in stores that sell food to high proportions of lower income families.[121] Higher costs might also relate to strict urban zoning requirements and the expense of urban land and development, which do not match the trends in this industry for bigger stores.

Frequently though, higher costs of doing business have to do with misperceptions driven by inaccurate data assessments of market demand in lower income neighborhoods. Social Compact, for instance, has illustrated in numerous studies that traditional methods of estimating market demand systematically undercount demand in lower income neighborhoods.[122] One company that sees enormous opportunity in lower income neighborhoods is Wal-Mart, which recently announced plans to open 150 stores in underserved lower income markets.[123] ■

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An Agenda and Models for Better Meeting the Market Needs of Lower Income Consumers

The hundreds or thousands of dollars that lower income families lose by paying higher prices every year should go back in their pockets, to be invested in income-growing assets, like education, housing, or retirement. Savings from lower prices can also be used to pay down debt, and to reduce demand for high-priced credit, like payday loans and rent-to-own establishments.

Public and private sector leaders have an opportunity to help connect lower income consumers to the mainstream economy to reduce these higher costs of living for lower income families.

Such a strategy would compliment existing efforts aimed to boost the incomes of lower income families. In recent years, the first step along this process was welfare reform, which sent millions of low-income adults into the workforce. Now, leaders have turned their attention to the question of whether those wages and benefits are sufficient to lift these new workers out of poverty; the result has been newly energized debates over boosting minimum wages, greater public investment in job-training, whether and how to prod low-paying businesses to lift wages and benefits, and attention on family strictures that may curb mobility into more remunerative jobs.

But a strategy to reduce household expenditures will bring needed attention to the other side of a family's ledger as well. By bringing down unnecessary out-of-pocket expenses and costs of living, leaders can give families the resources they need to save, invest, pay off debt, and avoid high-cost credit.

To address these issues and capitalize on the opportunity to help families get ahead, leaders must pursue three key goals. First, policymakers and community stakeholders should promote the market opportunity in lower income neighborhoods among mainstream businesses that have failed to recognize it or have been deterred by the higher costs of doing business in lower income neighborhoods. To address the particular opportunities that exist in their communities, leaders need to be fair-minded, fact-driven, and entrepreneurial. Businesses will respond to profitable opportunities. Political and community leaders must reach out to business leaders and determine actions to remove the barriers companies face in reaching lower income consumers. Additionally, as mainstream businesses enter these markets, their presence should

come in concert with community outreach efforts to dispel myths and misperceptions.

Second, leaders must weed out the alternative, high-priced businesses that have blossomed in lower income neighborhoods. At the local level, leaders can use their licensing and zoning authority to curb the development of these businesses. At the state and federal level, leaders can enact regulation that attacks the business model of unscrupulous businesses, while funding research that exposes questionable business practices.

Finally, leaders at all levels of government should identify strategies to inform and educate lower income consumers struggling with the complexity of making choices in the market today. Ultimately, consumers need to take responsibility for making smart bets on getting ahead, which means knowing how to compare prices, what goods and services to avoid, and how to manage day to day budget demands. In a world with hundreds of different mortgage products, dozens of mortgage and insurance companies, aggressive alternative financial service providers, and growing applications of credit reports and scores, this isn't easy. To take advantage of the benefits this complexity can yield, lower income consumers need more information about the markets they shop in.

We elaborate on each of these recommendations below.

GOAL ONE: PROMOTE MARKET OPPORTUNITIES IN LOWER INCOME NEIGHBORHOODS

As noted at the outset of this report, lower income households collectively have about $655 billion in buying power.[124] Unlike higher income households, they spend nearly all of that money on basic necessities, including food, financial services, transportation, housing, and insurance.[125] Collectively, these hundreds of billions of dollars spent by lower income households represent a massive market opportunity.

But mainstream businesses have largely overlooked these communities, leaving a vacuum, and alternative high-priced businesses thrive in that vacuum meeting the bulk of lower income demand. This is why the first, key step leaders need to take to lower costs of living for their lower income constituents is to promote mainstream businesses in lower income markets. In this section, we outline examples from around the country of leaders promoting an array of mainstream products for lower income families.

Promote Mainstream Basic Financial Services

Contrary to popular perceptions, mainstream banks and credit unions are located in or near lower income neighborhoods in competition with alternative providers of basic financial services.[126] In such neighborhoods, promoting mainstream financial services is about developing product lines and customer service norms that work for lower income families. In other areas, though, where there are neither mainstream nor alternative providers of basic financial services, leaders must focus on attracting mainstream financial institutions, while connecting lower income consumers with appropriate financial service products.

Form Public-Private Partnerships to Bank the Unbanked,
Bank on San Francisco

San Francisco is now taking action to develop appropriate banking products for lower income consumers and then connecting lower income, unbanked consumers to those products. The office of the mayor, the office of the treasurer, the Federal Reserve Bank of San Francisco, and twenty participating banks and credit unions, have come together to form four working groups to reach these goals. The first focuses on developing appropriate market products, the second group is devising strategies to market those products, the third is working to bring community voices into this process, and the fourth will benchmark the progress made in this effort.[127] To motivate everyone, the group of business, political, and research leaders has set a goal of bringing in 10,000 new lower income banking customers, out of a current estimated unbanked population of 50,000 households.

More than any other example in the country, Bank on San Francisco is built on the principle that alerting business leaders to the market opportunity in lower income neighborhoods, and then helping businesses connect to those opportunities, will help these families get connected to the mainstream economy.

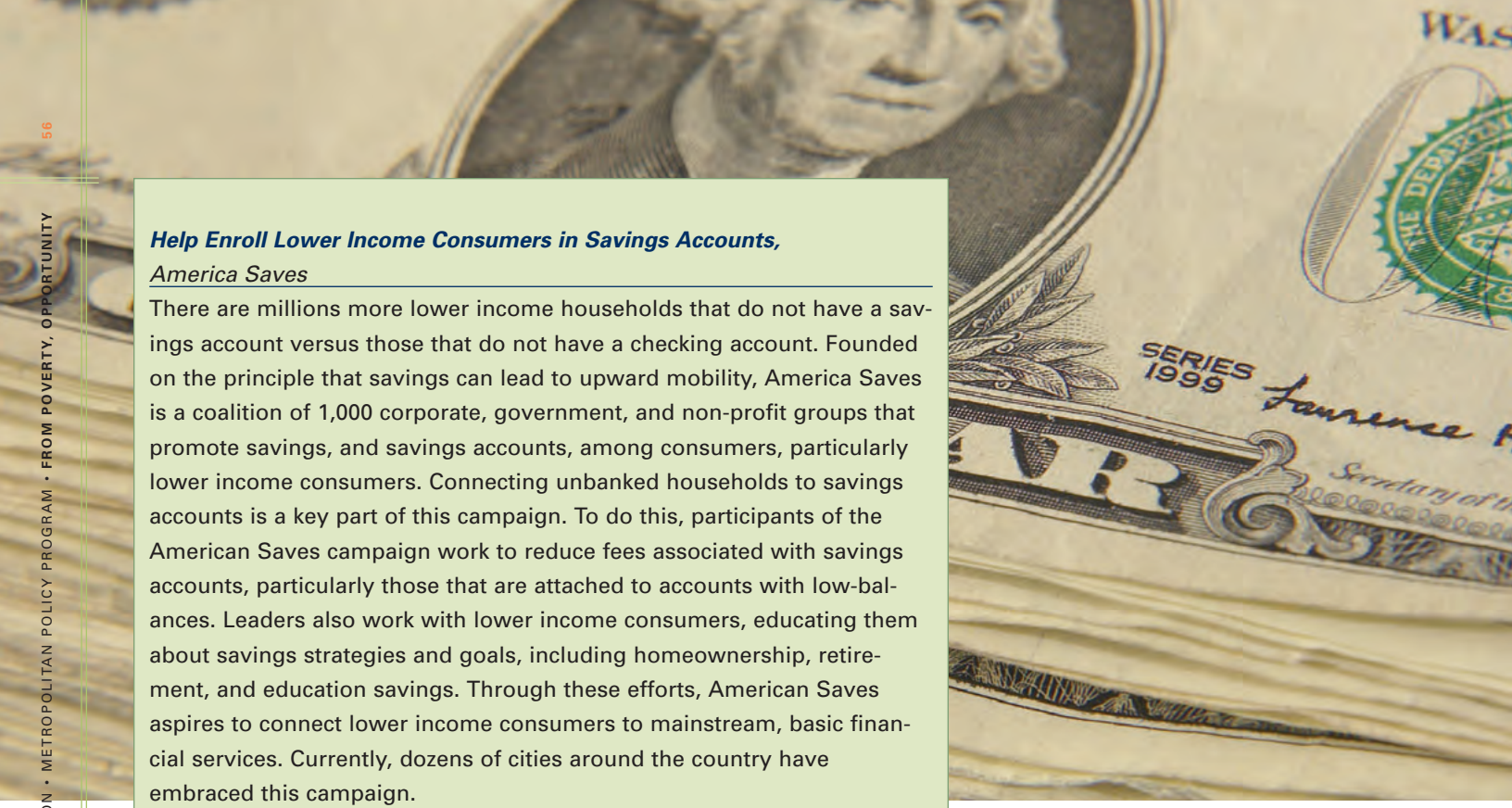
For more information: **www.frbsf.org/community/resources/agendajan20.pdf**

Adopt Innovative, Bi-Partisan Policies,
New York's Banking Development Districts

There are still hundreds of lower income neighborhoods that lack any type of financial service provider. To address this market gap, the state of New York uses its considerable depository power to subsidize banks that open up branches in designated underserved neighborhoods.

In particular, local governments partner with banks and the New York State Banking Department to identify specific neighborhoods that lack banks, but may not have enough depository power to attract banks on their own. If state and local government choose to designate these neighborhoods as "banking development districts," they will then provide below-market rate deposits, along with market-rate deposits, to the banks that move into these communities. As Diana Taylor, the superintendent of the state banking department, says, "The state has all this money, and it has to be put somewhere. Why not put this money to work for something?"[128] Through this innovative program, the state has already signed up 26 banks and thrifts, each of which is now committed to opening up new branches in underserved markets throughout the state.

For more information: **http://www.banking.state.ny.us/bdd.htm**



Help Enroll Lower Income Consumers in Savings Accounts, America Saves

There are millions more lower income households that do not have a savings account versus those that do not have a checking account. Founded on the principle that savings can lead to upward mobility, America Saves is a coalition of 1,000 corporate, government, and non-profit groups that promote savings, and savings accounts, among consumers, particularly lower income consumers. Connecting unbanked households to savings accounts is a key part of this campaign. To do this, participants of the American Saves campaign work to reduce fees associated with savings accounts, particularly those that are attached to accounts with low-balances. Leaders also work with lower income consumers, educating them about savings strategies and goals, including homeownership, retirement, and education savings. Through these efforts, American Saves aspires to connect lower income consumers to mainstream, basic financial services. Currently, dozens of cities around the country have embraced this campaign.

For more information: **http://www.americasaves.org/**

Create Low-Priced Market Alternatives

Where there are unreasonably high prices, there often is a market opportunity to retail a lower cost market product. Recognizing that market opportunity, entrepreneurs in a handful of metropolitan areas around the country, including San Francisco and Seattle, have been working on creating a business alternative to high-priced businesses, like check cashers, payday lenders, and pawnshops. These entrepreneurs are constructing their businesses to be profitable and scalable, rather than as charitable enterprises. At the same time, these efforts are designed to prove that lower cost alternatives to high-priced financial services are a profitable opportunity for banks and credit unions. It is still too early to assess the viability of these business models, but each is certainly built on strong intuitive reasoning that there is a market opportunity created today by the exorbitant prices of alternative financial services.[129]

Promote Market Opportunities for Low-Priced Products in Automobile Markets

In the auto industry, the lines between alternative and mainstream businesses are not as clearly drawn as in the financial services industry due to the sheer variety in car prices and their lack of transparency. Thus, responsible companies are intermingled with unscrupulous businesses. With demand for autos on the upswing among lower income consumers, leaders have an opportunity to hatch new, mainstream market alternatives in markets not currently served by responsible businesses. In other cases, leaders need to promote market alternatives that bring down the costs of lower income car ownership.

Promote Low-Cost Alternatives to Car Dealers,
Targeted Car-Ownership Programs

Many car ownership programs for lower income consumers have evolved as far-sighted leaders promoted experimentation with new business models to meet the rising demand for cars in that market. According to one recent count, over 150 programs across the country are now working to expand car ownership among lower income families.[130] Some of these are based on non-scalable business models, surviving only on foundation contributions, charity, and good will. Others may very well be scalable. Vehicles for Change, for instance, is a Baltimore-based program that sells 40 to 50 cars a month to lower income households. This company also sells auto-loan products to qualified, lower income car-buyers, along with a six-month warranty. The program has carefully carved out a market niche to appeal to lower income drivers looking for responsible car dealers who will not overcharge for cars. Vehicles for Change works closely with community leaders to market the company and has connected with national organizations to raise the visibility of its effort.

For more information: **http://vehiclesforchange.org/**

Develop Low-Cost Insurance Pools,
The California Low-Cost Automobile Insurance Program

In response to the growing need among lower income consumers for auto-insurance, California now requires insurers in eight high-priced counties within the state to offer a low-cost auto-liability insurance policy to qualified lower income drivers, defined within the program as drivers that live in households that earn less than 250 percent of the poverty line.[131] In Los Angeles, the minimum state-required insurance costs $347 a year, compared to about $314 a year in San Francisco. State law requires any insurance company that fields a consumer inquiry about purchasing the minimum level of required insurance to inform the consumer about this market product. By limiting enrollment in the program to drivers who have perfect or nearly perfect driving records, California has been able to hold down costs.

This model is unique from the others discussed in this section because the state is requiring mainstream businesses to serve this market with a below market-rate product. Still, this state program provides a model for how government can engage mainstream insurance companies to sell low-priced services to lower income drivers.

For more information: **http://www.insurance.ca.gov/0400-news/0100-press-releases/0070-2006/release051-06.cfm**

Where there are unreasonably high prices, there should be a market opportunity to retail a lower cost market product.

Promote Lower Cost Insurance Companies, *New York's Home Insurance Shopping Guide*

Mindful of their mission to serve consumers, a growing number of state departments of insurance have developed online shopping guides to homeowners insurance.[133] Besides explaining the differences between policy options, these guides frequently include comparative price information. The homeowners insurance shopping guide published by the New York Department of Insurance is typical of these efforts. Using filings submitted to the state by insurance companies, the guide lists every company that sells insurance in the state, and the prices they charge for the same line of insurance in every insurance territory in the state. Annual premiums for the exact same line of insurance can vary by over $1,000, depending on the seller. Some of this price variance is explained by the different mixes of risk that insurance companies are exposed to in the market, but it also has to do with different pricing strategies across companies.

Key to this effort is outreach: Leaders can use this information to promote competitively priced home insurance products in their communities,mayors can set this agenda by speaking about the availability of these products, community organizations can integrate into their outreach campaigns, and the media can publicize higher and lower-priced companies.

For more information: **http://www.ins.state.ny.us/homeown/html/hmonguid.htm**

Promote Responsible Mortgage Companies, *University of Pennsylvania's Guaranteed Mortgage Program*

Another way to reduce homeownership costs is to promote responsible lenders in the lower income market. To do this, the University of Pennsylvania created the Guaranteed Mortgage Program to promote homeownership among its employees. The University entered into an agreement with Advance Bank, GMAC Mortgage Corporation, and Citizens Bank, three lenders in the Philadelphia market, to administer this program. To lower potential costs of business for the lending institutions, the University requires that applicants attend a home counseling session, where they review the financial tools families need to responsibly manage mortgage debt in their budget.

By connecting families to pre-approved lenders, the university is ensuring that its employees are connected to responsible mortgage companies that offer fair prices. This very deliberately promotes mainstream companies in Philadelphia's housing markets.

For more information: **http://www.business-services.upenn.edu/communityhousing/mortgagePrograms.html**

Promote Low-Cost Mortgage Alternatives, *the PHIL-Plus and Mini-PHIL Loan Program*

Leaders can also bring down homeownership costs by working with lenders to sell alternative, low-cost loan alternatives. In Philadelphia, the mayor's office, the Greater Philadelphia Urban Affairs Coalition and eight banks (Beneficial Savings Bank, Citizens Bank, Commerce Bank, Fleet Bank, PNC Bank, National Penn Bank, Sovereign Bank, United Bank of Philadelphia, and Wachovia) created two loan products for lower income consumers with weak credit histories. Since these consumers are the mostly likely among all consumers to overpay for mortgage products, this program is designed to promote a competitively-priced product to effectively crowd out higher-priced lenders. Besides the product, these programs also identify responsible lenders in Philadelphia, and work with community groups to inform their clients about these lenders.

For more information: **http://www.phila.gov/ohnp/miniPHIL.htm**

Promote Market Opportunity for Mid-Sized to Large Grocery Stores in Lower Income Neighborhoods

Collectively, the grocery stores in the sample of metropolitan areas in this report earned $100 billion in revenue last year. Nationwide, that revenue is increasingly being earned in large grocery stores that enjoy the economies of scale to offer low prices, and the space to stock a wide variety of goods, from generic food items to an ample selection of nutritious food. In many lower income neighborhoods, however, these changes have not taken root, and the grocery market still looks today as it did in the 1960s everywhere: Stores are smaller, prices are higher, and nutritious food items are scarce.

This is a market opportunity for mid-sized and large grocery stores. Leaders can promote this market opportunity by creating incentives for these grocery stores to move into lower income neighborhoods. States can marshal development funds, cities can streamline their zoning process, and leaders everywhere can work with businesses to quantify the potential market demand in these neighborhoods for bigger grocery stores. Here are a few examples of successful efforts:

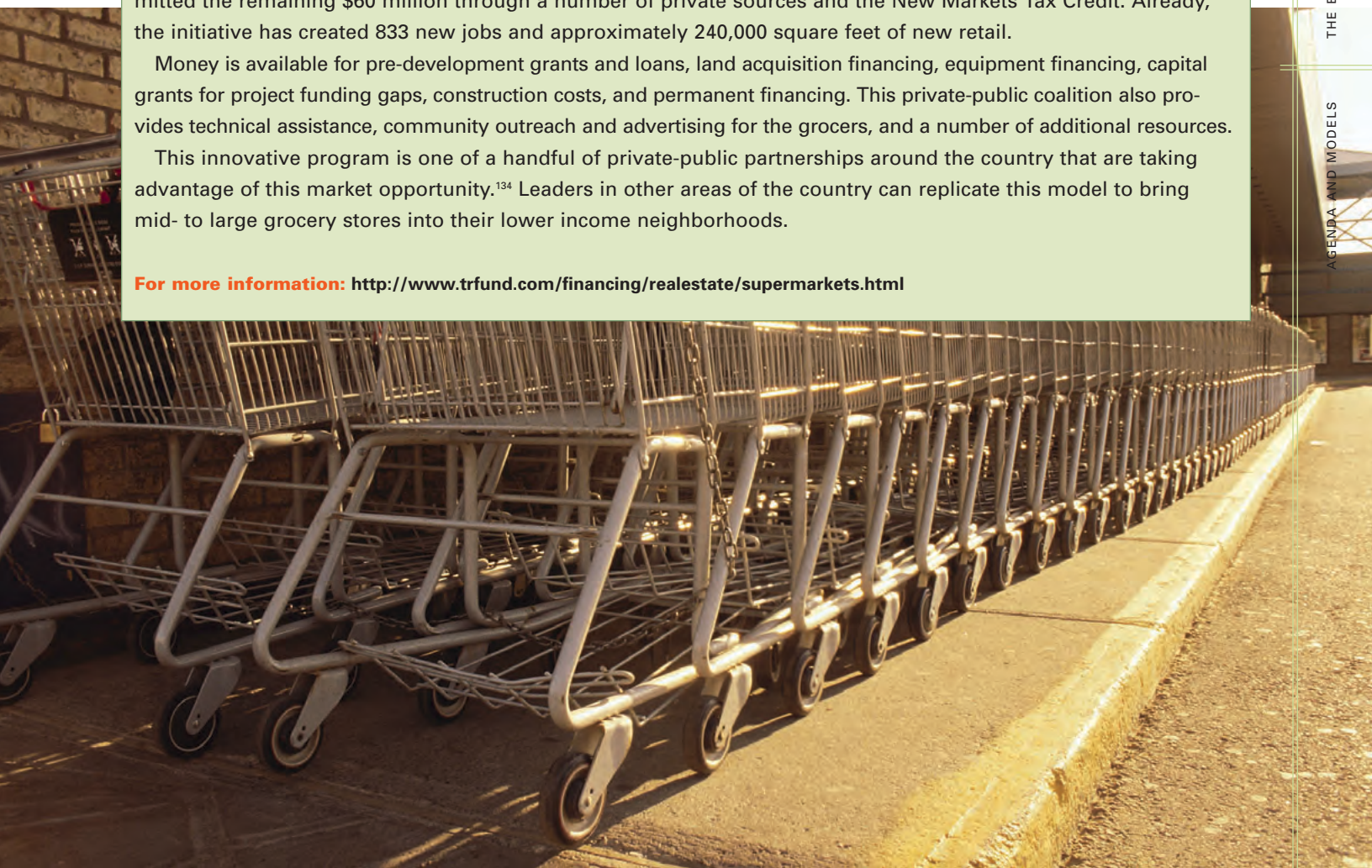
Help Finance Large Grocers in Underserved Markets, *Pennsylvania's Fresh Food Financing Initiative*

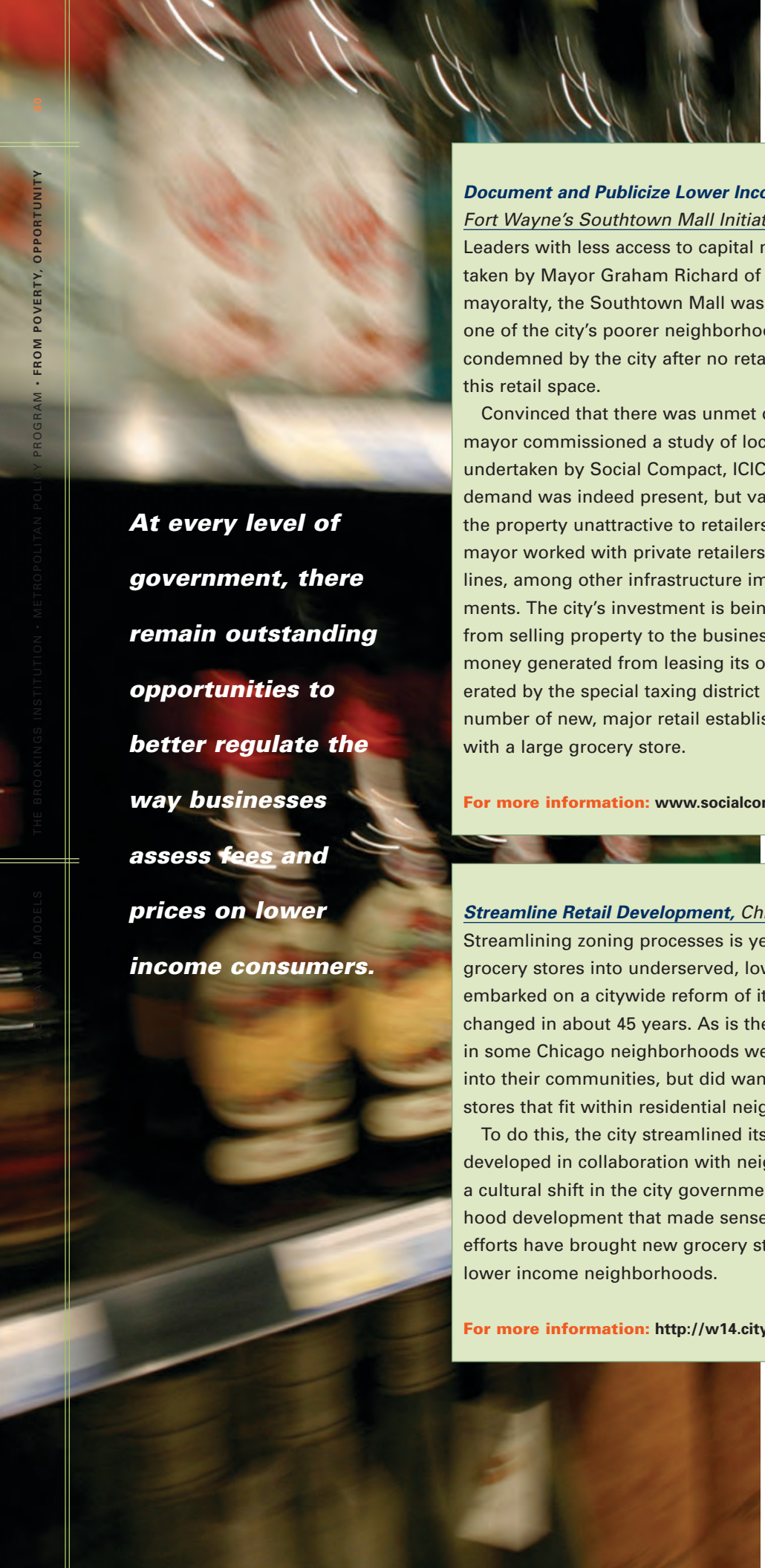
Leaders with access to capital can use a variety of incentives to bring mid- to large- grocery stores into lower income neighborhoods. In Pennsylvania, a public-private partnership formed in 2005 already has spurred the development of seven new grocery stores in Philadelphia's underserved neighborhoods. Along with The Food Trust and the Greater Philadelphia Urban Affairs Coalition (GPUAC), The Reinvestment Fund (TRF) formed this coalition, with crucial leadership provided by State Representative Dwight Evans. Together, this coalition put together an $80 million financing pool to attract mid- to large grocers into Philadelphia's underserved markets. Under the leadership of Representative Evans, the state appropriated $20 million for this initiative, while TRF committed the remaining $60 million through a number of private sources and the New Markets Tax Credit. Already, the initiative has created 833 new jobs and approximately 240,000 square feet of new retail.

Money is available for pre-development grants and loans, land acquisition financing, equipment financing, capital grants for project funding gaps, construction costs, and permanent financing. This private-public coalition also provides technical assistance, community outreach and advertising for the grocers, and a number of additional resources.

This innovative program is one of a handful of private-public partnerships around the country that are taking advantage of this market opportunity.[134] Leaders in other areas of the country can replicate this model to bring mid- to large grocery stores into their lower income neighborhoods.

For more information: **http://www.trfund.com/financing/realestate/supermarkets.html**





At every level of government, there remain outstanding opportunities to better regulate the way businesses assess fees and prices on lower income consumers.

Document and Publicize Lower Income Market Demand, *Fort Wayne's Southtown Mall Initiative*

Leaders with less access to capital might consider an alternative path taken by Mayor Graham Richard of Fort Wayne, Indiana. During Richard's mayoralty, the Southtown Mall was abandoned by its owner. Located in one of the city's poorer neighborhoods, this decaying infrastructure was condemned by the city after no retailers expressed interest in taking over this retail space.

Convinced that there was unmet demand in the neighborhood, the mayor commissioned a study of local buying power, similar to studies undertaken by Social Compact, ICIC, and Metro Edge. He found that demand was indeed present, but various costs made redevelopment of the property unattractive to retailers. To overcome these difficulties, the mayor worked with private retailers, and invested in new water and sewer lines, among other infrastructure improvements and resource investments. The city's investment is being paid back through profits generated from selling property to the businesses that located at the site, along with money generated from leasing its old electric utility, and from taxes generated by the special taxing district at the site. The site is now home to a number of new, major retail establishments, including a new supercenter with a large grocery store.

For more information: **www.socialcompact.org**

Streamline Retail Development, *Chicago's Zoning Reform Initiative*

Streamlining zoning processes is yet another way to attract mid- to large grocery stores into underserved, lower income markets. In 2001, Chicago embarked on a citywide reform of its zoning codes, which had not been changed in about 45 years. As is the case in many large cities, residents in some Chicago neighborhoods were opposed to bringing supercenters into their communities, but did want to attract mid-sized to large grocery stores that fit within residential neighborhoods.

To do this, the city streamlined its zoning process to create new codes developed in collaboration with neighborhood groups. At the same time, a cultural shift in the city government led to greater focus on neighborhood development that made sense for local residents. Together, these efforts have brought new grocery stores into Chicago's underserved lower income neighborhoods.

For more information: **http://w14.cityofchicago.org:8080/zoning/default.jsp**

GOAL TWO: CURB UNSCRUPULOUS BUSINESS PRACTICES IN THE LOWER INCOME MARKETPLACE

Just as important as incentives to promote responsible business practices, governments at the local, state, and federal levels are also increasingly utilizing sticks to crack down on predatory practices that increase the out-of-pocket-costs of lower income families.

Alternative, price-gouging businesses have blossomed in the vacuum left by some mainstream businesses. At every level of government, there remain outstanding opportunities to better regulate the way businesses assess fees and prices on lower income consumers.

Moreover, middle income consumers also benefit from these strategies as check cashers, rent-to-own stores, and other high-priced basic services increasing locating in moderate- and middle-income neighborhoods.

Curb Unscrupulous Businesses and Practices in the Basic Financial Services Market

Alternative financial services are very densely concentrated in lower income neighborhoods. These check cashers and short-term loan providers often charge higher prices for comparable services than mainstream companies. Other expensive services, mainly tax preparation firms and wire services, are more likely to be used by lower income consumers. However, some high-priced products in the mainstream financial marketplace have particularly punitive features for low-income households.

Cities, states, and even the federal government have taken steps to curb these businesses and practices. Here are some examples of pioneering efforts by leaders to curb these high-priced products in lower income markets, along with some recommendations for new initiatives.

Limit Development of High-Priced Businesses, *San Francisco's Moratorium on Check Cashers and Payday Lenders*

Stopping the entry of the alternative financial service sector into a lower income market is the surest way to cut demand for these high-priced services, and city officials in San Francisco have made this a top priority. In conjunction with the Bank on San Francisco initiative reviewed earlier, the city issued a temporary moratorium on licensing new check cashers and payday lenders in January 2006. Together, these initiatives opened up the market opportunity for banks and credit unions, while temporarily removing the ability of the alternative, higher-priced businesses to expand. The city has since renewed this moratorium and is now considering regulations to further curb the market share of check cashers and payday lenders.

A growing number of state and local governments have launched similar efforts. For instance, New Mexico issued a moratorium against any additional licenses for check cashers and payday lenders in early 2006. Similarly, the Pima County government voted to ban payday lenders and check cashers from locating within 1,200 feet of a similar business, and within 500 feet of any property zoned as a private residence.

For more information: **http://www.sfgov.org/site/treasurer_page.asp?id=36902**

Lower income consumers are much more likely than higher income taxfilers to purchase a refund anticipation loan.

Tighten State Regulations on Prices and Fees Charged by Financial Businesses, *Georgia's Amendments to the Industrial Loan Act*

Regulating the prices alternative financial service businesses charge, or their right to do business in an area, is another way to curb demand for the high-priced products they sell. A handful of states have either refused to authorize payday lending or have banned this business outright. But loose regulation of this industry is the norm across the country, with caps on interest rates but not on fees, for instance. In 2004, Georgia bucked this trend by passing one of the strictest state bills in the country. Among its many features, this measure capped the annual percentage rate for short-term loans sold in the state at 16 percent. The law also eliminated the ability of these businesses to rent the charter of banks in states with less stringent laws. Just as important, the law gave the state authority to seek stringent civil penalties when businesses violate these laws.

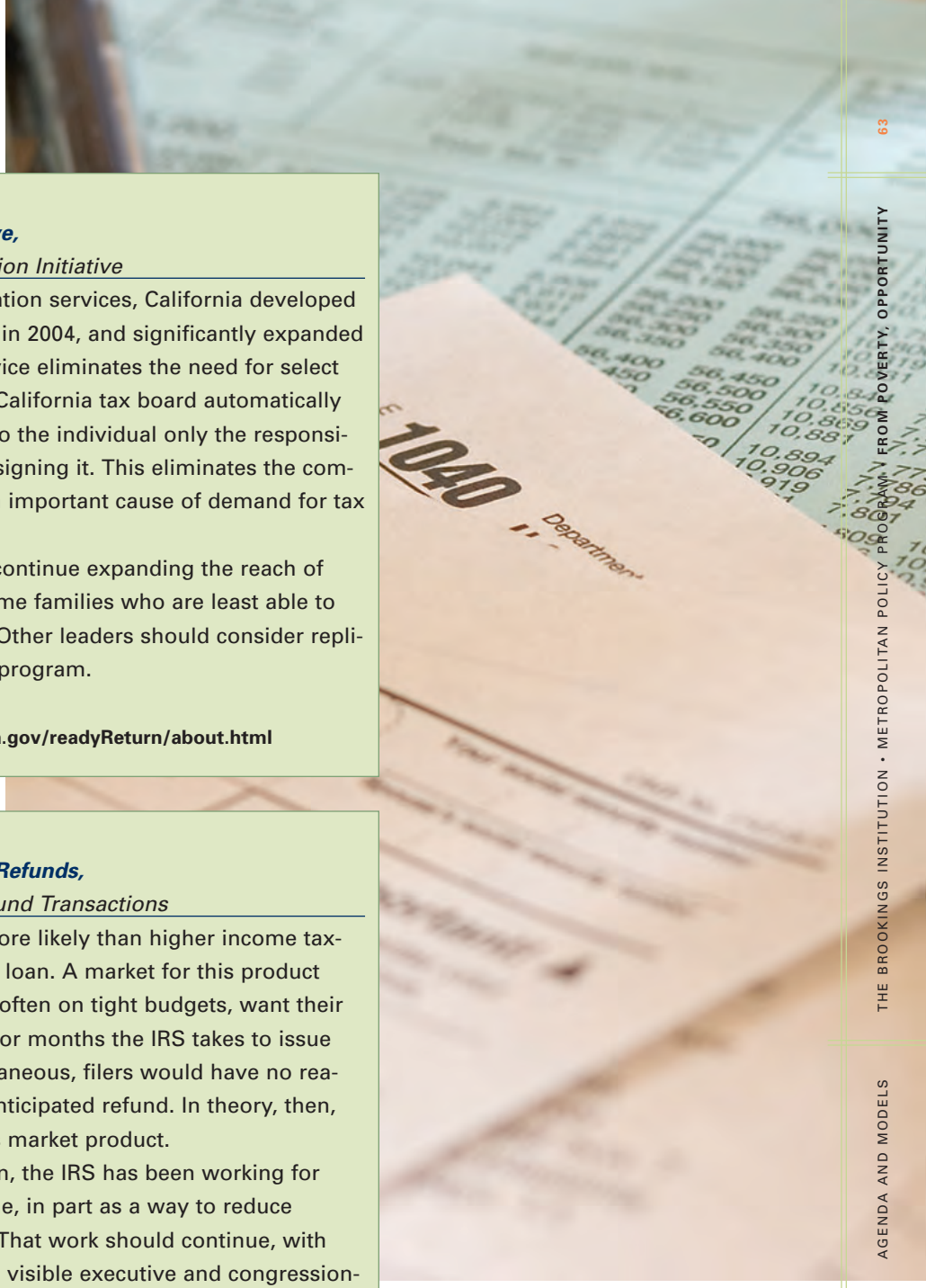
For more information: **http://www.ganet.org/dbf/dbf.html**

Don't Overlook Mainstream Financial Institutions,
The Need to Update Regulation Z

While the alternative financial services sector comprises a large share of the high-priced market in lower income neighborhoods, customers at mainstream institutions can also pay high rates for short-term loans if they regularly overdraw their accounts and do not enroll in overdraft protection plans. If used once per month, most overdraft protections will be modestly less expensive than short-term loans. But lower income consumers often struggle to meet payments, and may be more likely to use these services with greater frequency. In this case, they can pay substantially higher prices for what are effectively short-term loans than if they were to use a payday lender.

Because banks often find these fees an important source of additional income, it is not in their best interest to unilaterally lower them. To spur the market to move in a more responsible direction, the Federal Reserve suggested in a May 2004 statement that there may be a need to revisit the exemption of overdraft services from Regulation Z, which implements the Truth in Lending Act. Extending the regulation would oblige institutions to prominently advertise the cost of these policies, something they are currently not required to do. By more prominently advertising the costs of these policies, consumers may be better able to make cost-saving decisions.

For more information: **http://www.federalreserve.gov/Regulations/#z**



Offer a Free Tax Preparation Alternative,
California's Ready Return Tax Preparation Initiative

To reduce demand for paid tax preparation services, California developed the Ready Return tax preparation pilot in 2004, and significantly expanded it in 2005. This free state-provided service eliminates the need for select filers to fill out tax forms. Instead, the California tax board automatically prepares the filer's tax forms, leaving to the individual only the responsibility for reviewing the form and then signing it. This eliminates the complexity associated with filing taxes—an important cause of demand for tax preparation services.

For California, the next steps are to continue expanding the reach of this service, particularly for lower income families who are least able to afford for-profit tax preparation firms. Other leaders should consider replicating and extending California's pilot program.

For more information: **http://www.ftb.ca.gov/readyReturn/about.html**

Accelerate the Release of Federal Tax Refunds,
The Need for the IRS to Speed-Up Refund Transactions

Lower income consumers are much more likely than higher income taxfilers to purchase a refund anticipation loan. A market for this product exists because lower income workers, often on tight budgets, want their refunds sooner than the typical weeks or months the IRS takes to issue checks. If that transaction were instantaneous, filers would have no reason to purchase a loan based on the anticipated refund. In theory, then, the IRS has the power to eliminate this market product.

Although technical limitations remain, the IRS has been working for several years to shorten the refund time, in part as a way to reduce demand for refund anticipation loans. That work should continue, with reinforcement from stronger and more visible executive and congressional leadership.

Identify and Weed Out Unscrupulous Business Practices in the Auto-Market

We have documented in this report how lower income families routinely pay higher prices for many car-related products. While some of these higher prices have to do with real, higher costs businesses incur when operating in these markets, unscrupulous behavior also plays a role as businesses exploit information gaps and other market failures to charge higher prices to lower income consumers.

State and local governments have responded to these market dynamics by passing new laws, tightening regulation, and, just as importantly, commissioning research about price-inflating practices. But as in other regulatory examples discussed in this report, progress is mostly uneven, leaving much work in this area for leaders around the country.

A car buyer's race and income affects the price he or she pays for cars, even after controlling for a number of other effects.

Curb Abuses by Car Dealers, *California's Car Buyer Bill of Rights*

California's new car buyer bill of rights law became effective on July 1, 2006, putting the state at the forefront of efforts to address abusive practices by automobile dealers and auto loan providers. Lower income consumers pay higher prices for both cars and loans, making this bill a particularly valuable tool to bring down automobile costs for lower income consumers in the Golden State.

Among its numerous provisions, the law requires dealers to itemize components of their monthly installment bill, and makes it illegal for them to add terms of the contract without first disclosing additions to the consumer. Along those same lines, the law caps the incentive financial institutions can provide to dealers for selling high-priced loans and requires dealers to submit information to the consumer about the role of credit scores in determining auto loan rates. The measure also provides for an optional cooling-off period, through which the consumer can pay a fee for the right to return the car within 48 hours. Together, these efforts mark an important step forward in cutting into the ability of car dealers to drive up costs for lower income consumers.

For more information: **http://www.dca.ca.gov/legis/2005/miscconsumer.htm**

Limit the Ability of Prices to Vary With Income,
Hawaii's Department of Insurance Credit Score Regulation

State legislatures are increasingly asking why credit scores should be used to determine insurance rates. Of course, lower income households are going to be paying higher prices using this method because they typically have lower credit scores than higher income drivers.

In part because the use of credit scores automatically assigns a higher premium to many lower income families, Maryland and Hawaii have banned insurance companies from using them to set rates.[136] Over the past two years, state legislatures in at least Washington, Michigan, and West Virginia have proposed bills that would do the same. Additionally, bills under consideration in Tennessee, Missouri, and North Dakota would prevent premium increases based on credit scores—a change that would protect people who fall on hard times after they already have been underwritten.

For more information: **http://www.insurance.wa.gov/publications/news/Final_SESRC_Report.pdf**

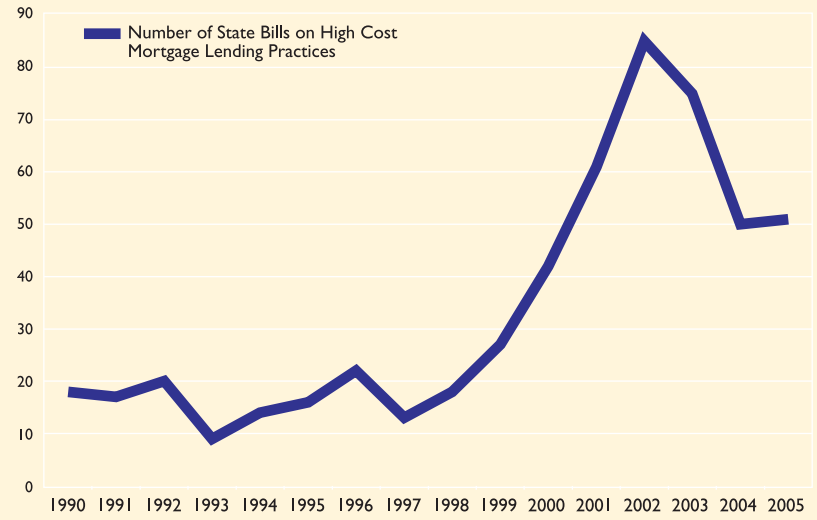
Consider Bold Disclosure Rules, *Car Price Disclosure Act*

A car buyer's race and income affects the price he or she pays for cars, even after controlling for a number of other effects. In the 1970s, similar evidence about the effect of race in the mortgage market prompted Congress to pass the Home Mortgage Disclosure Act (HMDA), chiefly designed to shine a spotlight on credit availability in neighborhoods with high concentrations of minorities. Since then, concern about pricing discrimination prompted the Federal Reserve to expand the HMDA to include information about high-cost loans.

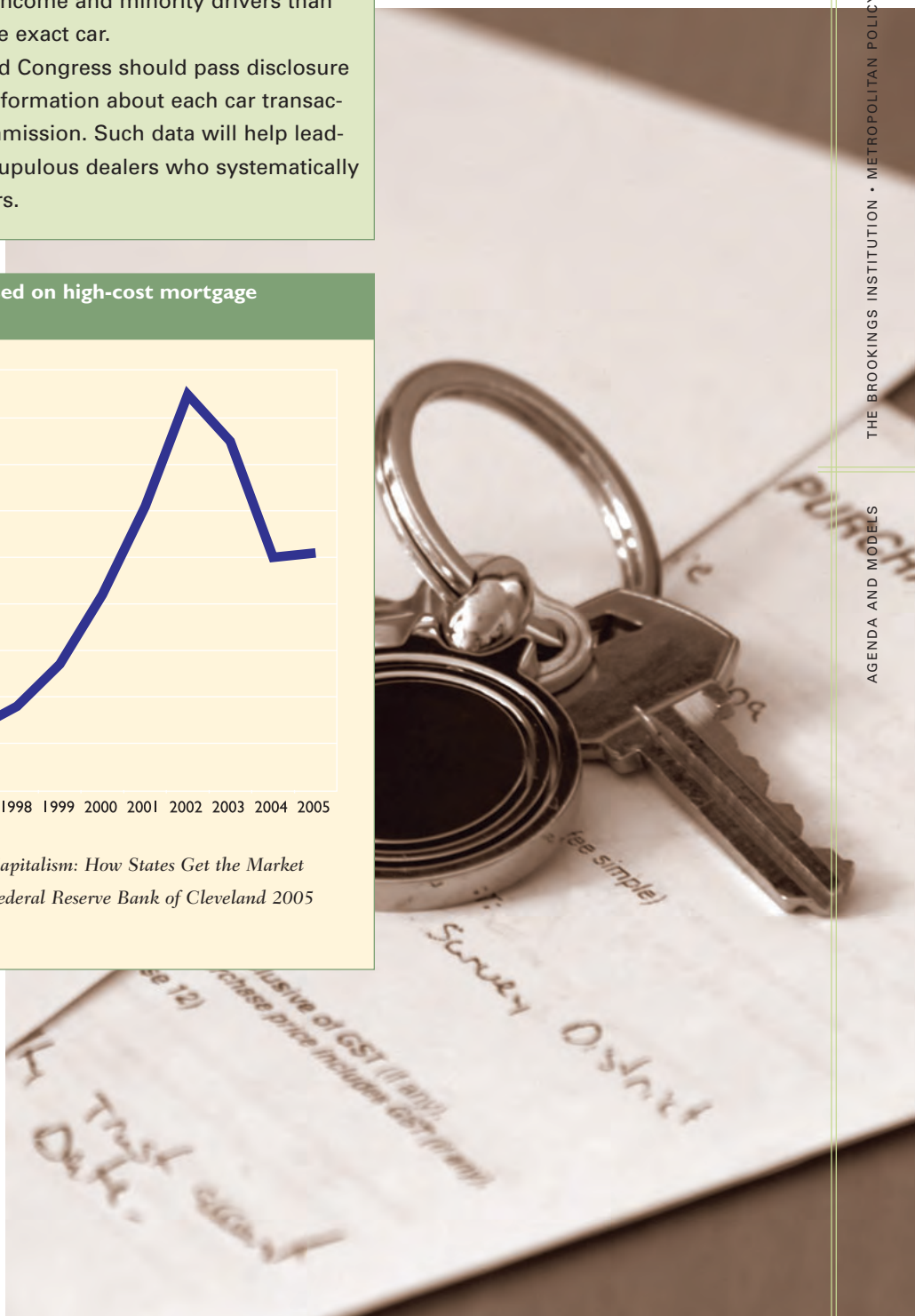
A similar effort is needed in the auto market. No justification exists for systematically higher prices for lower income and minority drivers than what better-off buyers pay for the same exact car.

To curb this practice, statehouses and Congress should pass disclosure laws that require dealers to transmit information about each car transaction to a state or federal oversight commission. Such data will help leaders (and consumers) identify the unscrupulous dealers who systematically drive up prices for lower income drivers.

States have increasingly become focused on high-cost mortgage lending practices



Source: Matt Fellowes 2005. "Laboratories of Capitalism: How States Get the Market Right for Working Families." Presented at the Federal Reserve Bank of Cleveland 2005 Policy Summit



Curb Unscrupulous Business Practices in the Housing Markets

Estimates suggest that between 14 and 20 percent of all borrowers of high-priced mortgages could have qualified for a prime mortgage product, saving them hundreds or thousands of dollars in interest charges every year.[137] Even for those who cannot qualify for prime loans, some companies tack on additional features to mortgage products that unnecessarily drive up costs for consumers. Together, these forces help drive a highly variable price spread among consumers for the same amount of borrowed money. As this report has shown, lower income consumers are particularly likely to pay higher prices.

To reduce these higher costs for lower income families, leaders can promote more competitively priced products. But government should also pass regulations to weed out unscrupulous lenders and practices. This section includes a number of examples from states and the federal government that do just this.

Even for those who cannot qualify for prime loans, some companies tack on additional features to mortgage products that unnecessarily drive up costs for consumers.

Limit Fees and Provide More Information for Mortgage Buyers, *New Mexico's Mortgage Lending Law*

In 2005, nineteen states considered nearly 50 different bills proposing revisions to their mortgage lending laws. This intense state-level focus on mortgage lending has been building steadily since the mid-1990s. Among the numerous laws now on the books, New Mexico's Home Loan Protection Act ranks among the strongest efforts to curb unscrupulous practices that drive up prices for lower income consumers. Provisions in this measure include restrictions on pre-payment penalties, limits on refinancing practices that strip equity from homeowners, and a requirement that borrowers receive financial counseling prior to buying a high-cost mortgage.

Since this law was passed, a recent analysis found that the proportion of all loans in New Mexico with these price-inflating features has fallen by nearly 40 percentage points, compared to the average percentage change among all states without these protections. At the same time, the volume of sub-prime lending has not changed, suggesting that the market is working more efficiently with this regulation.

For more information: http://www.rld.state.nm.us/fid/News/Home%20Loan%20Protection%20Act.htm

Analyze the Need for Regulation,
Pennsylvania State Department of Banking Study

To inform the need for regulation and additional laws, a number of states have commissioned analyses of their mortgage market. Under the leadership of Secretary William Schenck, the Pennsylvania Department of Banking commissioned The Reinvestment Fund, a non-partisan group based in Philadelphia, to assess lending in Pennsylvania. Their study confirmed that much of the market for high-cost loans is based on refinanced mortgages, particularly for homes owned by minorities, the elderly, and those with low incomes. Using this study, the state is now developing stronger regulations to curtail lending abuses that drive up costs for homebuyers, including lower income ones. Leaders can replicate this effort by connecting with independent, highly respected institutions to conduct research in this area.

For more information: www.trfund.com/resource/downloads/policypubs/Mortgage-Forclosure-Filings.pdf

Limit Prices at High-Priced Businesses, *Rent-to-Own State Laws*

Rent-to-own stores are regulated by specific rent-to-own statutes or by general state regulations that govern credit transactions. The stringency of these regulations varies widely across the states. In New York, for instance, rent-to-own businesses cannot charge more than 50 percent of a product's total worth in interest. On the other hand, Connecticut sets the limit at 100 percent, and Wisconsin sets it at 30 percent.

Leaders can bring down prices for consumers by implementing stricter caps on fees and interest charged by rent-to-own establishments, and by requiring these companies to fully disclose their pricing.

GOAL THREE: PROMOTE CONSUMER RESPONSIBILITY AND THE POWER OF LOWER INCOME SHOPPERS

The first two strategies for bringing down higher costs address the suppliers of basic necessities. Leaders need to grow the mainstream, price-competitive suppliers to force the alternative, higher-priced businesses to compete.

The other side of this equation is to assist the lower income consumers who buy high-priced goods and services from these suppliers. Here, leaders need to provide incentives for consumers to assume more responsibility for their buying decisions. At the same time, leaders need to strengthen consumers' capacity to do so by increasing the amount of information buyers can use to comparatively shop and making smarter strategies more available.

While some of these strategies are targeted to specific markets, many of the steps needed to strengthen consumer responsibility and the power of lower income consumers work across the board. This section reviews a handful of examples from around the country.

Promote Access to Online Price-Lowering Tools, and Internet Access and High Level Uses

Consumers save money when they can comparatively shop, particularly if they can do it in a timely fashion. Today, there are countless web-based companies designed to do just that, by pooling together the range of prices in a market for the exact same good or service. Lendingtree.com, for instance, provides comparative information on mortgages; einsurance.com and progressive.com provide comparative prices for insurance premiums; carbargain.com and cars.com provides prices for new and used cars; and shopping.com provides comparative prices for appliances and electronics. Similarly, a growing number of state departments of insurance offer drivers annual insurance shopping guides including prices for different premiums. Numerous consumer publications that rate the service and quality of local businesses are also available, and beehive.org provides an excellent portal for price-lowering information.

Lower income consumers can utilize all these extremely valuable market products to bring down the prices they pay for basic necessities. These resources may also inspire lower income families to take more responsibility for their budget decisions. Also, by steering consumers toward the best prices in the market, leaders can help curb the higher-priced businesses that thrive from charging lower income consumers unnecessarily high prices.

To start with, access to the Internet among lower income households still lags behind higher income households, although there have been significant gains over the past decade. This points to the many important gaps that need to be filled by promoting computer ownership and access among lower income households. It is also important to connect families to high-quality, high-impact uses of the Internet.

One way this could happen is through Idea Stores. Started in London, these are high-impact, transformative investments in libraries located in lower income neighborhoods. Part cutting-edge architecture, part community meeting place, part cafe, Idea Stores have emerged as new community institutions in lower income neighborhoods. Part of this effort could include investments in local, online, shopping infrastructure for lower income families, combined with incentives for families to use these resources. These would be go-to resources for families that are buying big-ticket items, like houses, cars, and insurance, along with smaller-ticket items like groceries, appliances, and bank accounts. Together, these tools could harness the potential that the Internet holds to make markets more efficient and competitive in lower income neighborhoods—and save untold sums for lower income consumers.

For more information: **http://www.ideastore.co.uk/**

Invest in Consumer Education, Promote Financial Education

A financial education should give clients basic money management skills, along with the know-how to find trusted information resources when they need to make a major financial decision, like buying insurance or a new car. These skills can help lower income families make financially responsible decisions and help them ward off offers by unscrupulous businesses that charge higher than necessary prices.[141]

The need for financial education has increased as markets have become more complex, credit has become more available, and costs of living have increased. Making savvy, smart decisions today is much more difficult as a result of these changes.

Importantly, this need for an investment in financial education comes at a time when a great many institutions have already invested in financial education. There are countless providers of financial education today, for instance, including banks, employers, public schools, community colleges, faith-based groups, community groups, and the military. There are also hundreds of thousands of pages devoted to financial education online, including excellent web pages like beehive.org that are targeted to lower income families; and nearly every state has at least considered legislation over the past year related to financial education. Some states, like Pennsylvania, have even established a separate state Office of Financial Education dedicated to promoting financial management skills throughout the state.

Going forward, public and private leaders need to build on these investments by a) evaluating the gaps in financial education delivery in their jurisdictions; b) determining the best practices that can be used to fill those gaps; and c) establishing a methodology for benchmarking the impact of investments in financial education.

The proliferation of financial education programs and initiatives across the country does not mean that the need for financial education has been addressed. There is wide diversity in the quality of financial education.[142] There are also glaring gaps in the delivery of financial education.[143] For instance, most public schools have abandoned their financial literacy curricula, even though there is evidence that kids that participate in a financial education program are more likely to save, and achieve a higher net worth. Similarly, few consumers receive counseling before they buy a sub-prime mortgage, even though these loans are substantially more likely than prime loans to become delinquent.[145] These types of gaps need to be filled by public and private investment.

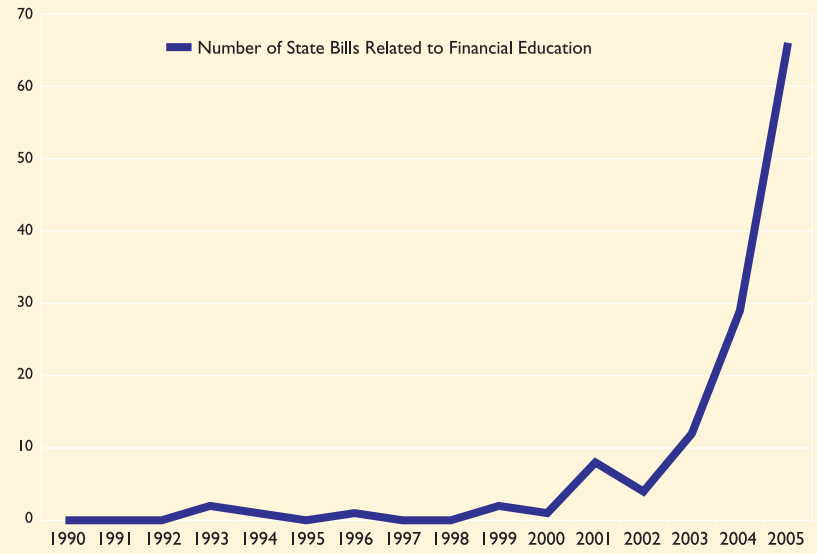
Public and private leaders also need to invest in researching and then publicizing best practices in financial education at different delivery points. These delivery points are often generalized into two different categories: those that provide a general financial education and those that provide an education targeted toward a specific purchase, like buying a home or investing in an Individual Development Account. Many of the assessments into the efficacy of financial education programs have been stunted by a number of methodological problems, including selection bias (i.e., recipients of financial education may self-select into these programs, and thus be systematically different non-recipients) and by validity (i.e., there are so many outlets for financial education, it is difficult to generalize findings based on an assessment of a single program). Going forward, public and private leaders should take an inventory of the most successful financial education programs, and then invest in those programs.[146]

Finally, leaders need to benchmark the impact that their investments have had on consumers. This type of evidence is absolutely critical to motivate continued or additional spending, and to ward off investing scarce resources in unproductive programs or partners.

Together, these three steps can give lowerincome consumers the resources to make more responsible decisions, and the power to fend-off the dynamic, often very entrepreneurial efforts of unscrupulous businesses.

For more information: **http://www.chicagofed.org/cedric/financial_education_research_center.cfm**

States have increasingly become focused on providing financial education to consumers



Source: Matt Fellowes. 2005. "Laboratories of Capitalism: How States Get the Market Right for Working Families." Presented at the Federal Reserve Bank of Cleveland 2005 Policy Summit.

Overall, Promote Trusted, Dynamic Resources for Market Information, Invest in Community Experiments

Markets are incredibly dynamic and complicated. There are now hundreds of different mortgage products, for instance. Consumers also often have dozens of insurance companies to choose from and the option of using the Internet or brick and mortar establishments to buy a growing number of necessities. Understanding how to manage the accuracy of three different credit reports is also crucial.

Financial education can go a long way towards helping lower income consumers ward off some of the risks associated with these market characteristics, while also positioning lower income consumers to capture the benefits it yields. But financial education is, by definition, static. Consumers participate in a financial education class, complete it, and then are sent off into the world. Meanwhile, markets continue to evolve. This means that consumers, and lower income consumers in particular (because they have the smallest margin of budgeting error), need a financial education resource that is just as dynamic and comprehensive as the market. Importantly, that resource also needs to be trusted by lower income consumers who, together, represent an incredibly diverse set of backgrounds and circumstances.

Such a resource such has not yet emerged. It might be the Idea Stores, reviewed earlier. It might be a website like beehive.org. It might be some type of free, publicly-monitored financial services, such as found in court rooms today. Or, it might be some type of faith-based service. Whatever it looks like, public and private leaders need to invest in thinking about how to deliver a trusted, dynamic resource for lower income consumers to keep pace with the incredibly complicated marketplace of today. ■

Endnotes

1. Author's analysis of the 2004 Survey of Consumer Finances. In this report, low-income households are defined as all households that earn less than $30,000 a year, and lower income neighborhoods are defined as any neighborhood with a median income less than $30,000. The empirical reasoning for this definition is reviewed in the methods section of this report.
2. See, for instance, David Caplovitz. 1967. *The Poor Pay More.* New York: The Free Press.
3. Pamela Loprest. 2003. "Fewer Welfare Leavers Employed in Weak Economy." Washington: Urban Institute; Gary Burtless. 2000. "Can the Labor Market Absorb Three Million Welfare Recipients?" Washington, DC: The Brookings Institution; Rebecca M. Blank and David Card. 2000. *Finding Jobs: Work and Welfare Reform.* New York: Russell Sage Foundation; Bruce Katz. 2004. "The Evolution of American Neighborhood Policy and What It Means for the United Kingdom." Washington, DC: The Brookings Institution; Alan Berube. 2006. "The New Safety Net: How the Tax Code Helped Low-Income Working Families During the Early 2000s." Washington, DC: The Brookings Institution; Audrey Singer. 2005. "The Rise of New Immigrant Gateways." Washington, DC: The Brookings Institution.
4. Matt Fellowes. 2006. "Credit Scores, Reports, and Getting Ahead in America." Washington, DC: The Brookings Institution. Other important changes in the financial service industry over the past decade include automated underwriting systems and automated account management systems.
5. William Fulton, Rolf Pendall, Mai Nguyen, and Alicia Harrison. 2001. "Who Sprawls Most? How Growth Patterns Differ Across the U.S." Washington, DC: The Brookings Institution.
6. Keith R. Ihlanfeldt and David L. Sjoquist. 1998. "The Spatial Mismatch Hypothesis: A Review of Recent Studies and Their Implications for Welfare Reform." *Housing Policy Debate,* 9: 849-93. Also see: Michael A. Stoll. 2005. "Job Sprawl and the Spatial Mismatch between Blacks and Jobs." Washington, DC: The Brookings Institution.
7. Bureau of Transportation Statistics. 2005. *Transportation Statistics Annual Report.* U.S. Department of Transportation, Research and Innovative Technology Administration, Bureau of Transportation Statistics.
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9. Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto. 2005. *The State of Working America.* Washington, DC: The Economic Policy Institute.
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11. For instance, please see: Matt Fellowes. 2006. "Grounds for Competition: The Basic Financial Service Infrastructure in Low-Income Neighborhoods." Presented at the 2006 Louis L. Redding Public Policy Forum, University of Delaware. Available at: **http://www.brookings.edu/metro/speeches/20060317_financialserv.htm** [accessed April 2006].
12. For an interesting assessment of these changes please refer to: Nicolas P. Retsinas and Eric S. Belsky, eds. 2005. *Building Assets, Building Credit: Creating Wealth in Low-Income Communities.* Washington, DC: The Brookings Institution, and Cambridge, MA: Center Joint Center for Housing Studies, Harvard University.
13. See, for instance: Robert Berner. 2006. "Wal-Mart's Urban Renewal." *Business Week,* April 4, 2006.
14. See, for instance, the numerous studies by Social Compact, which point to unmet market demand in lower income neighborhoods: **www.socialcompact.org**.
15. See annual survey administered by Providian Financial and the Consumer Federation of America; or GAO, "Credit Reporting Literacy: Consumers Understood the Basics but Could Benefit from Targeted Educational Efforts" GAO-05-223 (2005); and Kathryn Gwatkin and George McCarthy. 2003. "A Critical Examination of Financial Literacy Education." Presented at the 2003 Building Assets, Building Credit: A Symposium on Improving Financial Services in Low-Income Communities.
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17. Certainly, this has at least something to do with the fewer number of choices in some lower income neighborhoods. But, it also has to do with real behavioral differences among consumers.
18. For instance, see: Ephraim S. Leibtag and Phil R. Kaufman. 2003. "Exploring Food Purchase Behavior of Low-Income Households: How Do They Economize?" AIB-747-07, USDA, Economic Research Service.
19. U.S. Census Bureau, 2004 American Community Survey, and the Decennial Census for the Hartford metropolitan area population count. We chose these areas because they represent a diverse sample. Several are also areas where the Annie E. Casey Foundation, which generously supported this project, has heavily invested in neighborhoods.
20. The ACCRA cost-of-living metro index is available at **www.accra.org** [accessed April 2006]. Also see: Leah B. Curran, Harold Wolman, Edward W. Hill, and Kimberly Furdell. 2006. "Economic Wellbeing and Where We Live." Washington, DC: The Brookings Institution.
21. Author's analysis of data from the Bureau of Labor Statistics.
22. Author's analysis of the 2004 Survey of Consumer Expenditures.
23. For instance, see: Ephraim S. Leibtag and Phil R. Kaufman. 2003. "Exploring Food Purchase Behavior of Low-Income Households: How Do They Economize?" AIB-747-07, USDA, Economic Research Service.
24. The NAICs definition used by InfoUSA for grocery stores is: "This industry comprises establishments generally known as supermarkets and grocery stores primarily engaged in retailing a general line of food, such as canned and frozen foods; fresh fruits and vegetables; and fresh and prepared meats, fish, and poultry. Included in this industry are delicatessen-type establishments primarily engaged in retailing a general line of food." Note that this definition DOES NOT contain convenience stores. For more information, please refer to the Census webpage on NAICs: **http://www.census.gov/epcd/www/naics.html** [accessed April 2006).
25. In some states there was also public, license data. These data are not always available in electronic format, the data are not always updated, and it can be unclear whether businesses licensed to sell a service sell that service in all of their establishments. Also, these

data are not always available across states. For all of these reasons, we use private data in this report to assess the population of establishments. Importantly, the InfoUSA data is also different from state license data because it categorizes establishments by their primary and secondary business service, and not all of the business services they sell. This means, for instance, that a gas station that sells gas as its primary business, food as its second business, and check-cashing services as its third, will not be listed in the InfoUSA database as a check-cashing business. Both public and private data consequently have limitations.

26. Evidence suggests that smaller stores charge higher prices than larger stores. Since low-income neighborhoods generally have much less access to larger stores than higher income neighborhoods, we can infer that food is, on average, more expensive in lower income neighborhoods. For evidence of the relationship between store size and price see the results section of this report, and: Phillip R. Kaufman and Charles R. Handy. 1989. "Supermarket Prices and Price Differences: City, Firm, and Store-Level Determinants." United States Department of Agriculture, Economic Research Service, Technical Bulletin Number 1776; and Howard Kunreuther. 1973. "Why the Poor Pay More for Food: Theoretical and Empirical Evidence." *Journal of Business.* 46:368-83.

27. Mari Gallagher. 2005. "Chain Reaction: Income, Race, and Access to Chicago's Major Player Grocers. Chicago: Metro Chicago Information Center.

28. For other examples of grocery baskets used in this line of research see: Lashawan Richburg Hayes. 2000. "Do the Poor Pay More? An Empirical Investigation of Price Dispersion in Food Retailing." Industrial Relations Section Working Paper #446. Princeton University; Phillip R. Kaufman, James M. MacDonald, Steven M. Lutz, and David M. Smallwood. 1997. "Do the Poor Pay More for Food? Item Selection and Price Differences Affect Low-Income Household Food Costs." Agriculture Economic Report Number 759. Washington, DC: U.S. Department of Agriculture, Economic Research Service; Trinity Center for Neighborhoods. 2002. "Food Pricing in Hartford, Connecticut: Supplement to the Self Sufficiency Study."

29. The strength of this method is that it yields a very large, cross-store comparison. The important downside, however, is that we delimit the range of the products considered. This is important because large stores generally use the large floor space to sell a greater diversity of products than smaller stores.

30. This means, for instance, that we compared the price of a six-pack of Coke across each of these 3,000 grocery stores. The product categories represented by these 132 products include: eggs, milk, cheese, coffee, canned tuna, margarine, frozen potatoes, frozen poultry, carbonated beverages, frozen dinners, and cereal.

31. U.S. Census Bureau, 2004 American Community Survey.

32. There may be other types of higher auto-related costs, like the cost of gasoline and the cost of maintaining a car. Gas may cost more in lower income neighborhoods because of the higher costs of security and because they are more likely to be located in urban neighborhoods. Maintaining a car may be more expensive because lower income households are much more likely to drive a used car than higher income households. Unfortunately, we were unable to find data on these costs.

33. Fiona Scott Morton, Florian Zettelmeyer, and Jorge Silva-Risso. 2001. "Consumer Information and Price Discrimination: Does the Internet Affect the Pricing of New Cars to Women and Minorities?" Working Paper 8688, National Bureau of Economic Research. Also see: Ian Ayers and Peter Siegelman. 1995. "Race and Gender Discrimination in Bargaining for a New Car." *The American Economic Review,* 85:304-21; and David W. Harless and George Hoffer. 2002. "Do Women Pay More for New Vehicles? Evidence from Transportation Price Data." *The American Economic Review,* 92:270-79.

34. For more information about direct, indirect, and total effects, please see: Rex Kline. 1998. Principles and Practice of Structural Equation Modeling. New York: The Guilford Press.

35. But, for a local market assessment see: Anne Kim. 2002. "Taken for a Ride: Subprime Lenders, Automobility, and the Working Poor." Washington, DC: Progressive Policy Institute.

36. For more information about this survey, please refer to: Brian K. Bucks, Arthur B. Kennickell, and Kevin B. Moore. 2006. "Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances." Federal Reserve Bulletin. vol. 92 (February 2006), pp. A1-A38.

37. For instance, a 2003 report by the Washington Office of the Insurance Commissioner found that driver income is significantly related to credit scores—one variable considered by some insurance companies. In particular, they "concluded that credit scores, and consequently, insurance premiums, improve as income rises." For more information, see: Washington Insurance Underwriting and Pricing." Submitted to the State Legislator in December 2003.

38. According to the Insurance Information Institute, Allstate has about 10 percent of the auto insurance market, Progressive has about 7 percent, and Geico has about a 6 percent market share [accessed April 2006: **http://www.iii.org/media/facts/statsbyissue/auto/**]

39. We did this because we wanted as conservative an estimate as possible. A downside, however, is that these estimates should not be compared across the metropolitan areas in our analysis, since we consider a different amount of insurance across each of these areas. For a comparable assessment of average prices, please see publications by the National Association of Insurance Commissioners, or data available from the Insurance Information Institute [**www.iii.com**, accessed April 2006].

40. Insurance quotes were not available for all of the ZIP codes in these areas. We also dropped any ZIP codes with a population less than 500 in these metropolitan areas.

41. This methodology is derived from a series of studies that have analyzed price variance across ZIP codes. See for instance: Scott E. Harrington and Greg Niehaus. 1998. "Race, Redlining, and Automobile Insurance Prices." Journal of Business. 71(3): 439-69; R. Klein. 1995. "Urban homeowners insurance markets: Problems and possible solutions." Working Paper. National Association of Insurance Commissioners; and Missouri Department of Insurance. 2004. "Affordability and Availability of Personal Lines Insurance in Underserved Communities."

42. The Washington Office of the Insurance Commissioner, Texas Department of Insurance, the Michigan Office of Financial and Insurance Services, and the Missouri Department of Insurance have all undertaken analyses to estimate the relationship between credit scores and driver income. A forthcoming Federal Trade Commision analysis of this issue promises to be a generalizable assessment of this issue.

43. For instance, see: Albert B. Crenshaw and Caroline E. Mayer. 2006. "Geico's Risk Criteria Challenged: Insurer Denies That Education and Occupation Are Used to Discriminate" *Washington Post:* D01, March 21, 2006.

44. Credit cards and debit cards are two other financial service products often thought of as "basic," but no data is available to compare prices for these products.

45. For instance, please see: www.banking.pennslyvania.gov.

46. In some cases public license data is also available, but we chose not to use these for a number of reasons: these data are not always available in electronic format, the data are not always updated, it is sometimes unclear

whether businesses licensed to sell a service do so in all of their establishments;these data are not always available across states, and these data are not compatible with the InfoUSA data. Importantly, the InfoUSA data is also different from state license data because it categorizes establishments by their primary and secondary business service, not all of the business services they sell. This means, for instance, that a gas station that sells gas as its primary business, food as its second business, and check-cashing services as its third, will not be listed in the InfoUSA database as a check-cashing business.

47. Please see previous note for an explanation of the pros and cons associated with different data sources.

48. But, see evidence of systematic differences in tax assessments: Matt Fellowes and Bruce Katz. 2005. *The Price is Wrong: Getting the Market Right for Philadelphia's Working Families.* Washington, DC: The Brookings Institution.

49. Robert B. Avery, Glenn Canner, and Robert E. Cook. 2005. "New Information Reported Under HMDA and Its Application in Fair Lending Enforcement." *Federal Reserve Bulletin,* Summer 2005.

50. For more information about this comparison please refer to Keith S. Ernst and Deborah N. Goldstein. 2005. "Comment on Federal Reserve Analysis of Home Mortgage Disclosure Act Data." Center for Responsible Lending, CRL Comment #1.

51. James M. Lacko, Signe-Mary McKernan and Monoj Hastak. 2000. "Survey of Rent-to-Own Customers." Federal Trade Commission, Bureau of Economics Staff Report.

52. For instance, see: Iceland, John (Rapporteur). 2005. *Workshop on Experimental Poverty Measures.* Washington, D.C.: National Academy Press. Also see: Gary Burtless. 1999. "Political Consequences of an Improved Poverty Measure," *The LaFollette Policy Report,* Vol. 10, no. 1, Spring/Summer 1999

53. Neighborhood is defined in this report as a census tract. When using the 2004 Survey of Consumer Finance data this represented about 71 percent of the median household income (and about 44 percent of the mean income). When using the 2000 Census for median neighborhood income estimates in our sample of 12 metropolitan areas, our measure of lower income neighborhoods represented about 16 percent of the 14,903 neighborhoods in our analysis.

54. HUD estimates that the median income in 2006 is $59,600. For more information please see: **http://www.hud.gov/local/shared/working/localpo/xestmedinc.cfm?state=us** [accessed May 2006].

55. For instance, a family in Atlanta with a net annual income of $30,000 earned from one salaried worker can pay $1,500 over the course of a year to cash checks at a check casher. If they also occasionally took out a payday loan or a pawnshop loan, in addition to paying for a tax preparation service and refund anticipation loan, this family would pay at least $2,000 in fees for all of these basic financial services.

56. We jointly analyze these companies because an increasing number of establishments that serve one service, also sell the other service. For evidence of this market trend, please refer to Patrick Bolton and Howard Rosenthal (eds). 2005. *Credit Markets for the Poor.* New York: Russell Sage Foundation. Also, see: Sheila Bair. 2005. "Low Cost Payday Loans: the Opportunities, the Obstacles," Report prepared for the Annie E. Casey Foundation.

57. For instance, a family in Atlanta with a net income of $30,000 a year earned from one salaried worker can pay $1,500 to cash checks from a private company if they lived and worked in Atlanta. If they also occasionally took out a payday loan or a pawnshop loan, in addition to paying for a tax preparation service and refund anticipation loan, this family would pay at least $2,000 in fees.

58. John P. Caskey. 2002. "Check-Cashing Outlets in a Changing Financial System." Working Paper #02-4. Federal Reserve Bank of Philadelphia; John P. Caskey. 2002. "The Economics of Payday Lending." Monograph. Madison, WI: Filene Research Institute; and Robert W. Johnson and Dixie P. Johnson. 1998. "Pawnbroking in the U.S.: A Profile of Customers." Washington, DC: Georgetown University Credit Research Center. Please keep in mind that the income values here all reflect the year that these surveys were conducted.

59. See discussion of overdraft fees in this section for an example of an exception to this trend.

60. For a full listing of current state regulations please refer to the "Check Casher Fee Schedule," maintained by the Financial Service Centers of America, Inc. – a trade association for the industry. Note that these regulations were compiled in September 2005.

61. Colorado and Washington, two states whose regulations determine policies in two of our sample cities, have no specific regulations governing these fees, making it difficult to know exactly how much is charged in these states. Also, research has found that most establishments raise prices to the maximum amount allowed under state law, defying traditional price pressures engendered by competition. See, for instance: Mark Flannery and Katherine Samolyk. 2005. "Payday Lending: Do the Costs Justify the Price." FDIC Center for Financial Research. Working Paper. No. 2005-09.

62. Mark Flannery and Katherine Samolyk. 2005. "Payday Lending: Do the Costs Justify the Price?" FDIC Center for Financial Research Working Paper No. 2005-09.

63. Jane J. Kim. April 2, 2006. "Banks sweeten promotions for new checking customers; rates creating profit pressures—bounced-check fees, other penalties rising.

64. William Streeter and Steve Cocheo. April 2006. Deposit battle: "Winning at a zero-sum game." ABA Banking Journal, American Bankers Association.

65. Author's analysis of the 2004 Survey of Consumer Finances; and Sheila Bair. 2005. "Low-Cost, Payday Loans: Opportunities and Obstacles." Baltimore, MD: The Annie E. Casey Foundation.

66. Results from a 2004 survey administered by the Center for Financial Services Association, cited from Sheila Bair. 2005. "Low-Cost, Payday Loans: Opportunities and Obstacles." Baltimore, MD: The Annie E. Casey Foundation

67. Importantly, though, payday lenders in many of these states can legally avoid these limits by renting the charter of a bank located in another state. State limits should often be interpreted as rough guides to the very high prices these payday loan establishments charge. All federal regulatory agencies ban or strongly discourage banks from engaging in this practice.

68. For more information, please see: **http://www.ncsl.org/programs/banking/paydaylend-intro.htm** and **www.paydayloaninfo.org** [accessed May 2006]

69 John P. Caskey. 2005. "Fringe Banking and the Rise of Payday Lending," in Patrick Bolton and Howard Rosenthal (eds), *Credit Markets for the Poor.* New York: Russell Sage Foundation; author's analysis of the 2004 Survey of Consumer Finances.

70. Glen Tenney. 2004. The Effects of Government Regulation on Competition and Supply in the Pawn Industry: A Quantitative and Qualitative Study. Touro University International Doctoral Dissertation. P2—202. Amanda Quester and Jean Ann Fox. 2005. "Car Title Lending: Driving Borrowers to Financial Ruin." Washington, DC: Consumer Federation of America. Note that these compilations of state regulations are at least one year old.

71. Amanda Quester and Jean Ann Fox. 2005. "Car Title Lending: Driving Borrowers to Financial Ruin." Washington, DC: Consumer Federation of America.

72. Mark Flannery and Katherine Samolyk. 2005. "Payday Lending: Do the Costs Justify the Price?" FDIC Center for Financial Research Working Paper No. 2005-09. Also see: Michael A. Stegman and Robert Faris. 2003. "Payday Lending: A Business Model

That Encourages Chronic Borrowing." *Economic Development Quarterly.* 17: 8-32. Also, for an informative consumer profile and assessment of this industry, please see: Washington State Department of Financial Institutions. 2006. "Payday Lending Report Statistics & Trends 2004." Washington State Department of Financial Institutions, Division of Consumer Services.

73. San Francisco Consumer Action. 2005. "2005 Credit Card Survey."; Chase Bank [**http://mortgage02.chase.com/pages/homeequity/hefaqs.jsp**], accessed April 2006.

74. Late payments on a credit card can also exceed the APR charged by these alternative short-term loan companies.

75. For instance, see: Sheila Bair. 2005. "Low-Cost, Payday Loans: Opportunities and Obstacles." Baltimore, MD: The Annie E. Casey Foundation; Jean Ann Fox and Eric Halperin. 2005. New Study: Most Big Banks Level High "Courtesy Overdraft" Loan Fees Without Consumers' Permission. Washington, DC: The Consumer Federation of America; and Lisa James and Peter Smith. 2006. "Overdraft Loans: Survey Finds Growing Problem for Consumers." Center for Responsible Lending, Issue Paper No. 13.

76. Quoted from: Dean Foust. 2005. "Banks: "Protection" Racket?" Business Week, May 2, 2005.

77. Quoted from: Dean Foust. 2005. "Banks: "Protection" Racket?" Business Week, May 2, 2005.

78. In this section only, we use a different definition of "lower income" because of data limitations. In particular, we use all households with an income that qualifies them for the earned-income tax credit, or an income less than or equal to 34,678 in 2003. These data come from unpublished data from Alan Berube, a fellow at the The Brookings Institution's Metropolitan Policy Program.

79. Alan Berube, The Brookings Institution, unpublished data.

80. Alan Berube, Anne Kim, Benjamin Forman, and Megan Burns. 2002. "The Price of Paying Taxes: How Tax Preparation and Refund Loan Fees Erode the Benefits of the EITC." Washington, DC: The Brookings Institution.

81. Illinois, Office of the Attorney General, **http://www.ag.state.il.us/consumers/rals.html** [accessed April 2006]; California, Office of the Attorney General, February 15, 2006 Press Release, "Attorney General Lockyer Files Lawsuit Against H&R Block for Illegally Marketing and Selling High-Cost Loans as 'Instant' Tax Refunds." Chi Chi Wu and Jean Ann Fox. 2006. "Refund Anticipation Loans: Updated Facts and Figures." Washington, DC: The Consumer Federation of America.

82. Bendixen and Associates. 2004. State by State Survey of Remittance Senders: U.S. to Latin America. Coral Gables, Florida.

83. We are not aware of comparable, metropolitan-level information.

84. Dr. Manuel Orozco. 2004. "The Remittance Marketplace: Prices, Policy and Financial Institutions." Washington, DC: Pew Hispanic Center Report.

85. Also see: Marrianne A. Hilgert et. al. 2005. "Banking on Remittances: Increasing Market Efficiencies for Consumers and Financial Institutions." Federal Reserve Community Affairs Research Conference; and the Multilateral Investment Fund, Remittances as a Development Tool Project.

86. We jointly analyze these companies because an increasing number of establishments that offer one service, also sell the other service. For evidence of this market trend, please refer to Patrick Bolton and Howard Rosenthal (eds). 2005. *Credit Markets for the Poor.* New York: Russell Sage Foundation.

87. Audrey Singer. 2005. "The Rise of New Immigrant Gateways." Washington, DC: The Brookings Institution.

88. Author's analysis of the Survey of Consumer Finances.

89. This assessment was provided on background.

90. For instance, see: Anna Paulson, Audrey Singer, Robin Newberger, and Jeremy Smith. 2006. "Financial Access for Immigrants: Lessons from Diverse Perspectives." The Brookings Institution and The Federal Reserve Bank of Chicago. Also, see publications by the Center for Financial Service Innovation.

91. For instance, see annual survey administered by Providian Financial and the Consumer Federation of America; or GAO, "Credit Reporting Literacy: Consumers Understood the Basics but Could Benefit from Targeted Educational Efforts" GAO-05-223 (2005); Elizabeth Bell and Robert Lerman. 2005. "Can Financial Literacy Enhance Asset Building?" Washington, DC: The Urban Institute; Lois Vitt, Gwen Reichbach, Jamie Kent, and Jurg K. Siegenthaler. 2005. "Goodbye to Complacency: Financial Literacy Education in the U.S. 2000-2005." Washington, DC: AARP; and Marsha Courchane and Peter Zorn. 2005. "Consumer Literacy and Credit Worthiness." Paper presented at the 2005 Federal Reserve System Community Affairs Research Conference, Promises & Pitfalls: As Consumer Finance Options Multiply, Who Is Being Served and at What Cost?

92. Anna Paulson, Audrey Singer, Robin Newberger, and Jeremy Smith. 2006. "Financial Access for Immigrants: Lessons from Diverse Perspectives." The Brookings Institution and The Federal Reserve Bank of Chicago.

93. In New York, for instance, it costs nearly $1,000 more every year, on average, to insure the exact same car and driver in lower income neighborhoods than in a moderate-income neighborhood, with a median income between $30,000–60,000. This does not include all of the other higher costs reviewed in this section, which can make this premium even higher than we report here.

94. Fiona Scott Morton, Florian Zettelmeyer, and Jorge Silva-Risso. 2001. "Consumer Information and Price Discrimination: Does the Internet Affect the Pricing of New Cars to Women and Minorities?" Working Paper 8688, National Bureau of Economic Research. Also see: Ian Ayers and Peter Siegelman. 1995. "Race and Gender Discrimination in Bargaining for a New Car." *The American Economic Review,* 85:304-21; and David W. Harless and George Hoffer. 2002. "Do Women Pay More for New Vehicles? Evidence from Transportation Price Data." *The American Economic Review,* 92:270-79.

95. Taken from: Matt Fellowes and Bruce Katz. 2005. *The Price is Wrong: Getting the Market Right for Philadelphia's Working Families.* Washington, DC: The Brookings Institution.

96. This average was generated by taking the average of all auto loans reported in the Survey of Consumer Finances for each household. For instance, for a household with three auto loans, we considered the average APR charged across all three loans.

97. For instance, see Albert B. Crenshaw and Caroline E. Mayer. March 21, 2006. "Geico's Risk Criteria Challenged," *The Washington Post,* p D01;

98. Author's analysis of the 2004 Survey of Consumer Finances.

99. Ian Ayers and Peter Siegelman. 1995. "Race and Gender Discrimination in Bargaining for a New Car." *The American Economic Review,* 85:304-21.

100. Bureau of Transportation Statistics. 2005. *Transportation Statistics Annual Report.* U.S. Department of Transportation, Research and Innovative Technology Administration, Bureau of Transportation Statistics.

101. Providian Financial and the Consumer Federation of America. See also: GAO, "Credit Reporting Literacy: Consumers Understood the Basics but Could Benefit from Targeted Educational Efforts" GAO-05-223 (2005).

102. This estimate includes the combined results of both the first and second mortgages carried on a home.

103. The Survey of Consumer Finances asks a sequence of questions to determine the number of loans a person has taken out using their primary residence as collateral. The first question inquires whether the respondent has a loan on the primary resi-

dence; the second asks if there is an additional mortgage; and then a third asks if the respondent has any other loan that uses the property as collateral. Approximately 5.6 percent of respondents who initially indicated they had a mortgage answered the second question by stating that they have a second loan.

104. These loans are defined by the Federal Reserve Board as three percentage points above comparable Treasury notes for first liens and 5 percentage points above for junior liens. In using this definition, the Board estimated they would capture over 95 percent of the sub prime market. For more information, please refer to: Robert B. Avery, Glenn Canner, and Robert E. Cook. 2005. "New Information Reported Under HMDA and Its Application in Fair Lending Enforcement." *Federal Reserve Bulletin,* Summer 2005. But, please note that recent comparisons of private sector data with these public data suggest that the Federal Reserve's definition of "high cost" mortgages misses a large proportion of this market. For more information about this comparison please refer to Keith S. Ernst and Deborah N. Goldstein. 2005. "Comment on Federal Reserve Analysis of Home Mortgage Disclosure Act Data." Center for Responsible Lending, CRL Comment #1.

105. For instance, see Albert B. Crenshaw and Caroline E. Mayer. March 21, 2006. *The Washington Post,* p. D1; Matt Fellowes. 2006. "Credit Scores, Reports, and Getting Ahead in America." Washington, DC: The Brookings Institution; and Washington Office of the Insurance Commissioner. "Washington Insurance Underwriting and Pricing." Submitted to the State Legislator in December 2003.

106. James M. Lacko, Signe-Mary McKernan and Monoj Hastak. 2000. "Survey of Rent-to-Own Customers." Federal Trade Commission, Bureau of Economics Staff Report. But, see The Association of Progressive Rental Organizations [**http://www.rtohq.org**, accessed April 2006], for an industry perspective on its customer base.

107. State of Wisconsin, Department of Financial Institutions, **http://www.wdfi.org/wca/consumer_credit/credit_guides/rent-to-own.htm** [accessed April 2006].

108. State of Maryland, Office of the Attorney General, **http://www.oag.state.md.us/consumer/edge109.htm**

109. State of Wisconsin, Department of Financial Institutions, **http://www.wdfi.org/wca/consumer_credit/credit_guides/rent-to-own.htm** [accessed April 2006].

110. According to one recent survey, the average credit card APR was 12.6 percent in 2004 across 146 different credit card products. For more information, see: San Francisco Consumer Action. 2005. "2005 Credit Card Survey."

111. Matt Fellowes. 2006. "Credit Scores, Reports, and Getting Ahead in America." Washington, DC: The Brookings Institution. Also see: Alan Berube, Matt Fellowes, Mia Mabanta. 2006. "Low-Income Credit Roadblocks," forthcoming.

112. Wei Li and Keith S. Ernst. 2006. "The Best Value in the Subprime Market: State Predatory Lending Reforms." Washington, DC: Center for Responsible Lending; M. Hudson and E.S. Reckard, More Homeowners with Good Credit Getting Stuck with Higher-Rate Loans. *Los Angeles Times:* A-1 (October 24, 2005).

113. The Center for Responsible Lending has a number of excellent studies that address these issues. Please refer to their homepage for more information: **www.responsiblelending.org**.

114. Please refer to the previous section, and the evidence from the Wisconsin Department of Financial Institution's and the Maryland's Attorney General Office, in particular.

115. Susannah Fox. 2005. *Digital Divisions: There are clear differences among those with broadband connections, dial-up connections, and no connections at all to the internet.* New York: Pew Internet and American Life Project.

116. For instance, see **http://www.lendingtree.com** [accessed April 2006].

117. For instance, see: **http://www.overstock.com, http://www.shoplocal.com, http://www.smartshopper.com, http://www.shop.com, http://www.pricescan.com** [accessed April 2006].

118. Please refer to the methodology section of this report for the NAICs definition of grocery stores that we use in this analysis.

119. Please refer to the section that reviews our methodology for information about these products.

120. For access to this report, and more information, please refer to: **http://www.thefoodtrust.org/php/programs/super.market.campaign.php#3** [accessed May 2006].

121. Robert P. King, Ephraim S. Liebtag, and Ajay S. Behl. 2004. "Supermarket Characteristics and Operating Costs in Low-Income Areas." Agricultural Economic Report No. AER839.

122. Please refer to their homepage to view these studies, www.socialcompact.org

123. Robert Berner. 2006. "Wal-Mart's Urban Renewal." *Business Week,* April 4, 2006.

124. Author's analysis of the 2004 Survey of Consumer Finances.

125. Author's analysis of the 2004 Survey of Consumer Expenditures. See also William D. Passero. 1995. "An Examination Of Spending Patterns Of Families Receiving Forms Of Public Assistance." Washington, DC: Bureau of Labor Statistics.

126. The Center for Financial Services Innovation assists the financial services industry in meeting this market opportunity. They have excellent, in depth, resources available on their webpage at: http://www.cfsinnovation.com.

127. For an excellent assessment of recent efforts by banks and credit unions to compete against high-priced alternative short-term loan providers, please see: Sheila Bair. 2005. "Low Cost Payday Loans: the Opportunities, the Obstacles," Report prepared for the Annie E. Casey Foundation.

128. As quoted in Clint Riley, March 21, 2006, "New York uses banks to kick-start renewal." *Wall Street Journal;* See also community efforts in Seattle and San Francisco to provide profitable alternatives to high-priced financial services.

129. For an assessment of the feasibility of basic financial service delivery in lower income neighborhoods, please see: Daniel M. Leibsohn. 2005. *Analysis of the Business Models and Financial Feasibility of Fringe Banking Institutions.* New Hampshire: Community Economic Development Press. Note, though, that recent research by the FDIC found that the high fixed costs of operating payday loan establishments partially explains why these loans are so expensive. This suggests that taking advantage of the massive existing infrastructure of banks and credit unions in lower income neighborhoods may be a more cost-effective way to bring mainstream, lower-priced basic financial service products into lower income neighborhoods. Please see: Mark Flannery and Katherine Samolyk. 2005. "Payday Lending: Do the Costs Justify the Price." FDIC Center for Financial Research. Working Paper. No. 2005-09.

130. National Economic Development and Law Center, Low Income Car Ownership (LICO) Clearinghouse. [www.nedlc.org, accessed February 2006].

131. The auto insurance quotes from California presented in the results section of this report were open-market quotes, and do not reflect the substantial cost savings available through this program.

132. Matt Fellowes. 2006. "Credit Scores, Reports, and Getting Ahead in America." Washington, DC: The Brookings Institution. See also: Nichola P. Retsinas and Eric S. Belsky. 2005. *Building Assets, Building Credit: Creating Wealth in Low-Income*

Communities. Washington, DC: The Brookings Institution; Patrick Bolton and Howard Rosenthal. 2005. *Credits Markets for the Poor.* New York: the Russell Sage Foundation.

133. New York's Department of Insurance. 2002. Consumer Shopping Guide for Homeowners and Tenants Insurance. Albany: New York Department of Insurance.

134. See, for instance: Tony Proscio. 2006. *Food, Markets, and Healthy Communities: How food stores accelerate local development and enrich residents' lives.* New York, New York: Local Initiatives Support Corporation.

135. Shutting down all the check cashers will not help poor families if they have nowhere else to go to conduct their financial business. In fact, without also pairing these regulatory efforts with aggressive campaigns to connect lower income consumers to mainstream businesses, these efforts could even raise prices by reducing competition for lower and moderate-income consumers.

136. For evidence of this point, please refer to the Washington Office of the Insurance Commissioner study cited in the results section of this report.

137. Wei Li and Keith S. Ernst. 2006. "The Best Value in the Subprime Market: State Predatory Lending Reforms." Washington, DC: Center for Responsible Lending; M. Hudson and E.S. Reckard, More Homeowners with Good Credit Getting Stuck with Higher-Rate Loans. *Los Angeles Times:* A-1 (October 24, 2005).

138. For an excellent, careful review of these bills, and the effect that they have had on the market, please see Wei Li and Keith S. Ernst. 2006. "The Best Value in the Subprime Market: State Predatory Lending Reforms." Washington, DC: Center for Responsible Lending.

139. As with most empirical research, outstanding questions remain. One important issue here is that there is no true, null alternative; although this analysis very reasonably assumes that states without these provisions can serve as a proxy.

140. Susannah Fox. 2005. *Digital Divisions: There are clear differences among those with broadband connections, dial-up connections, and no connections at all to the internet.* New York: Pew Internet and American Life Project.

141. The assessment of the efficacy of financial education programs has been stunted by a number of methodological problems, including selection bias (i.e., recipients of financial education may self-select, and thus be systematically different non-recipients) and by validity (i.e., there are so many outlets for financial education, it is difficult to generalize findings based on an assessment of a single program. Still, available evidence does suggest a positive impact. For more information, please refer to: Elizabeth Bell and Robert I. Lerman. 2005. "Can Financial Literacy Enhance Asset Building?" The Urban Institute, Opportunity and Ownership Project, No.6; and Saundra Braunstein and Carolyn Welch. 2002. "Financial Literacy: An Overview of Practice, Research, and Policy." *Federal Reserve Bulletin,* November 2002.

142. See, for instance: Kathryn Gwatkin and George McCarthy. 2003. "A Critical Examination of Financial Literacy Education." Presented at the 2003 Building Assets, Building Credit: A Symposium on Improving Financial Services in Low-Income Communities.

143. Elizabeth Bell and Robert I. Lerman. 2005. "Can Financial Literacy Enhance Asset Building?" The Urban Institute.

144. Douglas B. Bernhein, Daniel M. Garret, and Dean M. Maki. 2001. "Education and Savings: The Long Term Effects of High School Financial Curriculum Mandates." *Journal of Public Economics.* Volume 80, p435-65.

145. For an excellent review of state laws related to mortgage lending, as well as an assessment of the impact of these laws, please refer to: Wei Li and Keith S. Ernst. 2006. "The Best Value in the Subprime Market: State Predatory Lending Reforms." Washington, DC: Center for Responsible Lending.

146. The Bernhein et. al. paper is an excellent example of a very well designed assessment of a public education curriculum – one, potentially important delivery point for financial education.

ABOUT THE METROPOLITAN POLICY PROGRAM

The Metropolitan Policy Program was launched in 1996 to provide decisionmakers cutting-edge research and policy analysis on the shifting realities of cities and metropolitan areas.

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Predatory Profiling:

The Role of Race and Ethnicity in the Location of Payday Lenders in California

Wei Li, Leslie Parrish, Keith Ernst and Delvin Davis
Center for Responsible Lending

March 26, 2009

CENTER FOR RESPONSIBLE LENDING

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"Study after study has demonstrated that payday lenders are concentrated in communities of color. A drive through minority neighborhoods clearly indicates that people of color regardless of income are a target market for legalized extortion. Payday lending is an economic drain that threatens the livelihoods of hardworking families and strips wealth from entire communities."

Julian Bond, Chairman, NAACP

"Many families rely on short-term credit to see their way through financial emergencies. Unfortunately, the exorbitant rates more often lead families into a cycle of debt rather than a bridge to financial recovery. We need prudent regulation, product innovations and financial counseling to avoid saddling families with debt and making it impossible to save for their future."

Lautaro "Lot" Diaz,
Vice President of Housing & Community
Development, National Council of La Raza

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EXECUTIVE SUMMARY

Payday loans trap working households in long-term debt at annual interest rates of over 400 percent. In California and elsewhere, African Americans and Latinos make up a disproportionate share of payday loan borrowers.

Our analysis reveals that the racial and ethnic composition of a neighborhood is the primary predictor of payday lending locations, while playing a very minimal role in explaining the variation in the location of bank branches. As a result, payday lending storefronts are most heavily concentrated in African American and Latino communities. By contrast, the location of mainstream financial service providers such as banks can be largely explained by supply and demand factors such as the presence of retail space.

Specifically:

- Payday lenders are nearly eight times as concentrated in neighborhoods with the largest shares of African Americans and Latinos as compared to white neighborhoods, draining nearly $247 million in fees per year from these communities.
- Even after controlling for income and a variety of other factors, payday lenders are 2.4 times more concentrated in African American and Latino communities. On average, controlling for a variety of relevant factors, the nearest payday lender is almost twice as close to the center of an African American or Latino neighborhood as a largely white neighborhood.
- Race and ethnicity play a far less prominent role in the location of mainstream financial institutions, such as bank branches. While race and ethnicity account for over half of the variation in payday lender location explained by neighborhood factors, they explain only one percent of the variation in bank branch locations.

Payday loans are small, short-term loans secured by a borrower's personal check. The typical two-week payday loan is costly, with lenders allowed to charge up to 459 percent APR. While these loans are advertised as a quick and easy way to deal with an occasional unexpected expense before payday, borrowers have a hard time retiring this debt, taking out one loan after another and becoming ensnared in a long-term debt trap. Because of this, $247 million is drained from California's African American and Latino communities to service payday loans annually.

The payday lending industry depends on this cycle of repeat borrowing for the bulk of its revenues. Nationally, 90 percent of their business is generated by borrowers with at least five loans per year and over 60 percent of business is generated by borrowers with at least 12 loans per year.

The Payday Lending Debt Trap in California

- ***California payday borrowers take out an average of 10 loans per year.***
- ***The industry reports that 84 percent of its business in California is attributable to "repeat customers."***
- ***Only four percent of revenues are generated by borrowers with a single loan in a year.***

If payday loans were a helpful product, we might applaud the increased access to credit that these storefronts provide to African Americans and Latinos. However, as the foreclosure crisis spurred on by harmful mortgage lending practices has shown, mere access to credit is not beneficial if it ultimately leaves the borrower worse off. Similarly, payday borrowers typically end up in a harmful borrowing cycle, ultimately paying more in fees than is extended in credit.

To protect consumers from predatory products while preserving a responsible small loan marketplace, California should adopt a comprehensive 36 percent APR small loan rate cap, as 15 states and the District of Columbia have done. In addition to this key protection, California policymakers should employ strategies to help households increase their emergency savings as an alternative to taking on additional debt altogether. While these steps would benefit all Californians, they would especially help African American and Latino households, who make up a large share of payday borrowers.

INTRODUCTION

A payday loan is a small, short-term loan secured by a personal check. Marketed to consumers as a quick and easy solution to dealing with an unexpected expense, these loans are due at the borrower's next payday—generally in about two weeks. To be eligible for a payday loan, a borrower needs only a checking account and a source of income, either from a job or government benefits, such as Social Security. The borrower provides the lender with a personal check for the amount of cash they are receiving that day, plus a fee. On their next payday, the borrower must return to the lender to pay back the loan. If the borrower does not do so, the lender can be repaid by cashing the borrower's personal check. Since many borrowers do not have enough money from one paycheck to pay back their loan and meet their other obligations, they often must take out a new loan shortly after paying off the first, starting a cycle of borrowing.[1]

Officially called deferred deposit transactions, check cashers were first authorized to advance cash against a customer's personal check by a California law enacted in 1996.[2] Borrowers can take out a loan of up to $255 for a $45 fee, equating to a fee of $17.65 per $100. This means that the typical two-week payday loan in California carries a 459 percent annual percentage rate (APR).[3] By the end of 2006, there were nearly 2,500 payday lenders located throughout the state making $2.5 billion in payday loans a year.[4]

Payday borrowers are disproportionately African American and Latino

In California and elsewhere, a disproportionate share of payday borrowers come from communities of color.[5] The California Department of Corporations recently released a survey of payday borrowers showing that, while they represent about a third of the overall adult population, over half of payday borrowers are African American or Latino.

This disproportionate market share is even more significant in light of the fact that African Americans and Latinos are much less likely to have a checking account than whites—a basic requirement for getting a payday loan. The Federal Reserve's Survey of Consumer Finances found that 19.4 percent of non-white households do not have a bank account, compared to less than five percent of whites.[6] Since nearly one in five adult African American or Latino residents are not even eligible for a payday loan, it is striking that they make up such a large share of borrowers. Table 1 demonstrates that while less than five percent of payday loan-eligible adults in California are African American, they make up 18.7 percent of all payday borrowers. Similarly, 25.6 percent of payday loan-eligible adults are Latino, but they represent about 37 percent of payday borrowers. In contrast, white borrowers represent 44.5 percent of the eligible population, but just 36 percent of borrowers.

While they represent about a third of the overall adult population, over half of payday borrowers are African American or Latino.

Table 1: Disproportionate use of payday loans by African Americans and Latinos

	Percent unbanked	California adult population*	California adult population potentially eligible for payday loan**	Payday loan borrowers
African Americans	19.4%	5.9%	4.8%	18.7%
Latinos	19.4%	31.8%	25.6%	37.0%
Whites	4.5%	46.6%	44.5%	36.1%

*The remaining 8% of payday loan borrowers are Asian, American Indian, Hawaiian/Pacific Islander, or of another race/ethnicity. Analysis of payday loan borrowers and race/ethnicity statistics done by the California Budget Project.[7]

**We assume that adults are only eligible for a payday loan if they have a bank account, since the lender requires a personal check from the borrower to be held as collateral.

Payday lending is destructive to households' well-being

The deregulation of credit has given lenders the incentive to develop new products. In the past, the fact that African Americans and Latinos were being offered these and other loans would be seen as a positive step away from redlining and towards a full "democratization of credit."[8] However, the recent subprime lending and foreclosure crisis has increased awareness that the interest rate and terms on which credit is offered can be as important as the credit itself. As a result, policymakers appear to be more willing to question whether the credit extended is ultimately helpful or harmful. More specifically, there is a renewed focus on a return to ensuring borrowers have the ability to repay loans.

A wide range of research has concluded that while payday loans may bridge a short-term gap, these loans cause longer-term financial harm. While some researchers have posited that the availability of payday loans can be positive for consumers, most of this research draws conclusions from broad state-level outcomes rather than examining the consequences for actual payday borrowers.[9] Analyses reviewing payday borrower data and industry records conclude that: (1) the vast majority of borrowers using payday loans are long-term users,[10] (2) payday lenders are dependent on these long-term users for the bulk of their revenues;[11] and (3) long-term payday loan usage has negative consequences for borrowers, leaving them worse off than they would be otherwise.[12] Finally, emerging payday borrower survey and focus group research indicates that payday loans are more typically taken because of chronic financial shortfalls in which a borrower's expenses regularly exceed their income, rather than specific financial emergencies.[13] This brings into question whether a payday loan—or any type of debt—is the best strategy for borrowers facing such challenges.

A wide range of research has concluded that while payday loans may bridge a short-term gap, these loans cause longer-term financial harm.

If payday loans have such potential to be destructive to a household's finances, why are African Americans and Latinos more likely to borrow from these high-cost lenders? Do they have characteristics that make them more likely to demand these loans, or do payday lenders intentionally target minority families?

Previous research on payday lending locations

To answer this question, a variety of researchers have examined the patterns of payday storefront locations. These studies have consistently found that payday lenders tend to locate their stores in or near communities of color. In 2005, a Center for Responsible Lending analysis of payday lender locations in North Carolina found that African American neighborhoods have three times as many payday lending stores per capita as white neighborhoods.[14] This disparity was shown to increase as the relative concentration of African Americans grew. An analysis controlling for a variety of other factors demonstrated that this disparity of payday lender locations could not be explained by income levels, homeownership rates, poverty, unemployment, whether the area was urban or rural, age of the population, education level, or gender mix.[15]

Another study, looking at the location patterns of both payday lenders and banks in North Carolina, found similar patterns, with the author noting that after controlling for other variables, "a one percentage point increase in the population that is [B]lack will reduce the number of banks by one percent and increase the number of payday lenders [in a given zip code] by one percent."[16] Likewise, a study of Washington State payday lenders concluded that "payday businesses do intentionally target localities with a high percentage of African Americans."[17]

In response to these findings, payday lenders deny targeting minority neighborhoods. Instead they claim to place their storefronts based on factors commonly used by other retail businesses. They also contend that they locate in areas neglected by mainstream financial institutions, filling a niche for the underserved.

In this paper, we seek to add to this growing discussion of *whether* and *why* the relative concentration of African American and Latino households is a factor that influences the location and clustering of payday lending locations.

We first examine the location of payday lenders, comparing their proximity to, and concentration in, African American and Latino communities relative to neighborhoods made up of primarily white households. To determine if payday lenders are serving areas that banks have neglected, we perform this same analysis on bank branch locations, incorporating neighborhood race and ethnicity to determine whether banks appear to be systematically under-serving such areas. A regression analysis is performed to isolate the effects of racial and ethnic composition from other variables.

Next, we determine the key factors explaining the location of mainstream financial institutions and see whether payday lenders follow the same location model, or if different factors better explain where they locate.

After generally finding that payday lending stores are disproportionately located near and concentrated in and around African American and Latino neighborhoods, we discuss the possible factors that allow payday lenders to flourish even in the presence of mainstream banking alternatives. In part, we hypothesize that the payday lending industry exploits the preferences and fears of underbanked[18] African American and Latino households. Finally, we conclude with policy recommendations.

METHODOLOGY

Hypotheses

The location of financial services firms like payday lenders reflects both the demand for and supply of credit. Firms make decisions on where to locate based on estimates of market potential. While technological advances have the potential to make geography less relevant, physical location remains a paramount consideration for payday lenders. Since payday lenders typically offer identical products at identical prices, the ability to locate close to potential customers is critical. In a survey of California payday borrowers, the leading reason a customer chose a particular store was because they "saw a payday location and went in."[19]

Since payday lenders typically offer identical products at identical prices, the ability to locate close to potential customers is critical.

The effectiveness of marketing and actual usage of a particular product may differ dramatically among various neighborhoods. Therefore, payday lenders likely need to take additional steps to determine which set of neighborhood characteristics increase their chances for success. The central purpose of this paper is to understand how race and ethnicity influence this last determination for payday lenders and how that relationship contrasts with factors influencing the same decision by banks.

Because the close proximity of a payday lending store makes customers more likely to visit, we expect that new payday lending storefronts are more likely to be placed in neighborhoods that are closer to existing payday lenders to compete for the same group of people. Once the concentration of payday lenders saturates to a certain level, newcomers must explore opportunities in other neighborhoods. So, we examine both distance and clustering of payday lending storefronts.

The spatial distribution of payday shops and bank branches are not isolated from each other. In a simplified framework, if they compete for the same group of customers, their location will be determined by the same set of neighborhood characteristics. If, on the other hand, they serve different customers, payday shops might be placed in neighborhoods underserved by traditional financial institutions such as banks and credit unions. This is a simplified framework because it does not differentiate between potential and realized customer bases. One neighborhood may have the same potential customer base for a payday store and a bank branch. However, their realized customer bases may differ in size because—in a given neighborhood—a bank's and payday lender's marketing effectiveness may be dramatically different. In any case, a systematic comparison of the spatial distribution of the two will shed light on these questions.

This comparative study will also provide answers to another question: do payday lenders place their storefronts based mainly on the factors commonly used by other retail financial institutions? If they do, then the same set of factors might explain the location of bank branches. In addition, we can also test whether payday lenders intentionally place storefronts at locations neglected by mainstream financial institutions by including locations of bank branches as an independent variable into the model we use to study the location of payday stores.

Data and Methods

This section summarizes data sources and methods used in the study. For a full treatment, see Appendix 1.

Our data are drawn from the following sources: payday lending storefront data from the California Department of Corporations; data on offices and branches of FDIC-insured banks from the Federal Deposit Insurance Corporation (FDIC); census block group-level data on the number of retail employees from the 2000 Census Transportation Planning package; and census block group-level demographic and economic data from the 2000 Census.

To examine whether California payday lenders tend to locate their stores in or closer to areas with different racial and ethnic compositions, for each census block group we summarize the spatial distribution of all the payday lending storefronts around it into two components: the distance from the center of the census block group to the nearest payday lender and the concentration of payday lenders around the census block group. Census block groups are subsets of census tracts generally consisting of about 1,500 people, which we refer to as "neighborhoods" throughout this paper.

Because the vast majority of payday lenders are located in metropolitan, rather than rural, areas, we limit our final analysis to census block groups with at least 500 persons that are located within the 16 metropolitan statistical areas (MSAs) in California. Of the 2,480 payday lending licensees in California as of October 2007, 2,252 are located within these metropolitan areas. Table A1 in Appendix 1 lists the number of payday lending licensees and the number of census block groups for each MSA, as well as the median distance to the nearest payday lending storefront in each of these metropolitan areas. To make the distance and concentration measurements of different MSAs comparable for our analysis, they are normalized with a zero mean and unit standard deviation by MSA.

To study the factors that influence the location and concentration of payday shops and bank branches, we employ regression models with distance and concentration specified as dependent variables and neighborhood characteristic variables as explanatory variables.

First, we include variables which determine whether households would be eligible for or demand a payday loan. Payday lenders would presumably want to locate in areas where there is not only a sizable population (particularly of adults, who can contract to enter into a loan); they would also want to be near people who are eligible for and demand their product. These demand-side variables are listed below:

- Total population
- % of population age 18 or older
- Median household income
- Poverty rate
- % of population with at least a high school diploma
- Unemployment rate
- Homeownership rate

Second, since payday lending storefronts can only be located in areas with proper zoning and retail space, we control for the total retail employees in the area, which serves as a proxy for the existence of retail centers.

Finally, we explore three additional demographic factors below, which we would not expect to increase eligibility or demand for payday loans to test whether they, nevertheless, are explanatory factors for payday lending location decisions.

- % of the population that is African American or Latino
- % of the population that is non-English speaking
- % of the population that is male (gender)

In addition to these variables, we incorporate the location of bank branches in the models that explore the location and concentration of payday lenders to control for the supply of credit offered by competing financial services providers.

To examine the relationship between the proximity and concentration of the nearest payday lending storefronts and neighborhood characteristics, we created quintiles for each neighborhood characteristic variable and treated them as ordered categorical variables with five orders, namely: low, medium-low, medium, medium-high, and high.

Because the neighborhood characteristics can vary greatly among different areas of California, we construct these quintiles for each MSA to reflect the varying relative feature of the measurements. For example, racial and ethnic compositions can vary greatly among the different metropolitan areas of California. In the Chico-Paradise MSA, there are relatively few African Americans and Latinos in the overall population compared to much of the state. In this MSA, census block groups with African Americans and Latinos making up at least 17.4 percent of the total population have a relatively high minority concentration. In contrast, African-Americans and Latinos make up a far greater share of the population in Los Angeles. Therefore, African Americans and Latinos must make up at least 83.4 percent of the population in census block groups in the Los Angeles-Riverside-Orange County MSA for these neighborhoods to be considered high-minority areas. For full breakdowns of African American or Latino concentration by quintiles for each metropolitan area, see Table A2 in Appendix 1.

Table 2. Breakdowns of African American or Latino concentration by quintiles for the Los Angeles-Riverside-Orange County MSA and Chico-Paradise MSA

MSA	Low	Medium Low	Medium	Medium High	High
Chico-Paradise	0–4.6%	4.6–7.6%	7.6–12.1%	12.1–17.4%	17.4%+
Los Angeles-Riverside-Orange County	0–13.1%	13.1–29.5%	29.5–54.9%	54.9–83.4%	83.4%+

Note: Indicated ranges are inclusive of lower bound and exclusive of upper bound.

For a valid regression model, the observations should be independent from each other. Otherwise, corrections should be made. In our study, census block groups are spatially correlated to each other. For example, if one block group is close to a payday lender, its neighboring block group tends to be close to the payday lender too. Specific steps are followed to correct the spatial correlations between census block groups, which should make the regression models statistically valid. The same type of analysis was repeated with bank branch data.

For more details on methods used and a discussion of the limitations of our analysis, see Appendix 1.

FINDINGS

Finding 1: Payday lenders are nearly eight times as concentrated in neighborhoods with the largest shares of African Americans and Latinos as compared to white neighborhoods, draining nearly $247 million in fees per year from these communities.

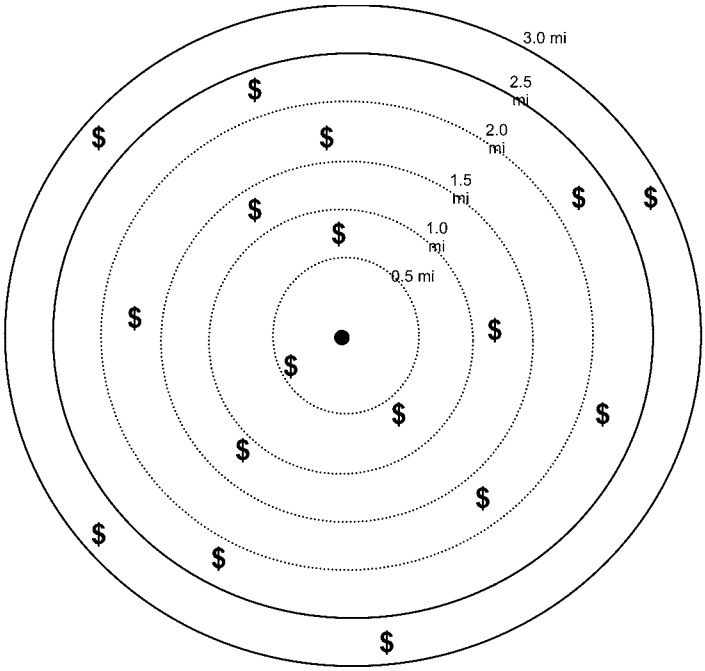
A comparison of the distance to the nearest payday store among neighborhoods of varying racial and ethnic composition reveals that payday lenders are located closer to African American and Latino communities than communities that are primarily made up of white households.

Our analysis finds that neighborhoods with the greatest concentration of African Americans and Latinos are about two and a half times closer to the nearest payday lender than neighborhoods with the fewest African Americans and Latinos.

Not only are payday lending storefronts located in or closer to communities of color, payday lenders also tend to cluster in these areas, with more stores in a given African American and Latino neighborhood than a neighborhood with a greater share of white households. Payday lenders are nearly eight times as concentrated in neighborhoods with the largest share of African Americans and Latinos as areas with the lowest concentrations of these groups.

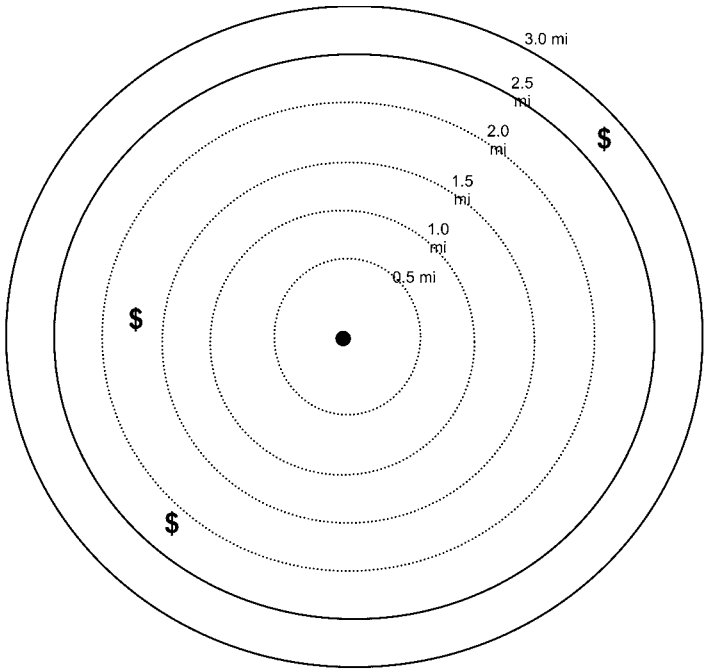
Figure 1 provides an example of this variation between the neighborhoods with the highest and lowest shares of African Americans and Latinos, labeled "African American/Latino" and "white," respectively. Each concentric circle represents a distance from the center of the neighborhood, with the closest ring a half mile away and the farthest ring three miles away. The "African American/Latino" neighborhood's nearest payday lender is within a half mile of the neighborhood center; while the nearest payday lender to the "white" neighborhood is 1.5 to two miles away. In addition, there are many more payday lenders clustered around African American and Latino neighborhoods.

Figure 1: Proximity and clustering of payday lenders to African American/Latino and white neighborhoods



African American/Latino Neighborhood

$ = Payday Lending Storefront
• = Neighborhood Center

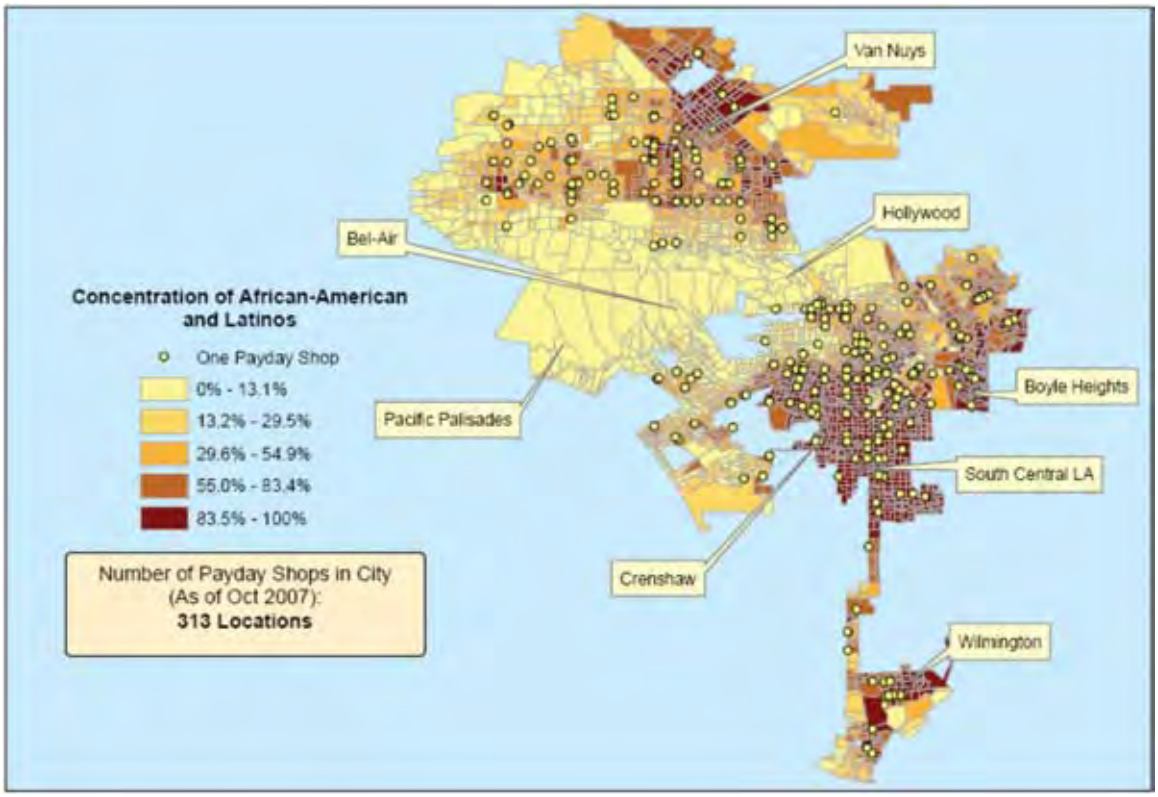


White Neighborhood

$ = Payday Lending Storefront
• = Neighborhood Center

In order to visualize the "real world" impact of these findings, we can imagine driving through two neighborhoods within a large metropolitan area. The first has one of the highest concentrations of African Americans and Latinos in the area; the second has the fewest. A drive through that first neighborhood would reveal many more payday lending stores in and near the area, as compared to the second neighborhood which is largely made up of white households. The following map shows the greater proximity and concentration of payday lenders to African American and Latino areas in one particular city, Los Angeles. Maps of other cities and metropolitan areas in Appendix 2 provide further illustration of how payday lenders largely cluster in African American and Latino neighborhoods.

Figure 2: Payday lender locations in Los Angeles



This clustering of payday lending storefronts results in the draining of nearly $247 million in fees from African American and Latino households in California. The Department of Corporations reported that just over 10 million loans were made in 2006, with an average loan size of $254. Since payday lenders can charge up to $17.65 per $100 borrowed, we estimate a fee of $44.83 per loan. Overall, we estimate that over $450 million in payday loan fees are paid annually in California. Because African Americans and Latinos make up about 55 percent of all payday loan borrowers in California, we assume they then pay approximately 55 percent of the fees, or about $247 million a year.

Table 3: Cost of payday loans to African American and Latino households

(A) Average fee per loan	$44.83
(B) Total number of loans (2006)	10,048,422
(C) Total fees paid (A*B)	$450,470,758
(D) Total fees paid by African Americans and Latinos	$246,857,976

Comparing payday lending and bank branch locations

Payday lending advocates often cite the disinvestment of banks and other mainstream financial institutions in communities of color as the reason for payday lenders moving in to these neighborhoods; they claim that while payday borrowers do have checking accounts, they may not benefit from having convenient nearby banking options. However, recent research mapping bank locations has called this assumption into question. For example, research from the Brookings Institution has found that banks and payday lenders generally locate in the same neighborhoods, and 95 percent of payday lenders are located within a mile of a bank or credit union.[20] Overall, the study shows that while payday lenders tend to overwhelmingly locate in lower-income areas, banks and credit unions locate in neighborhoods of all income levels.

Our analysis sheds further light on this issue. If we add up the number of payday lenders within two miles of a neighborhood's center (by adding 1 + 2 + 3 + 3 in the first four columns together, as highlighted below), we find there are nine payday lenders in a neighborhood with highest concentration of African Americans and Latinos, but only one payday lender in a neighborhood with the lowest concentration (as shown below, there are no payday lenders on average between 0-1.5 miles away, and only one 1.5-2 miles away). Turning to bank branch locations, there are seven bank branches within two miles of the center of the highest minority concentration neighborhood, and just slightly more—nine—bank branches within the same distance of the lowest minority concentration neighborhood. Thus, while there are slightly fewer bank branches in African American and Latino neighborhoods, we cannot conclude that these areas lack banks.

Table 4. Spatial distribution of payday lenders/bank branches and neighborhood minority concentrations in California.

	Relative Concentration of African Americans and Latinos in Neighborhood	Median number of payday shops/bank branches surrounding the neighborhood by distance ranges from the neighborhood center					
		0 to 0.5 miles	0.5 to 1 miles	1 to 1.5 miles	1.5 to 2 miles	2 to 2.5 miles	2.5 to 3 miles
Payday Lenders	High	1	2	3	3	4	4
	Medium High	0	1	2	2	3	3
	Medium	0	1	2	2	2	2
	Medium Low	0	0	1	1	2	2
	Low	0	0	0	1	1	1
Bank Branches	High	0	1	3	3	4	6
	Medium High	0	2	2	3	4	5
	Medium	0	2	3	4	4	5
	Medium Low	0	2	3	4	5	5
	Low	0	2	3	4	5	5

Finding 2: Even after controlling for income and a variety of other factors, payday lenders are 2.4 times more concentrated in African American and Latino communities. On average, controlling for a variety of relevant factors, the nearest payday lender is almost twice as close to the center of an African American or Latino neighborhood as a largely white neighborhood.

While the disparity of payday lending locations among various neighborhoods is interesting, we need to investigate the extent to which factors other than race and ethnicity explain the location of payday lenders. We first look at factors that impact household eligibility and demand for a payday loan. For example, payday loan applicants need a source of income, such as a job, so we look at the unemployment rate. In addition, we look at the median household income, poverty rate, and educational attainment, since payday borrowers typically have low- to moderate-incomes, and because higher education levels yield better paying job opportunities. Since homeownership would likely suppress the demand for payday loans because of the availability of other credit options by tapping home equity, we also take into account the homeownership rate. Finally, a payday lender can increase their potential customer base by locating in areas an area with a significant population, particularly those areas with adults (age 18 or older) that can legally contract for a payday loan, so we include these variables. In addition to locating near potential borrowers, payday lenders will also need to be located in a retail area, so we control for the amount of retail space in various neighborhoods by measuring the total number of retail employees.

The other variables we include—gender, race/ethnicity, and non-English speakers—are different in that we would not expect them to impact whether a payday lender would want to locate in a particular area. All else being equal, whether a person is male or female, black or white, or speaking English or another language should not affect their demand for a payday loan. Because of this, it is instructive to see whether these factors which we would not expect to influence payday lender location are significant in our analysis.

Overall, we found that payday lenders tend to locate in closer proximity to neighborhoods with a higher proportion of people of color, renters, adults, lower educational attainment, and non-English speakers. Similarly, payday lenders locate closer to areas with higher rates of poverty, higher rates of retail employees (and thus more retail locations), and higher unemployment. These findings are consistent with the payday lending business model as articulated in many surveys and literature, which notes that payday loans are used more frequently by low- to moderate-income renters.[21]

The full results are summarized in the tables below. Table 5 provides a comparison between the low quintile and other quintiles (medium-low, medium, medium-high, and high) for each variable. If we observe a result of 1.00, we would find no difference between the two quintiles measured. For variables with distance ratios above 1.00, as they increase (increased median household income, for example), the distance to the nearest payday lender increases. Conversely, those variables with distance ratios below 1.00 become closer to the nearest payday lender as they increase, as is the case for African Americans and Latinos. For example, if we look at the variable measuring the share of African Americans and Latinos in a neighborhood, we see that neighborhoods with the highest share of African American and Latinos are about half as far (0.54) from the nearest payday lender, compared to neighborhoods with the lowest share of African Americans and Latinos.

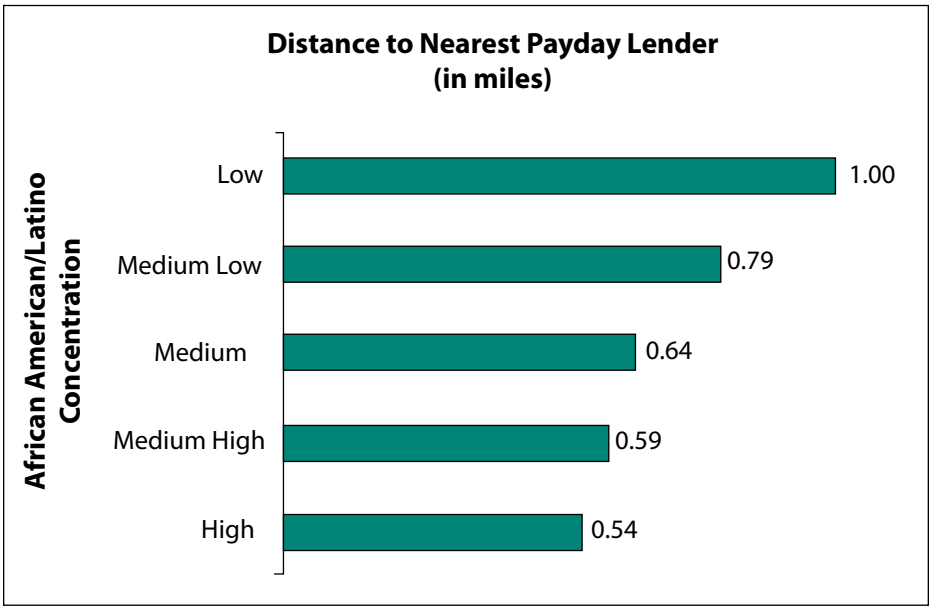
Table 5. Distance to the nearest payday lender: Fixed effect results for mixed regression, controlled for bank branch location

Distance Ratios between two levels of explanatory variables				
Explanatory Variable	High vs. Low	Medium High vs. Low	Medium vs. Low	Medium Low vs. Low
% African American and Latino	0.543***	0.587***	0.643***	0.788***
% Adult Population	0.874***	0.881***	0.907***	0.957***
% Non-English Speaker	0.975	0.944***	0.963*	0.966*
% with High School Diploma	1.427***	1.179***	1.087***	1.045*
Median Household Income	1.211***	1.057*	1.065***	1.079***
% Male Population	1.009	0.994	0.992	1.024
% of Homeowners	1.214***	1.227***	1.234***	1.164***
% Below Poverty	0.891***	0.941***	0.950***	1.01
Total Number of Retail Employees	0.891***	0.897***	0.923***	0.965*
Total Number of Population	1.092***	1.043***	1.057***	1.002
% Unemployed	0.979	0.958**	0.950***	0.979
Bank Branch Distance				1.221***

Note: *= statistically significant at the 95% level (p≤0.05)
**= statistically significant at the 99% level (p≤0.01)
***= statistically significant at the 99.5% level (p≤0.005)

We can also look at this information graphically, broken down by neighborhoods of varying concentrations of African Americans and Latinos. As shown below, the neighborhoods with the lowest minority concentration are a longer distance (one mile away) from the nearest lender, with this distance gradually decreasing to a little over a half a mile away as the concentration of African Americans and Latinos grows.

Figure 3: Miles to the nearest payday lender from the center of neighborhoods with varying African American and Latino concentration, controlling for other demographic and economic variables



Similar to the table above, Table 6 reports the concentration of payday lending locations in the lowest quintile compared to the others. In this case, we see that payday lenders are 2.4 times more concentrated in neighborhoods with the highest share of African Americans and Latinos than those neighborhoods with the lowest share.

Table 6. Concentration of payday lenders: Fixed effect results for mixed regression, controlled for bank branch location

Concentration Ratios between two levels of explanatory variables				
Explanatory Variable	High vs. Low	Medium High vs. Low	Medium vs. Low	Medium Low vs. Low
% African American and Latino	2.442***	2.068***	1.759***	1.316***
% Adult Population	1.161***	1.141***	1.086***	1.023
% Non-English Speaker	1.023	1.088***	1.071***	1.037*
% with High School Diploma	0.660***	0.801***	0.885***	0.942***
Median Household Income	0.852***	0.946*	0.938***	0.913***
% Male Population	0.975	1.009	1.021	0.986
% of Homeowners	0.921***	0.869***	0.846***	0.882***
% Below Poverty	1.214***	1.106***	1.066***	1.008
Total Number of Retail Employees	0.991	1.060***	1.071***	1.030*
Total Number of Population	0.914***	0.961**	0.958***	1.016
% Unemployed	1.056***	1.069***	1.052***	1.02
Bank Branch Concentration				1.545***

Note: *= statistically significant at the 95% level (p≤0.05)
**= statistically significant at the 99% level (p≤0.01)
***= statistically significant at the 99.5% level (p≤0.005)

The table below further summarizes our findings of payday lending storefront concentration:

Table 7. Clustering of Payday Lending Locations

High minority neighborhoods	2.4 times more concentrated than white neighborhoods
Medium-high minority neighborhoods	2 times more concentrated than white neighborhoods
Medium minority neighborhoods	1.8 times more concentrated than white neighborhoods
Medium-low minority neighborhoods	1.3 times more concentrated than white neighborhoods

Because we are modeling results isolating race and ethnicity while holding all other factors constant, we cannot see these findings just by driving through an African American or Latino neighborhood, compared to a white neighborhood. Rather, we have to imagine two neighborhoods that are identical in all but their racial and ethnic compositions. In this context, our model reveals that a neighborhood with large numbers of African Americans and Latinos that is otherwise indistinguishable from a white neighborhood will still have a greater concentration of payday lenders located in or near the area.

In sum, controlling for these other factors, we still find a meaningful disparity in proximity and concentration of payday lending locations. For example, when we compare the neighborhoods with the highest and lowest shares of African Americans and Latinos, we find that African American and Latino neighborhoods have a 2.4 times greater concentration of payday lending storefronts. Also, the nearest payday lender to the center of an African American or Latino neighborhood is located nearly twice as close relative to a neighborhood with the fewest African Americans and Latinos.

A neighborhood with large numbers of African Americans and Latinos that is otherwise indistinguishable from a white neighborhood will still have a greater concentration of payday lenders located in or near the area.

Therefore, we can conclude that payday lending storefronts are located closer to and cluster in neighborhoods with the largest shares of African Americans and Latinos, even when we account for a variety of demographic and economic variables that might otherwise explain the location decisions of payday lenders.

Comparing our results to bank branch locations

Turning our analysis back to the comparison of bank branch and payday lending locations, we again examine the proximity and concentration of bank branches in neighborhoods of varying racial and ethnic compositions—this time controlling for the same demographic and economic variables used in the payday lender location regression model. The tables below shows our full model results for bank branch proximity and concentration.

Similar to our payday lending location analysis, if we observe a result of 1.00, we would find no difference between the two quintiles measured. We observe that the neighborhoods with the highest shares of African Americans and Latinos are only 1.113 times farther away from the nearest bank than neighborhoods with the lowest levels of these groups, once we control for all other variables. In Table 9, we also find small differences in bank branch concentrations in neighborhoods with varying levels of African Americans and Latinos.

Table 8. Distance to the nearest bank branch: fixed effect results for mixed regression

Distance Ratios between two levels of explanatory variables				
Explanatory Variable	High vs. Low	Medium High vs. Low	Medium vs. Low	Medium Low vs. Low
% African American and Latino	1.113***	1.106***	1.088***	1.004
% Adult Population	0.716***	0.785***	0.822***	0.881***
% Non-English Speaker	0.704***	0.811***	0.876***	0.946***
% with High School Diploma	0.935*	0.948	0.948*	0.976
Median Household Income	0.989	0.975	0.988	1.02
% Male Population	1.110***	1.091***	1.053***	1.044***
% of Homeowners	1.701***	1.604***	1.459***	1.243***
% Below Poverty	1.032	0.992	0.988	0.982
Total Number of Retail Employees	0.602***	0.773***	0.899***	0.967*
Total Number of Population	1.265***	1.151***	1.110***	1.060***
% Unemployed	1.041*	1.008	0.984	1.005

Note: *= statistically significant at the 95% level (p≤0.05)
**= statistically significant at the 99% level (p≤0.01)
***= statistically significant at the 99.5% level (p≤0.005)

Table 9. Concentration of bank branches: fixed effect results for mixed regression

Concentration Ratios between two levels of explanatory variables				
Explanatory Variable	High vs. Low	Medium High vs. Low	Medium vs. Low	Medium Low vs. Low
% African American and Latino	0.966	0.879***	0.866***	0.948***
% Adult Population	2.105***	1.732***	1.523***	1.279***
% Non-English Speaker	2.215***	1.698***	1.394***	1.167***
% with High School Diploma	1.218***	1.143***	1.110***	1.064***
Median Household Income	1.272***	1.189***	1.093***	0.982
% Male Population	0.851***	0.873***	0.913***	0.934***
% of Homeowners	0.427***	0.452***	0.526***	0.687***
% Below Poverty	1.057*	1.047*	1.038*	1.024
Total Number of Retail Employees	1.719***	1.311***	1.127***	1.048***
Total Number of Population	0.688***	0.798***	0.843***	0.916***
% Unemployed	0.896***	0.964*	0.991	1.003

Note: *= statistically significant at the 95% level (p≤0.05)
**= statistically significant at the 99% level (p≤0.01)
***= statistically significant at the 99.5% level (p≤0.005)

We find that banks are only slightly farther away from areas with the highest share of African Americans and Latinos when compared to neighborhoods with the lowest levels of these minority groups. We also find that, though there is somewhat greater concentration of banks within areas with the smallest share of African Americans and Latinos, the disparities between these neighborhoods are much less significant than our findings on payday lending store locations. Therefore, we conclude that while a relatively small variance in the proximity and concentration of bank branches between high and low minority neighborhoods exists, race and ethnicity are not an important consideration in the location of bank branches. Finally we observe that a neighborhood's distance to bank locations and the concentration of bank branches are inversely related to the homeownership rate in an area, and are correlated with our retail proxy. This suggests that, all else being equal, banks tend to favor commercial neighborhoods.

Finding 3: Race and ethnicity play a far less prominent role in the location of mainstream financial institutions, such as bank branches. While race and ethnicity account for over half of the variation in payday lender location explained by neighborhood factors, they explain only one percent of the variation in bank branch locations.

Our analyses above show that while payday lenders are concentrated in African American and Latino neighborhoods, bank branches are more evenly distributed among areas of varying racial and ethnic composition. We now examine how each variable described in the previous section contributes to our model. Our analysis shows the extent to which each of these factors predict the proximity to and concentration of bank branches and payday lenders for a particular neighborhood.

First looking at bank branches, those variables with larger F values in Table 10 below, such as the share of the population that are homeowners or the number of retail employees, are far more important factors in explaining the location of banks than those variables with smaller F values, such as the poverty or unemployment rate.

We find that (1) the number of retail employees, which is our proxy for the degree to which the area has retail centers; (2) the area's homeownership rate; and (3) the share of the population which is at least 18 years old (ie: an adult) explain over three-quarters of our bank branch location model.[22]

Table 10. Bank Branch Distance and Concentration, F Values

Explanatory Variable	Bank Branch Distance	Bank Branch Distance
% African American + Latino	10.24 (1.25%)	23.59 (1.21%)
% Adult Population	85.81 (10.51%)	431.24 (22.14%)
% Non-English Speaker	59.50 (7.29%)	304.43 (15.63%)
% with High School Diploma (Educational Attainment)	1.48 (0.18%)	10.83 (0.56%)
Household Income	1.89 (0.23%)	34.86 (1.79%)
% Male Population	14.67 (1.80%)	34.30 (1.76%)
% of Homeowners	190.95 (23.39%)	511.87 (26.27%)
% Below Poverty	1.87 (0.23%)	1.69 (0.09%)
Total Number of Retail Employees	382.88 (46.89%)	420.46 (21.58%)
Total Number of Population	63.83 (7.82%)	160.22 (8.22%)
% Unemployed	3.39 (0.41%)	14.67 (0.75%)

Notes: Numbers inside parentheses are percentages of the total variation explained by each explanatory variable.

This differs markedly from the factors that best explain the location of payday lending storefronts. A small number of variables explain over three-quarters of the variation in payday lender storefront location captured by neighborhood factors in our models: (1) the neighborhood's share of African Americans and Latinos; (2) the percent of the population with at least a high school diploma (educational attainment); and (3) the homeownership rate. The racial and ethnic make-up of the neighborhood alone accounts for over half of the variation in payday lender location explained by neighborhood factors in our models, including two-thirds of payday lender clustering. In contrast, the share of African Americans and Latinos in the neighborhood explains only a little over one percent of the variation in bank branch location.

Table 11. Payday Lender Distance and Concentration, F Values

Explanatory Variable	Payday Lender Distance controlled for Bank Branch location	Payday Lender Concentration controlled for Bank Branch location
% African American and Latino	206.98 (51.83%)	382.90 (66.47%)
% Adult Population	18.46 (4.62%)	22.03 (3.83%)
% Non-English Speaker	3.17 (0.79%)	7.91 (1.37%)
% with High School Diploma (Educational Attainment)	57.21 (14.33%)	65.77 (11.42%)
Household Income	21.42 (5.37%)	16.14 (2.80%)
% Male Population	1.61 (0.40%)	2.97 (0.52%)
% of Homeowners	42.88 (10.74%)	29.77 (5.17%)
% Below Poverty	9.19 (2.30%)	18.68 (3.24%)
Total Number of Retail Employees	23.13 (5.79%)	11.18 (1.94%)
Total Number of Population	11.68 (2.93%)	13.57 (2.35%)
% Unemployed	3.59 (0.90%)	5.16 (0.89%)
Bank Branch Distance/Concentration (1STD)	1517.48 (79.17%)	6005.33 (91.25%)

Notes: Numbers inside parentheses are percentage of total model-explained variation attributable to each explanatory variable. While bank branch parenthetically-indicated results relate to proportion of the total explanation, the other variables relate to the total model-explained variation excluding the bank branch variable.

These results are also shown graphically below:

Figure 4: Top neighborhood factors explaining payday lender storefront proximity

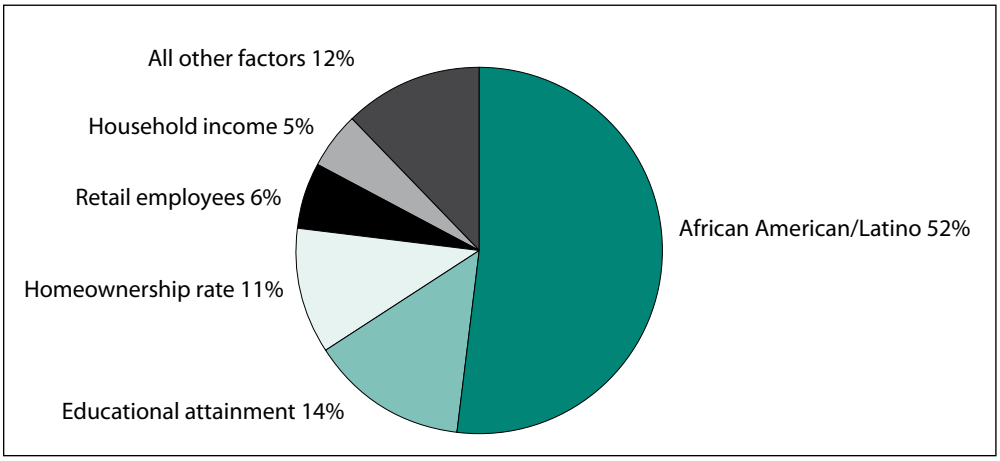
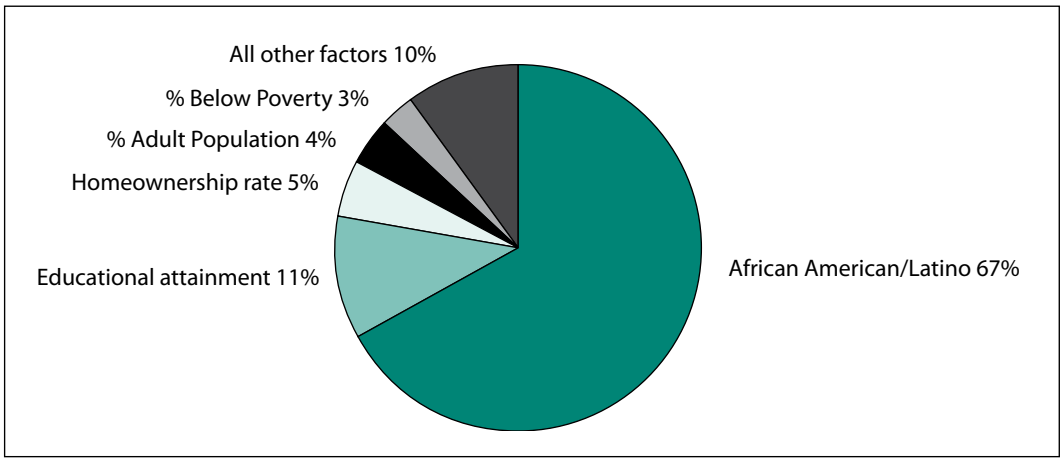


Figure 5: Top neighborhood factors explaining payday lender storefront concentration



In summary, since banks and payday lenders are both financial service providers that offer retail locations for their customers to conduct transactions, we might expect both types of institutions to follow similar patterns in their location decision-making. However, we find that the factors explaining payday lender location are quite different than those which predict bank branch location.

Table 12: Top three neighborhood factors explaining variation in bank location vs. payday lenders

Bank proximity and concentration	Payday lender proximity and concentration
1. Total number of retail employees	1. % African American or Latino
2. Homeownership rate	2. % with at least a high school diploma
3. % of population 18 or older	3. Homeownership rate

DISCUSSION

Our analysis demonstrates that payday lenders cluster in closer proximity to neighborhoods with the greatest concentration of African Americans and Latinos, and that this proximity exists even when controlling for a wide variety of demographic and economic variables. This is likely a key reason that African Americans and Latinos make up a disproportionate share of total payday borrowers. But what leads payday lenders to locate in these areas? In this section, we explore how payday lenders market their product in ways that may be particularly attractive to underbanked African Americans and Latinos, thus causing financial hardship in these communities.

Attracting underbanked African Americans and Latinos to payday loans

The design and marketing of payday loans appeal to the preferences and fears of the underbanked generally, and may be especially attractive to underbanked African Americans and Latinos. Payday lenders market three key features of their loans products: (1) the speed and convenience of getting a payday loan; (2) the assured approval of almost anyone with a checking account and source of income; and (3) the *seemingly* clear pricing of a simplistic, short-term product with no hidden or complex fees. These features are discussed in further detail below.

First, since conventional underwriting—an evaluation of the borrower's ability to repay a loan based on income and expenses—is not done in payday lending, the process is quick and convenient. In a recent survey of the underbanked, the top preference of respondents' satisfaction was timeliness.[23] While the cost of a payday loan ranks among the elements for which payday customers are least satisfied, the ease of taking out a loan is generally the most attractive feature.[24] As noted previously, locating a store near a potential consumer's home can be a key factor in getting them to try an initial loan, since borrowers report that they selected a payday lender after seeing the storefront presumably located in or convenient to an area they already frequent.[25]

Second, payday lenders can take advantage of a borrower's fear of being declined credit elsewhere, whether that fear is real or imagined. Research on perceptions of credit worthiness reveals that African Americans in particular tend to be overly pessimistic about their credit scores, potentially causing them to avoid prime lenders for fear of being denied a loan.[26] Payday lenders also build their customer base by rewarding current customers who refer them to friends and family members, often offering discounts on subsequent loans or other incentives.[27] These referrals from a trusted source are another leading determinant of people trying their first payday loan, ranking just second after the convenience of the location.[28] Getting a friend or family member's recommendation of a payday lender could sway someone weighing a variety of options to visit a payday lending storefront.

Finally, the underbanked population strongly prefers products with clearly stated terms and fees.[29] At least superficially, payday loans are simplistic, with a fixed fee per $100 borrowed for a two-week loan, without any additional charges if the loan is paid back on time. The price structure and marketing of payday loans encourages borrowers to rely on the fee per $100 borrowed to make price comparisons among payday loans and other options rather than more accurately comparing the annual percentage rates (APR). There is evidence that payday lenders de-emphasize the importance of APR. For example, respondents to a variety of surveys typically either could not recall the APR of a payday loan or reported an inaccurately lower rate closer to that of a credit card (20-30 percent APR) when in fact the typical payday loan is at least 10 times more expensive.[30] The result is that the borrower may mistakenly believe that the payday loan is a more affordable product than other available alternatives.

Creating a debt trap for African Americans and Latinos

The fact that payday lenders locate in African American and Latino neighborhoods to conveniently serve financially insecure families may sound simply like a business filling a niche. However, payday lending has a destructive effect on borrowers, and by extension, the communities in which they live.

While borrowers routinely report that they never intended to remain in payday lending debt long-term, the typical borrower is unable to pay back their loan without returning to the payday lender for another. Instead, after paying back the first loan, they often do not have enough of their paycheck remaining to make it through until their next payday, so they must take out a subsequent loan. Knowing this repeated borrowing dynamic is likely to occur, payday lenders often provide incentives for potential borrowers to take an initial loan, often offering the first loan for free or at a substantial discount.[31] California payday borrowers take out an average of ten loans per year.[32] Therefore, once a potential customer is lured into taking a payday loan—perhaps initially attracted by the convenient location and the advertised quickness and simplicity of the product—they become ensnared in the payday loan debt trap.

As noted previously, this repeated borrowing costs African Americans and Latinos in California almost $247 million in payday loan fees annually. The funds drained from these communities by payday lending could be saved or better spent on food, car repairs, medicine, housing, child care, education or other needs.

CONCLUSION & RECOMMENDATIONS

Since payday lenders do not compete on product or pricing, locating a store near people who are more likely to try this service—and then become trapped by repeat borrowing—is critical. We find that payday lenders tend to locate closer to and cluster in African American and Latino communities. Even when controlling for all other variables, race and ethnicity are among the most important factors explaining payday lending storefront locations. Mainstream financial service providers such as banks make their location decisions in a different manner. While they are slightly less likely to be located as close to or in as great of numbers in communities of color than predominantly white communities, the primary factors explaining their location are not tied to race or ethnicity.

Just like subprime adjustable rate mortgages initially seemed like a good deal for homeowners before they quickly became unaffordable, an initial payday loan is easy for a borrower to obtain, but the debt is difficult to ultimately retire.

This clustering of payday lenders results in African Americans and Latinos making up a disproportionate share of total payday borrowers in California. Because of this, their communities pay nearly $247 million to service payday loans each year. This drain on resources is not unlike the subprime mortgage loan crisis, with minority neighborhoods enduring the brunt of foreclosures, lost equity, and diminished property values. Just like subprime adjustable rate mortgages initially seemed like a good deal for homeowners before they quickly became unaffordable, an initial payday loan is easy for a borrower to obtain, but the debt is difficult to ultimately retire.

Policy Recommendation: Enact a comprehensive 36 percent small loan cap to protect borrowers from abusive products such as payday loans.

Our primary policy recommendation to address the abuses of high-cost payday loans is to enact a comprehensive interest rate cap on all small loan products. While a return to a more responsible small loan law would make a difference in the lives of all low- and moderate-income Californians facing financial shortfalls, it would provide particularly important aid to African American and Latino communities that are the most impacted by payday lending practices.

By enacting a rate cap, California would join 15 other states and the District of Columbia which have enacted comprehensive interest rate caps at or around 36 percent APR. Currently, about a third of the U.S. population is protected from loans at triple-digit rates. In some of these states, payday lending has never been legal; in others, payday loans were once made, but—after seeing the effects of high-cost loans on their citizens—policymakers chose to enact a rate cap. North Carolina is one of these states that once had payday lenders, but no longer does. A study of low- and moderate-income households in the state shows that North Carolinians with financial emergencies do not miss payday loans, but instead use a variety of other, often better, alternatives.[33] For example, credit products such as overdraft lines of credit, consumer finance installment loans, and credit card cash advances are used by households facing financial shortfalls in that state.

Similarly, the U.S. Department of Defense brought their concerns about servicemembers' use of payday loans and other high-cost credit to Congress because of the threat this debt was posing to security clearances and deployment schedules. Congress responded by passing a 36 percent APR rate cap for active duty military and their dependents, which President Bush signed into law in 2006. A progress report from the Department of Defense concluded that affordable loan options to the military increased after the cap and that military debt relief societies were able to reduce assistance given to indebted members of the military because of the reduction in payday loan usage.[34]

California could learn from these experiences at the state and national level, crafting an interest rate cap that allows for the continuation of responsible small loan products while discouraging predatory practices.

However, affordable credit products are not the only strategy needed to help households more effectively deal with a financial shortfall. The California Department of Corporations payday borrower survey illustrates that many borrowers are not taking out a payday loan because of a single financial emergency, but instead have expenses that regularly exceed their income.[35] For these households who may not be able to financially handle additional debt burdens at any interest rate, non-credit strategies may be more appropriate.[36]

To this end, efforts to help low- and moderate-income families build emergency savings should also be supported, perhaps through initiatives such as Bank on California. There is some evidence that a lack of savings may make it more likely that households seek out payday loans. For example, the Consumer Federation of America researchers found that families earning $25,000 per year with no emergency savings were eight times as likely to use payday loans as families in the same income bracket that had more than $500 in emergency savings.[37] Some financial institutions with locations throughout the state, such as Golden 1 Credit Union and BBVA Bancomer USA, offer innovative small loan products with built-in savings features that allow people to build up their savings while paying back a loan made on affordable terms.[38] Policies and programs that encourage and facilitate emergency savings among low- and moderate-income households would help alleviate the need for small loans, allowing households facing financial shortfalls to rely on their own savings rather than taking on additional debt.

Certainly, payday loans offered at triple-digit interest rates are not the answer for vulnerable households facing financial challenges. Rather, California should ensure that credit is only offered on reasonable terms, giving struggling families the opportunity to save and begin on a path to a more secure financial future.

APPENDIX 1: DETAILED METHODOLOGY AND LIMITATIONS

Data

We examine whether California payday lenders tend to locate their shops in or closer to neighborhoods with higher concentrations of African American and Latino residents than neighborhoods with predominantly white households. In addition to proximity, we also measure concentration, or the degree to which payday lenders cluster locations in areas with different racial and ethnic compositions.

Our data are drawn from the following sources: payday store data from the California Department of Corporations; data on offices and branches of FDIC-insured banks from the FDIC; census block group-level data on the number of retail employees from the 2000 Census Transportation Planning package; and census block group-level demographic and economic data from the 2000 Census.

Only payday stores recognized by the California Department of Corporations, the entity responsible for licensing, enforcement and regulation of payday lenders, were included in our data. As of October 2007, there were 2,480 stores licensed in the California. The street address of each store was geocoded to determine the store's location and proximity to the nearest census block group.

Because the vast majority of payday lenders are located in metropolitan, rather than rural, areas, we limit our final analysis to census block groups with at least 500 persons that are located within the 16 metropolitan statistical areas (MSAs) in California. The table below lists each MSA in our analysis, along with the distribution of payday lending licensees and census block groups among these areas.

Table A1: Metropolitan Statistical Areas included in analysis

	# of payday lending licensees	# of census block groups	Median distance (in miles) to the nearest payday lender
Bakersfield	63	274	0.706841
Chico-Paradise	18	135	0.760021
Fresno	112	464	0.592127
Los Angeles-Riverside-Orange County	1177	9363	0.675132
Merced	23	100	0.788407
Modesto	46	247	0.65945
Redding	15	48	0.968147
Sacramento-Yolo	161	891	0.710685
Salinas	12	132	1.302811
San Diego	198	1592	0.8289
San Francisco-Oakland-San Jose	301	4126	0.849689
San Luis Obispo-Atascadero-Paso Robles	13	102	0.875223
Santa Barbara-Santa Maria-Lompoc	20	268	1.135657
Stockton-Lodi	48	308	0.670126
Visalia-Tulare-Porterville	33	166	0.823675
Yuba City	12	62	1.000019

Once payday lending stores across the 16 selected MSAs were mapped, we obtained bank branch location data from the FDIC for these areas in order to compare payday lending and bank branch location.

Population data is aggregated at the census block level, the smallest geography covered by Census sample data. California has over 22,000 census block groups with an average population of around 1,500 people per group.

Methods

This section outlines the approach we use to measure the spatial distribution of payday shops or bank branches in a neighborhood, discusses a framework for examining which neighborhood factors might influence the location of a payday shop or bank branch, and lays out the analytical frameworks we use to explore the relationship between neighborhood characteristics and the location of a payday shop or bank branch.

1. Measuring spatial distributions of payday shops and bank branches

For each census block group, we summarize the spatial distribution of all the payday shops around it into two components: the distance from the center of the census block group to the nearest payday shop and the concentration of payday shops around the census block group.

First, each payday shop location is geo-coded with a latitude and longitude. Let $i \in \{1,...,I\}$ be the ith payday shop in MSA k, $k \in \{1,...,16\}$. Let Aik and Bik be the latitude and longitude in radians of the payday shop. Similarly the center of each of the census block groups for the state is geo-coded with a latitude and longitude. Let $j \in \{1,...,J\}$ be the jth census block group in MSA k. Let Cjk and Djk be the latitude and longitude in radians of the census block group. Then the spherical distance between payday shop i and the center of the census block group j can be calculated by

$$E_{ijk} = R \times 2 \times \arcsin\left\{\sqrt{\sin^2\left(\frac{A_{ik} - C_{jk}}{2}\right) + \cos(A_{ik}) \times \cos(C_{jk}) \times \sin^2\left(\frac{B_{ik} - D_{jk}}{2}\right)}\right\} \qquad (1),$$

Where R is radius of the Earth, which is about 3956 miles.[39]

Then for census block group j, the spherical distance to the nearest payday shop is given by

$$E_{jk} = \underset{i=1}{\overset{I}{MIN}}\{E_{ijk}\} \qquad (2)$$

The concentration of payday shops around census block group j is given by

$$F_{jk} = \sum_{i=1}^{I} 1/E_{ijk}^2 \qquad (3)$$

For census block group j, the distance to the nearest bank branches and the concentration of bank branches around the group can be calculated similarly.

2. Normalizing distance and concentration by MSA

To make the distance and concentration measurements of different MSA's comparable, they are normalized with a zero mean and unit standard deviation by MSA. For example, for census block group j in MSA k, the spherical distance to the nearest payday shop was normalized as

$$E'_{jk} = \frac{E_{jk} - \overline{E_k}}{SD_k}, \qquad (4)$$

Where $\overline{E_k}$ is the mean distance to the nearest payday shops of the census block groups in the MSA, and SDk is the standard deviation of the distance.

3. Creating quintiles for neighborhood characteristic variables by MSA

To examine the relationship between the proximity and concentration of the nearest payday lending storefronts and neighborhood characteristics, we created quintiles for each neighborhood characteristic variable and treated them as ordered categorical variables with five orders, namely: low, medium-low, medium, medium-high, and high.

Because the neighborhood characteristics can vary greatly among different areas of California, we construct these quintiles for each MSA that reflects the varying relative feature of the measurements. So, for example, in the Chico-Paradise MSA, census block groups with African Americans and Latinos making up 17.4 percent of the total population is a relatively high minority concentration. In contrast, African-Americans and Latinos must make up at least 83.4 percent of the population in census block groups in the Los Angeles-Riverside-Orange County MSA to be considered high minority areas. For breakdowns of African American or Latino concentration by quintiles for other metropolitan areas, see Table A2 below.

Table A2. Breakdowns of African American or Latino concentration by quintiles for 16 California metropolitan areas

MSA	Low	Medium Low	Medium	Medium High	High
Bakersfield	0-15.5%	15.5-32.5%	32.5-50.7%	50.7-77.7%	77.7%+
Chico-Paradise	0-4.6%	4.6-7.6%	7.6-12.1%	12.1-17.4%	17.4%+
Fresno	0-22.2%	22.2-38.3%	38.3-56.1%	56.1-78.3%	78.3%+
Los Angeles-Riverside-Orange County	0-13.1%	13.1-29.5%	29.5-54.9%	54.9-83.4%	83.4%+
Merced	0-27.0%	27.0-45.0%	45.0-52.8%	52.8-67.8%	67.8%+
Modesto	0-16.5%	16.5-23.9%	23.9-32.9%	32.9-51.1%	51.1%+
Redding	0-3.5%	3.5-5.2%	5.2-6.8%	6.8-10.5%	10.5%+
Sacramento-Yolo	0-8.6%	8.6-15.0%	15.0-23.7%	23.7-39.4%	39.4%+
Salinas	0-7.1%	7.1-21.4%	21.4-49.2%	49.2-81.6%	81.6%+
San Diego	0-9.4%	9.4-16.4%	16.4-32.1%	32.1-55.7%	55.7%+
San Francisco-Oakland-San Jose	0-6.9%	6.9-13.9%	13.9-24.5%	24.5-43.9%	43.9%+
San Luis Obispo-Atascadero-Paso Robles	0-6.9%	6.9-10.5%	10.5-15.2%	15.2-21.2%	21.2%+
Santa Barbara-Santa Maria-Lompoc	0-12.1%	12.1-21.4%	21.4-32.4%	32.4-58.3%	58.3%+
Stockton-Lodi	0-20.8%	20.8-30.1%	30.1-41.0%	41.0-58.8%	58.8%+
Visalia-Tulare-Porterville	0-29.0%	29.0-43.2%	43.2-66.6%	66.6-79.1%	79.1%+
Yuba City	0-13.8%	13.8-19.2%	19.2-25.0%	25.0-31.7%	31.7%+

Note: Indicated ranges are inclusive of lower bound and exclusive of upper bound.

4. Regression models

To study the factors that influence the location and concentration of payday shops and bank branches, we employ regression models with distance and concentration specified as dependent variables and neighborhood characteristic variables as explanatory variables.

First, we include variables which determine whether households would be eligible for or demand a payday loan. Payday lenders would presumably want to locate in areas where there is not only a sizable population (particularly of adults, who can contract to enter into a loan), they would also want to be near people who are eligible for and demand their product. These demand-side variables are listed below:

Total population
% of population age 18 or older
Median household income
Poverty rate
% of population with at least a high school diploma
Unemployment rate
Homeownership rate

Second, since payday lending storefronts can only be located in areas with proper zoning and retail space, we control for the total retail employees in the area, which serves as a proxy for the existence of retail centers.

Finally, we explore three additional demographic factors below, which we would not expect to increase eligibility or demand for payday loans to test whether they, nevertheless, are explanatory factors for payday lending location decisions.

% of the population that is African American or Latino
% of the population that is non-English speaking
% of the population that is male (Gender)

In addition to these variables, we incorporate the location of bank branches in the models that explore the location and concentration of payday lending outlets to control for the supply of credit offered by competing providers from different types of financial service providers.

5. Correcting spatial correlations

In matrix form, the regression model takes the following form:

$$D = X\beta + \varepsilon \quad (5),$$

Where X is the matrix of explanatory variables. Beta is the vector of parameters we would like to estimate, as well as the error term. Here our observation unit is census block groups. Since one block group is spatially correlated with another census block group, the error term is not independent across observations, i.e., the off-diagonal elements of the covariance matrix of the error term are not zero. Since the value of the off-diagonal elements of the covariance matrix depends on the distance between two census block groups, they can be modeled parsimoniously by functions of distance. For the ith row and jth column of the covariance matrix of the error term, we use a spherical spatial covariance structure, which is given by

With,

$$\mathrm{CV}_{ij} = \sigma_1^2 + \sigma^2\left[1 - \left(\frac{3d_{ij}}{2\rho}\right) + \left(\frac{d_{ij}^3}{2\rho^3}\right)\right]1\left(d_{ij} \le \rho\right) \quad (6),$$

$$1(d_{..} \le \rho) \text{ equals 1 if } d_{..} \le \rho \text{ and 0 otherwise} \quad (7)$$

Where in geostatistical concepts, σ_1^2 , σ^2 and ρ are called nugget, sill and range, respectively. dij is the Euclidean distance between the ith and jth of the observations in the input data set. By adopting the same strategy as used by Kleinschmidt et al., the following steps were used to estimate the mixed regression model with the SAS procedures Mixed:[40]

1). An initial estimate of all the fixed effect was made by assuming no spatial correlation. Residuals were obtained after subtracting model fits from the observed. A variogram was constructed by using the SAS Variogram procedure. Initial estimates of the spatial covariance parameters were estimated using non-linear regression procedure NLIN.

2). Mixed procedure was then used with spatial covariance parameters fixed at the values estimated from step 1.

3). From the Mixed procedure, a new set of estimates of the fixed effects was found; hence, a new set of residuals was obtained, which was used in a new cycle to redraw the variogram and derive new estimates of the spatial covariance parameters from the nonlinear regression.

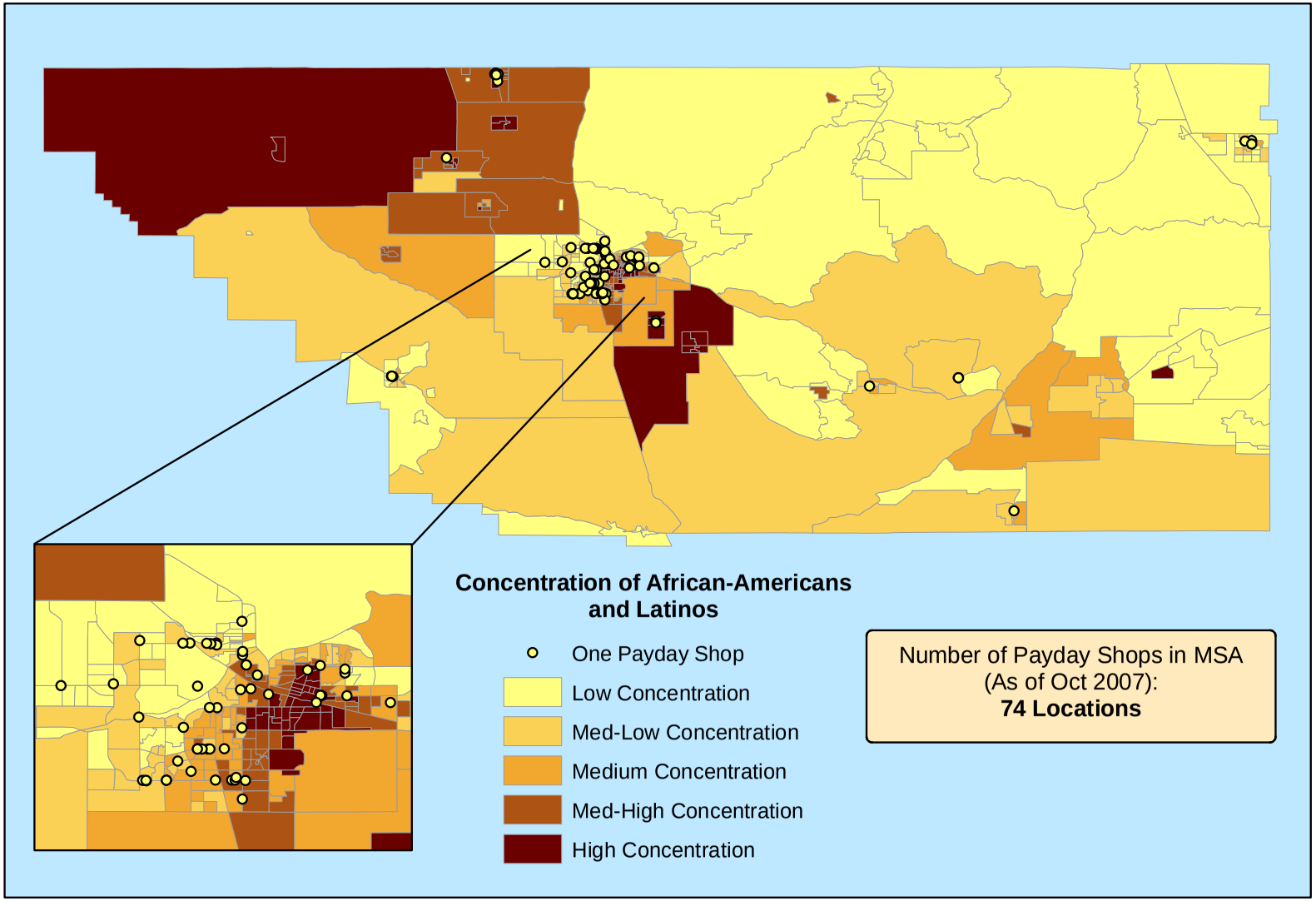
4). Iterate step 2 and 3 until there was no further change in the estimates.

What's the effect of the consideration of the spatial correlations? Assuming that any spatial correlation was positive rather than negative, standard errors of the fixed effect estimates might have been underestimated rather than overestimated in a model without consideration of the spatial correlations. Adjustment for spatial correlation may therefore lead to removal of some variables from the model whose contributions were overstated initially, consistent with Kleinschmidt et al.

Limitations

There are some limitations to our study. First, we only include payday lending storefronts which are licensed by the California Department of Corporations. Any lenders operating without proper licensing are not part of our analysis. Second, while we control for a large range of demographic, social, and economic factors, there may be other considerations that impact the location of payday lenders and bank branches for which we have failed to account. In addition, because much of the Census data analyzed for this report is from 2000 it is slightly dated and may need to be verified once the 2010 Census data is released. Finally, while other research from CRL and others has consistently shown that African Americans and Latinos are disproportionately impacted by payday lending, this analysis only considers African American and Latino neighborhoods, bank branches, and payday lending storefronts in California and therefore cannot be used to draw conclusions in other states.

Payday Shop Locations in African-American and Latino Neighborhoods
Bakersfield, CA MSA

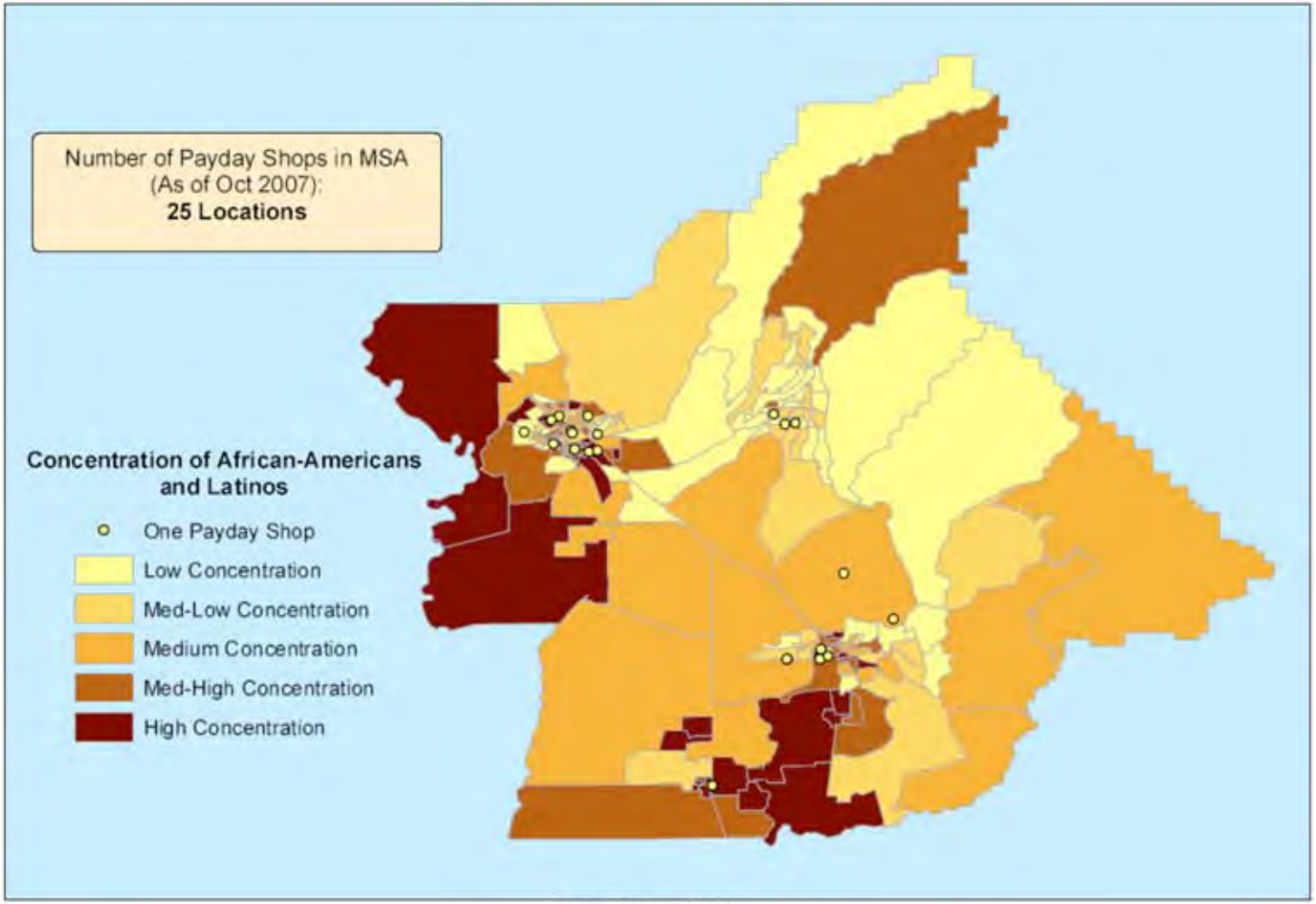


Center for Responsible Lending

Sources: 2000 U.S. Census; Oct 2007 CA Department of Corporations, Financial Services Division

Note: Racial concentrations are defined in quintiles relative to the MSA.

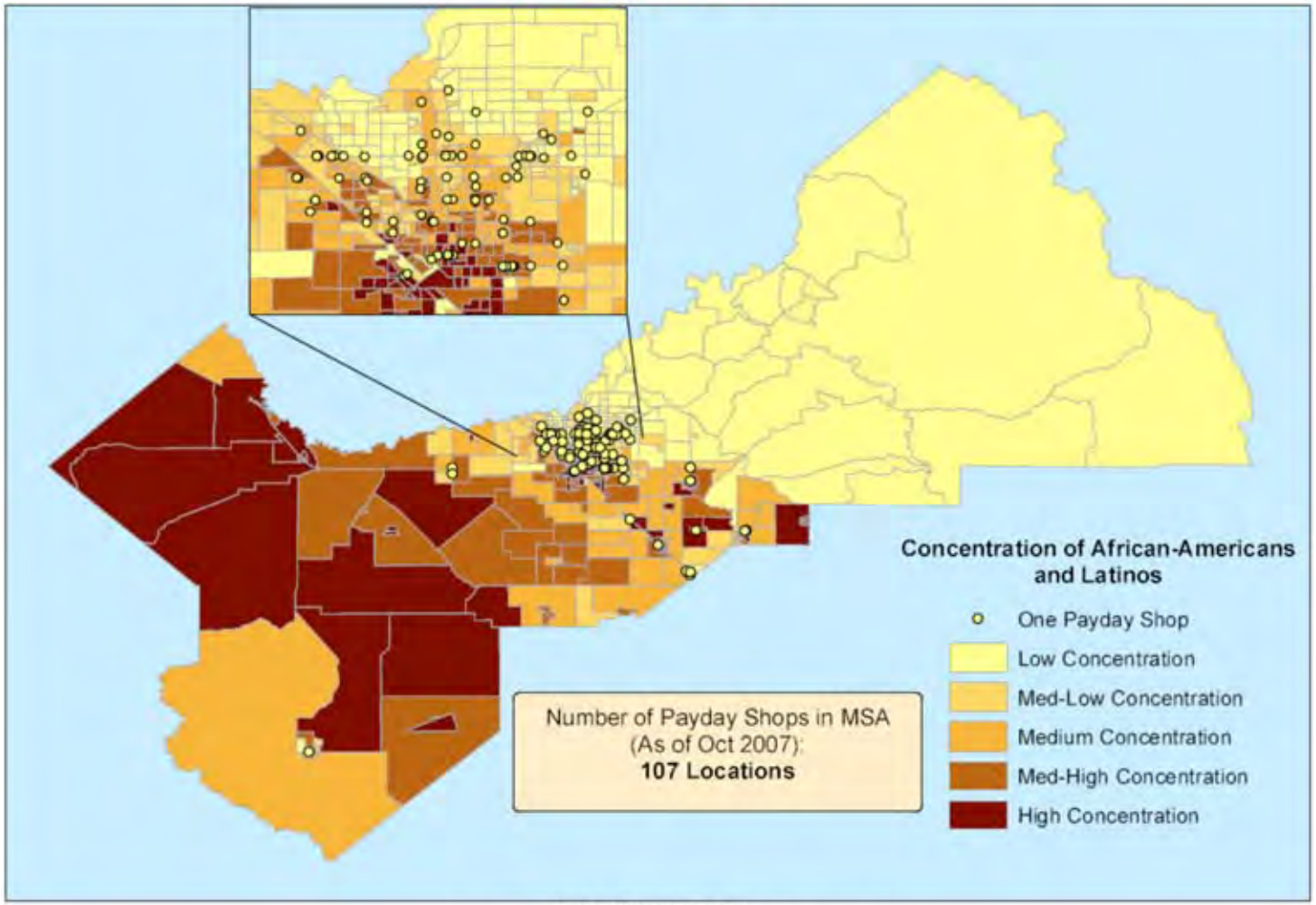
Payday Shop Locations in African-American and Latino Neighborhoods
Chico-Paradise, CA MSA



Center for Responsible Lending

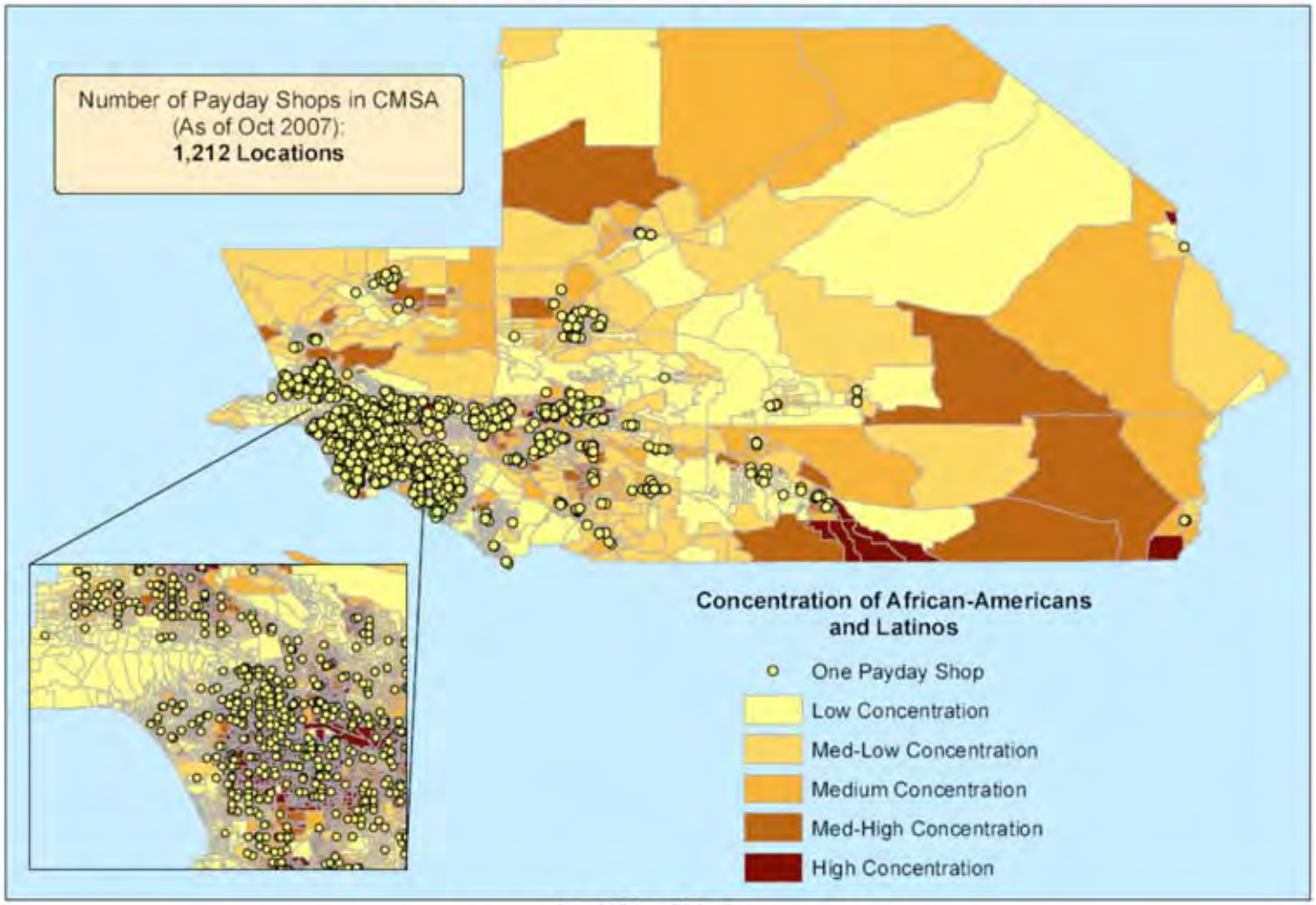
Sources: 2000 U.S. Census; Oct 2007 CA Department of Corporations
Note: Concentrations are defined in quintiles relative to MSA

Payday Shop Locations in African-American and Latino Neighborhoods
Fresno, CA MSA



Center for Responsible Lending
Sources: 2000 U.S. Census; Oct 2007 CA Department of Corporations
Note: Concentrations are defined in quintiles relative to MSA.

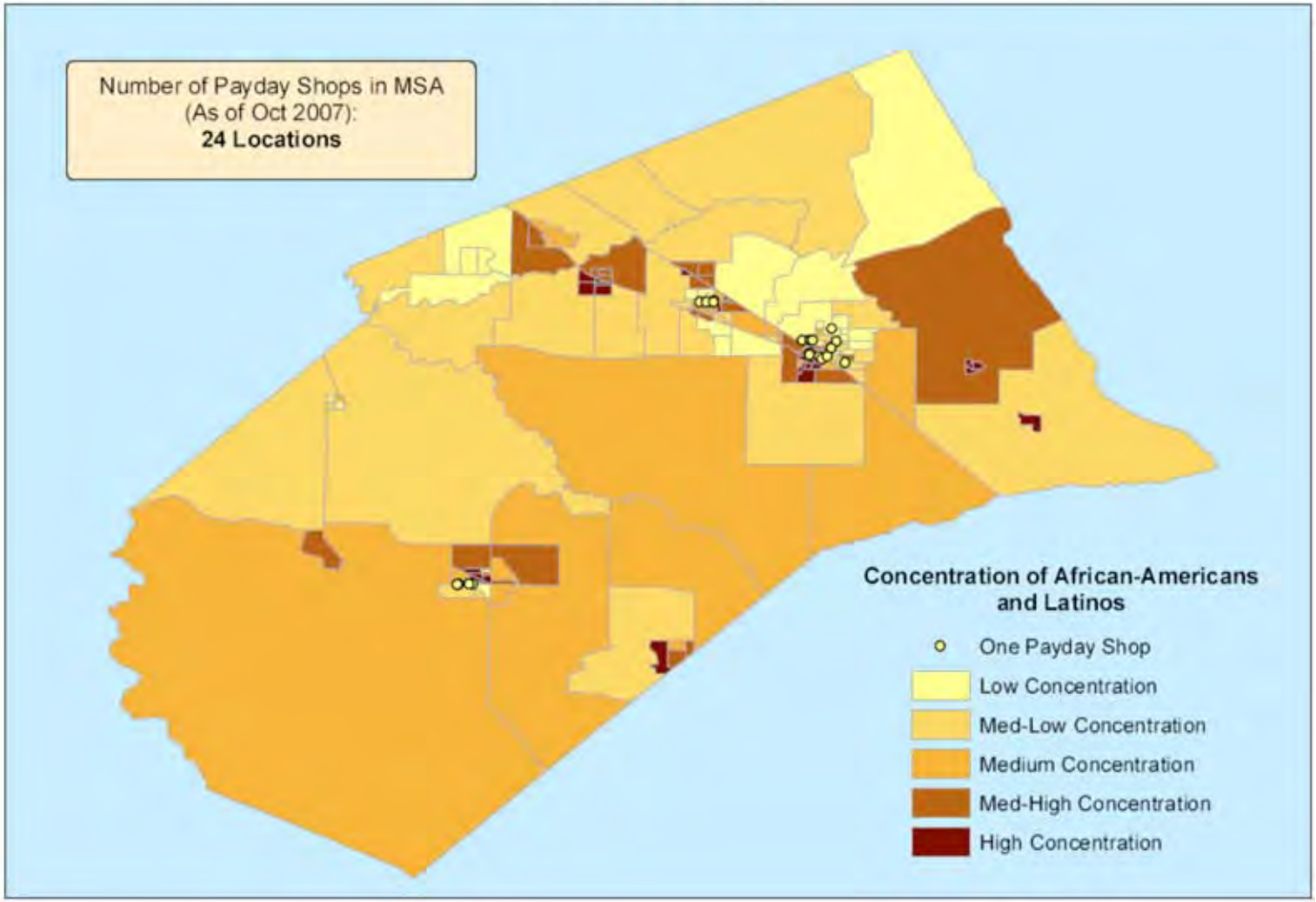
Payday Shop Locations in African-American and Latino Neighborhoods
Los Angeles-Riverside-Orange County, CA CMSA



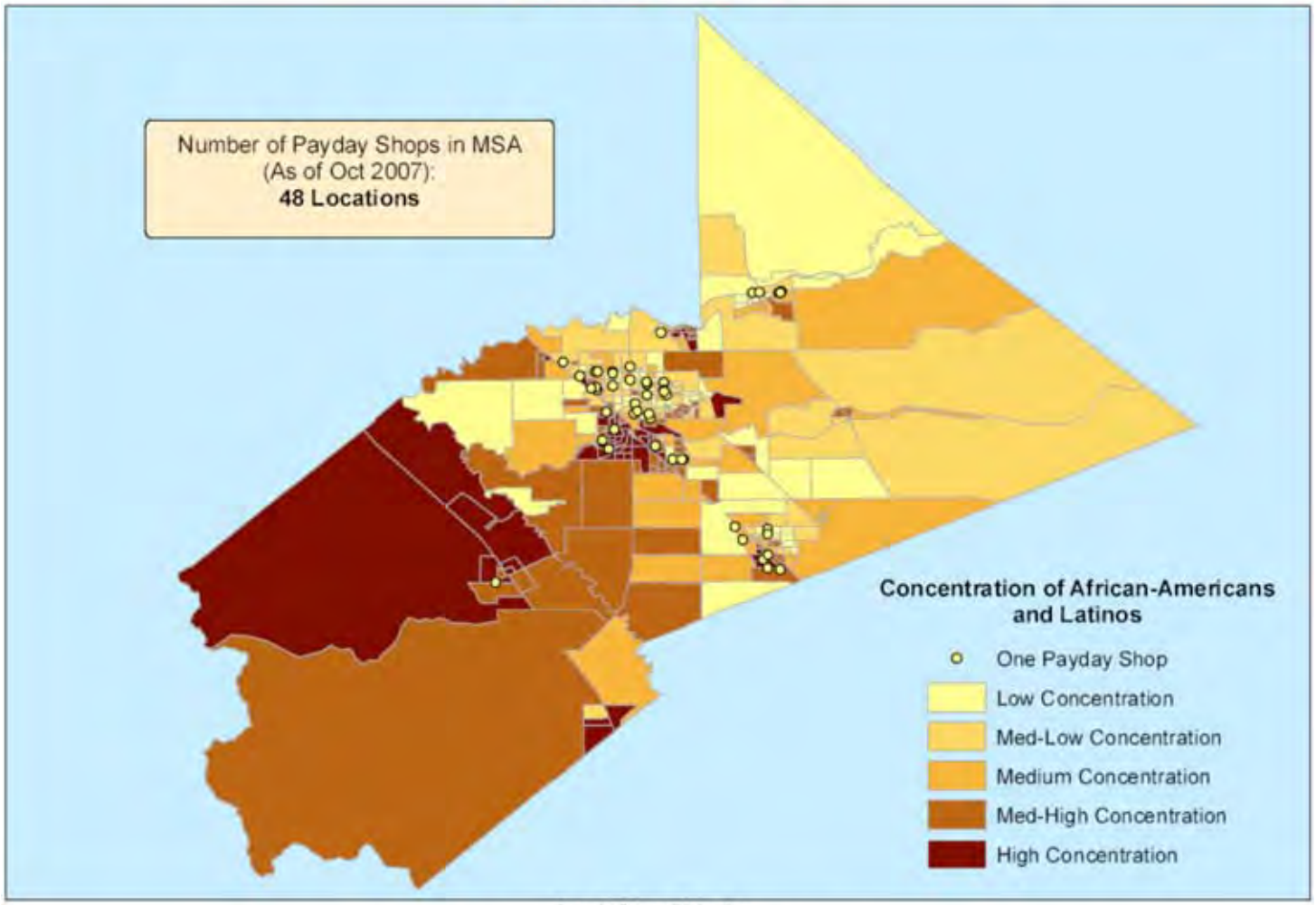
Center for Responsible Lending

Sources: 2000 U.S. Census; Oct 2007 CA Department of Corporations
Note: Concentrations are defined in quintiles relative to MSA

Payday Shop Locations in African-American and Latino Neighborhoods
Merced, CA MSA



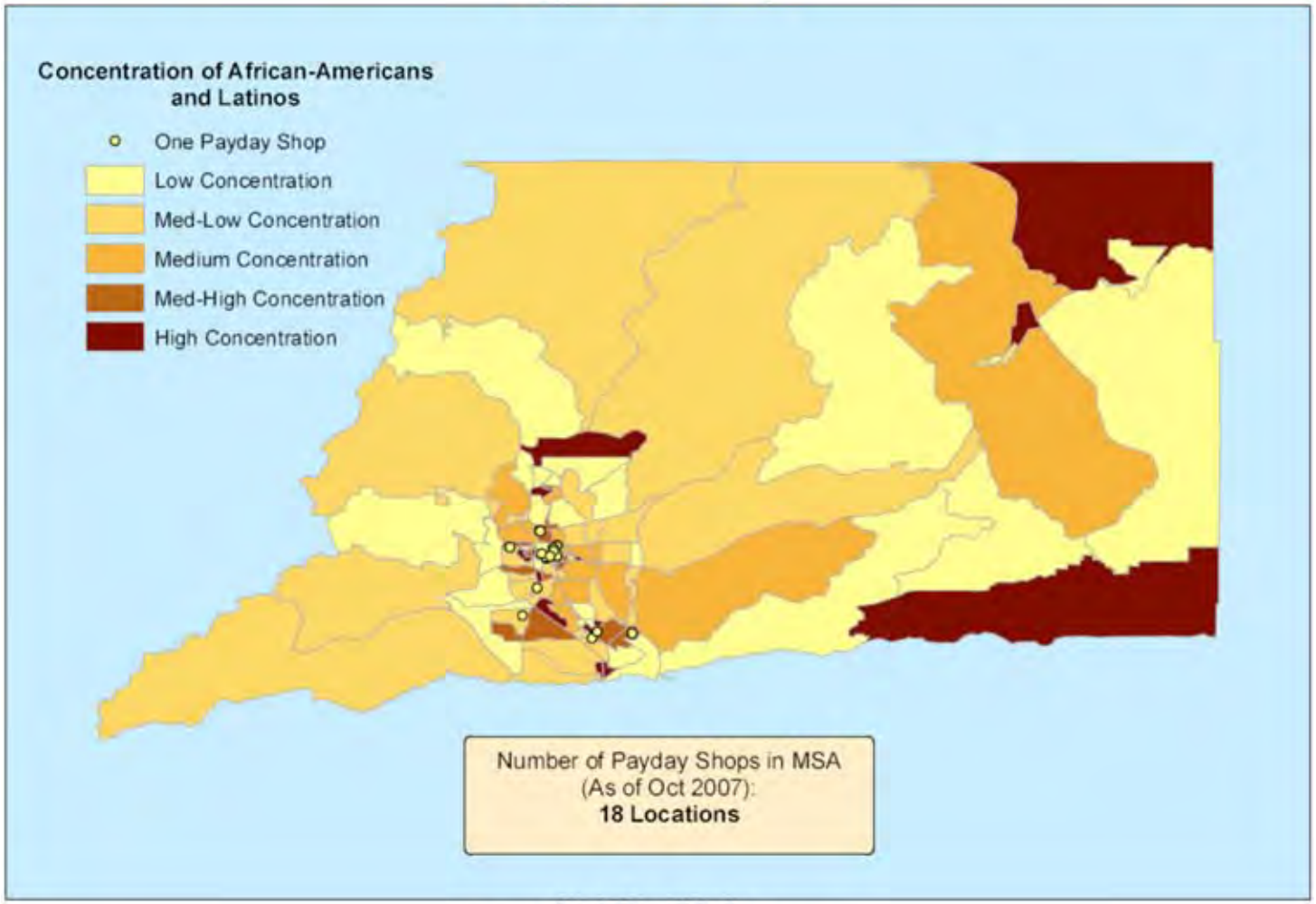
Payday Shop Locations in African-American and Latino Neighborhoods
Modesto, CA MSA



Center for Responsible Lending

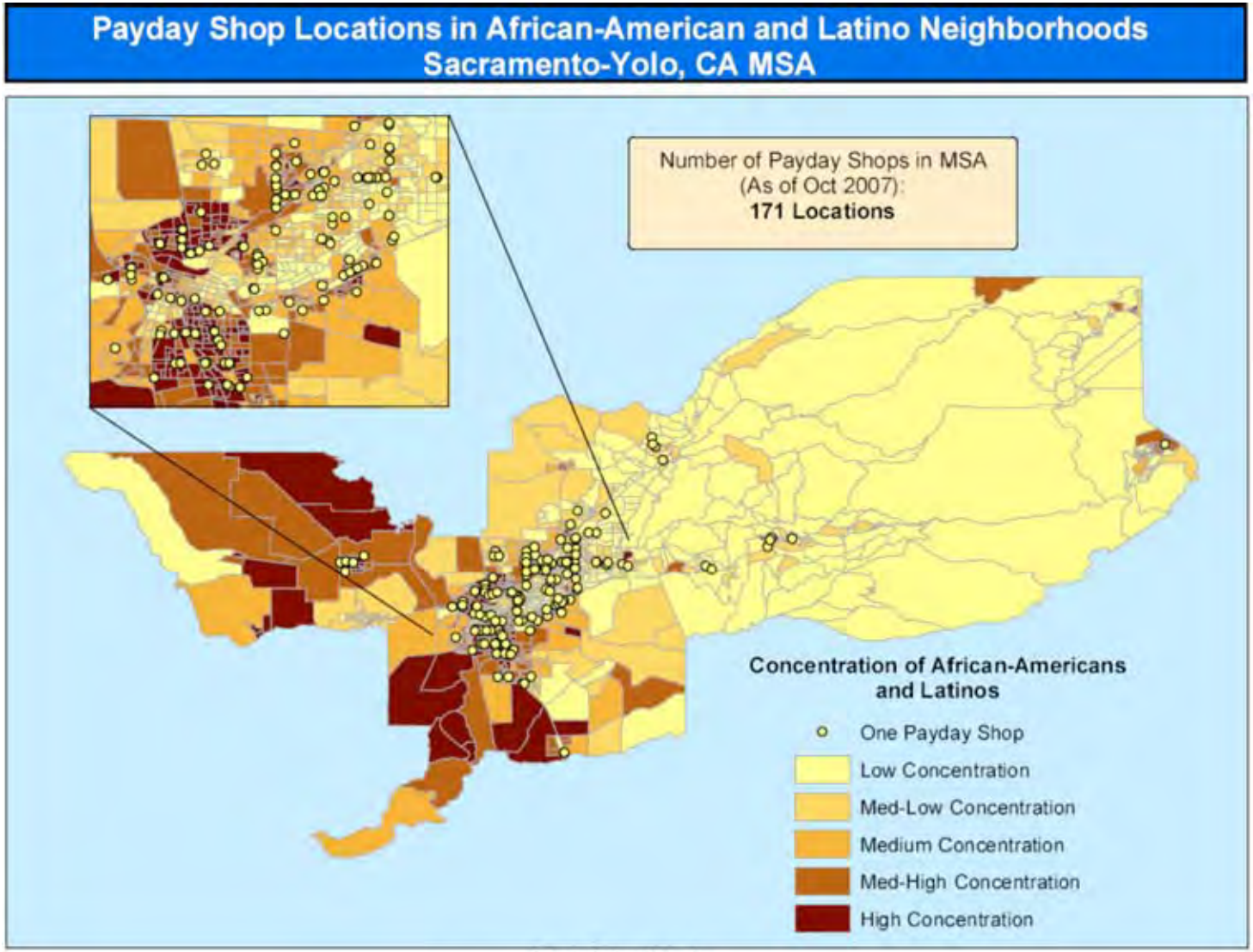
Sources: 2000 U.S. Census; Oct 2007 CA Department of Corporations
Note: Concentrations are defined in quintiles relative to MSA

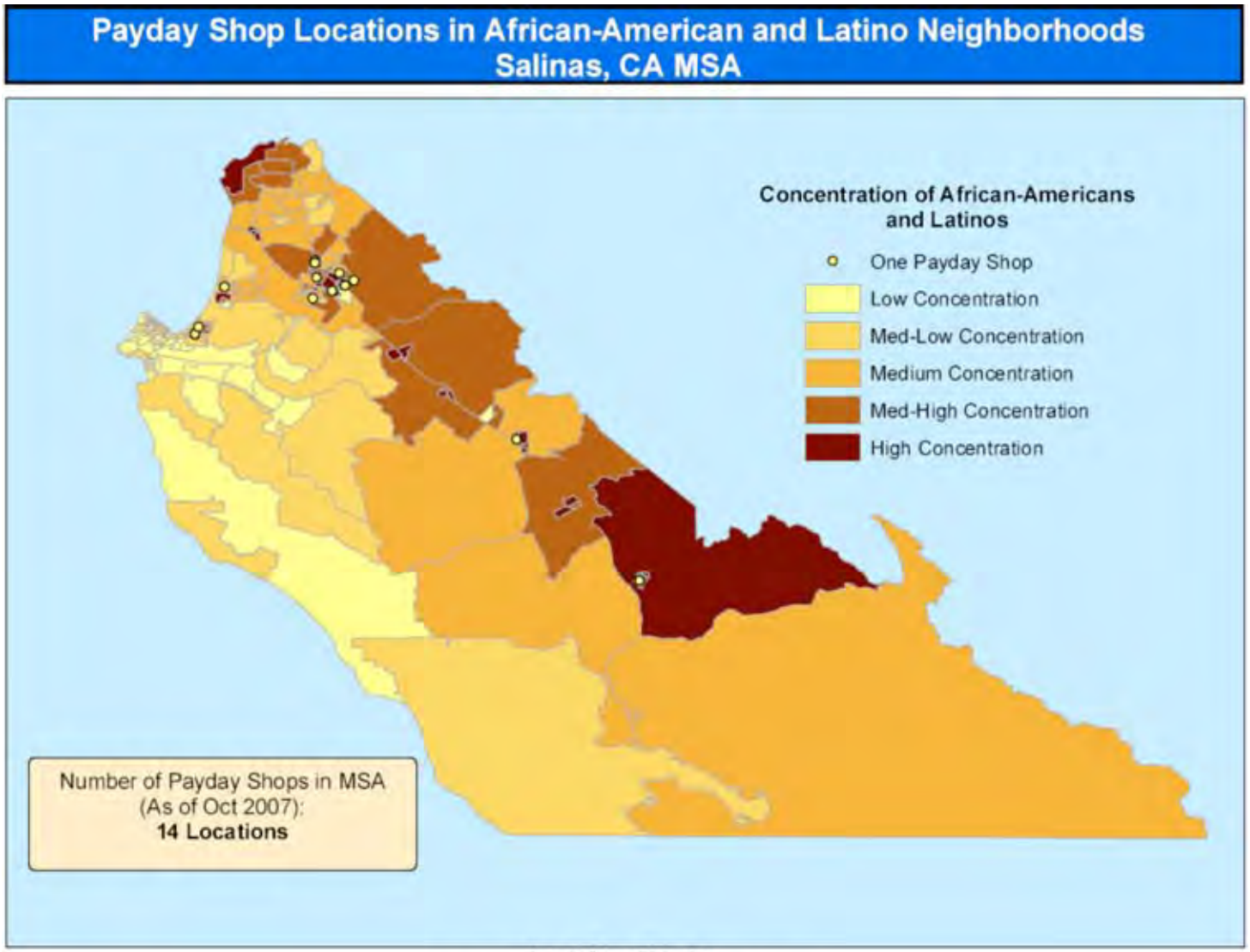
Payday Shop Locations in African-American and Latino Neighborhoods
Redding, CA MSA



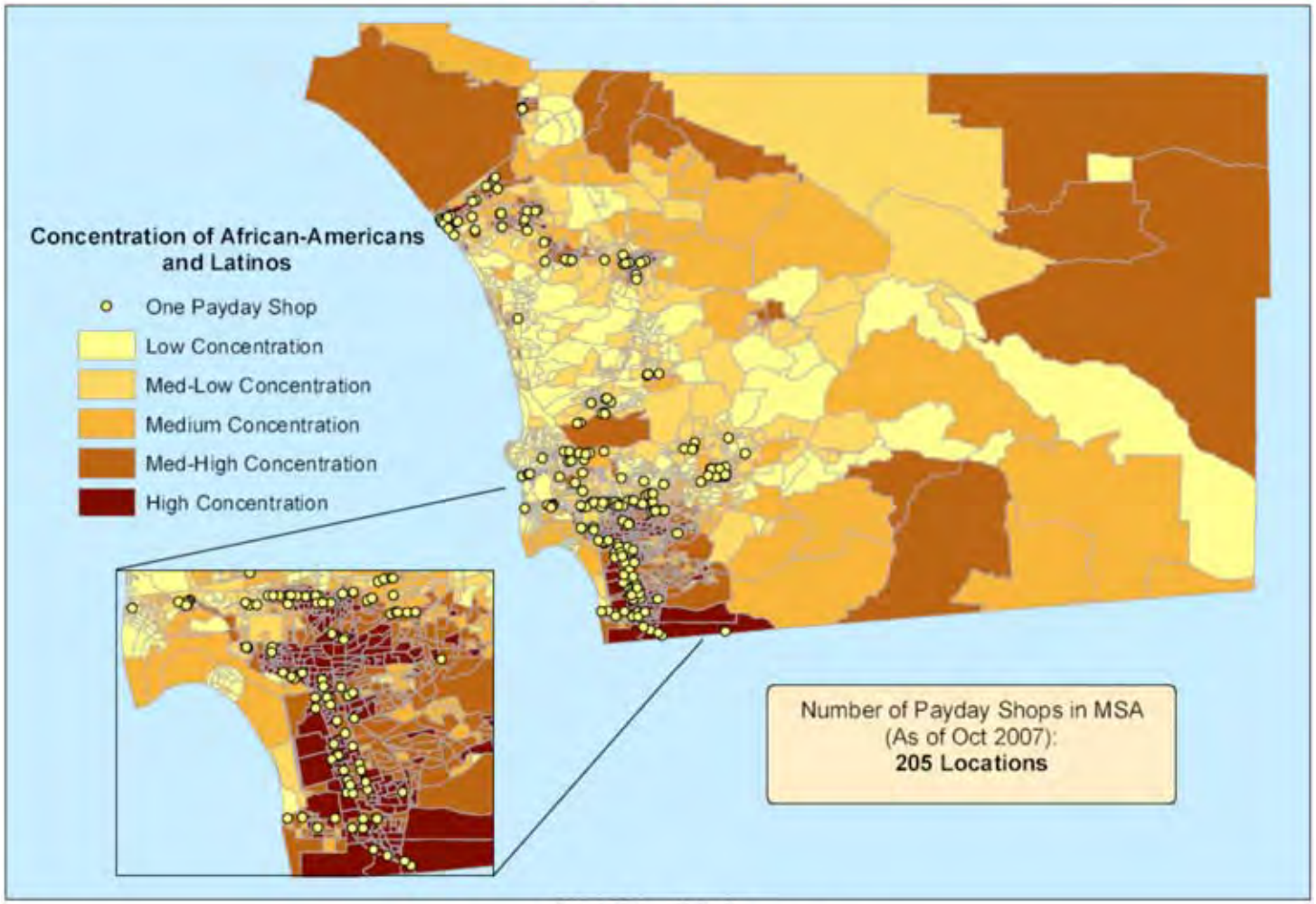
Center for Responsible Lending

Sources: 2000 U.S. Census; Oct 2007 CA Department of Corporations
Note: Concentrations are defined in quintiles relative to MSA.


Payday Shop Locations in African-American and Latino Neighborhoods
Sacramento-Yolo, CA MSA
Number of Payday Shops in MSA
(As of Oct 2007):
171 Locations
Concentration of African-Americans
and Latinos
One Payday Shop
Low Concentration
Med-Low Concentration
Medium Concentration
Med-High Concentration
High Concentration
Center for Responsible Lending
Sources: 2000 U.S. Census, Oct 2007 CA Department of Corporations
Note: Concentrations are defined in quintiles relative to MSA


Payday Shop Locations in African-American and Latino Neighborhoods
Salinas, CA MSA
Concentration of African-Americans and Latinos
One Payday Shop
Low Concentration
Med-Low Concentration
Medium Concentration
Med-High Concentration
High Concentration
Number of Payday Shops in MSA (As of Oct 2007):
14 Locations
Center for Responsible Lending
Sources: 2000 U.S. Census; Oct 2007 CA Department of Corporations
Note: Concentrations are defined in quintiles relative to MSA

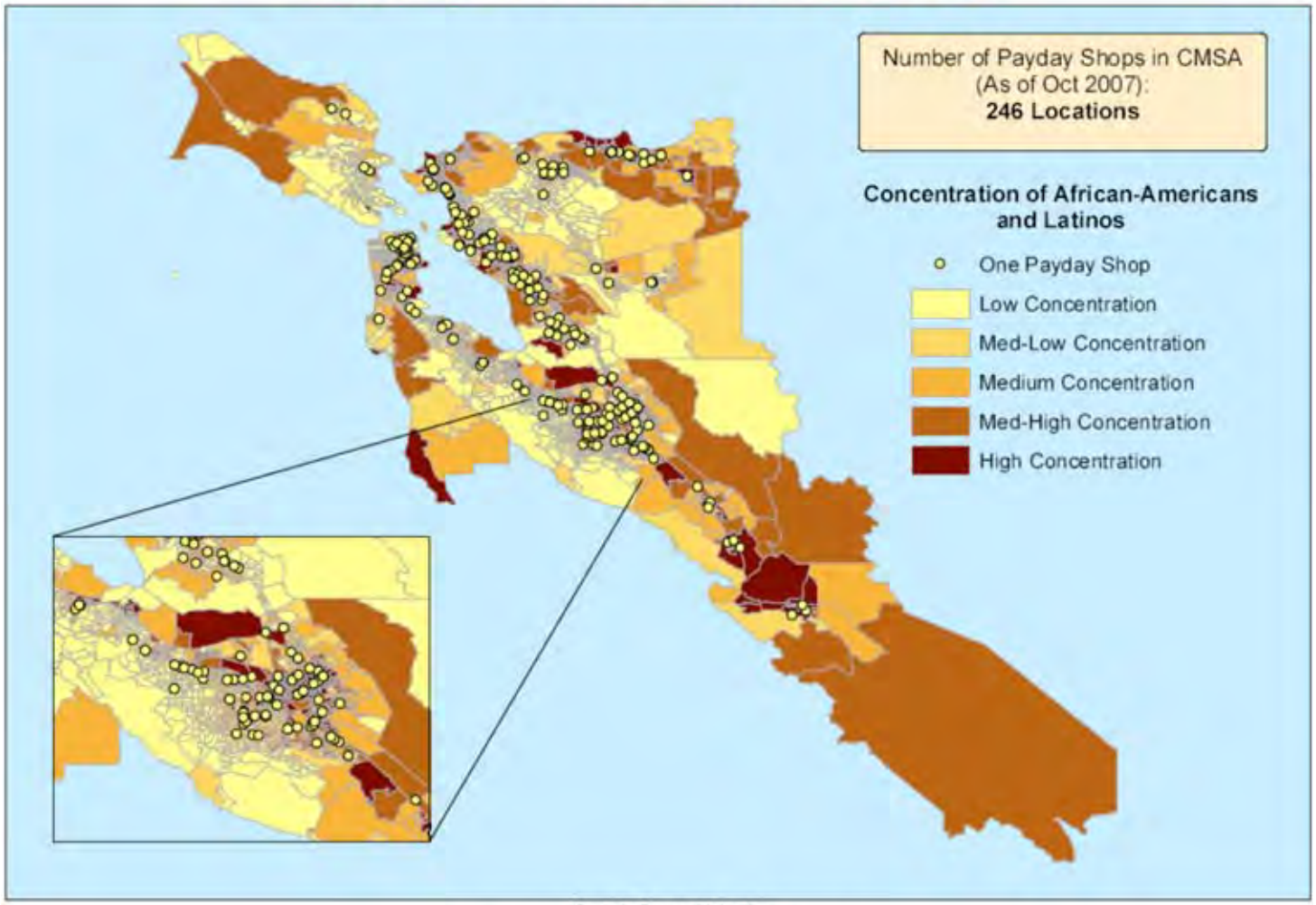
Payday Shop Locations in African-American and Latino Neighborhoods
San Diego, CA MSA



Center for Responsible Lending

Sources: 2000 U.S. Census; Oct 2007 CA Department of Corporations
Note: Concentrations are defined in quintiles relative to MSA

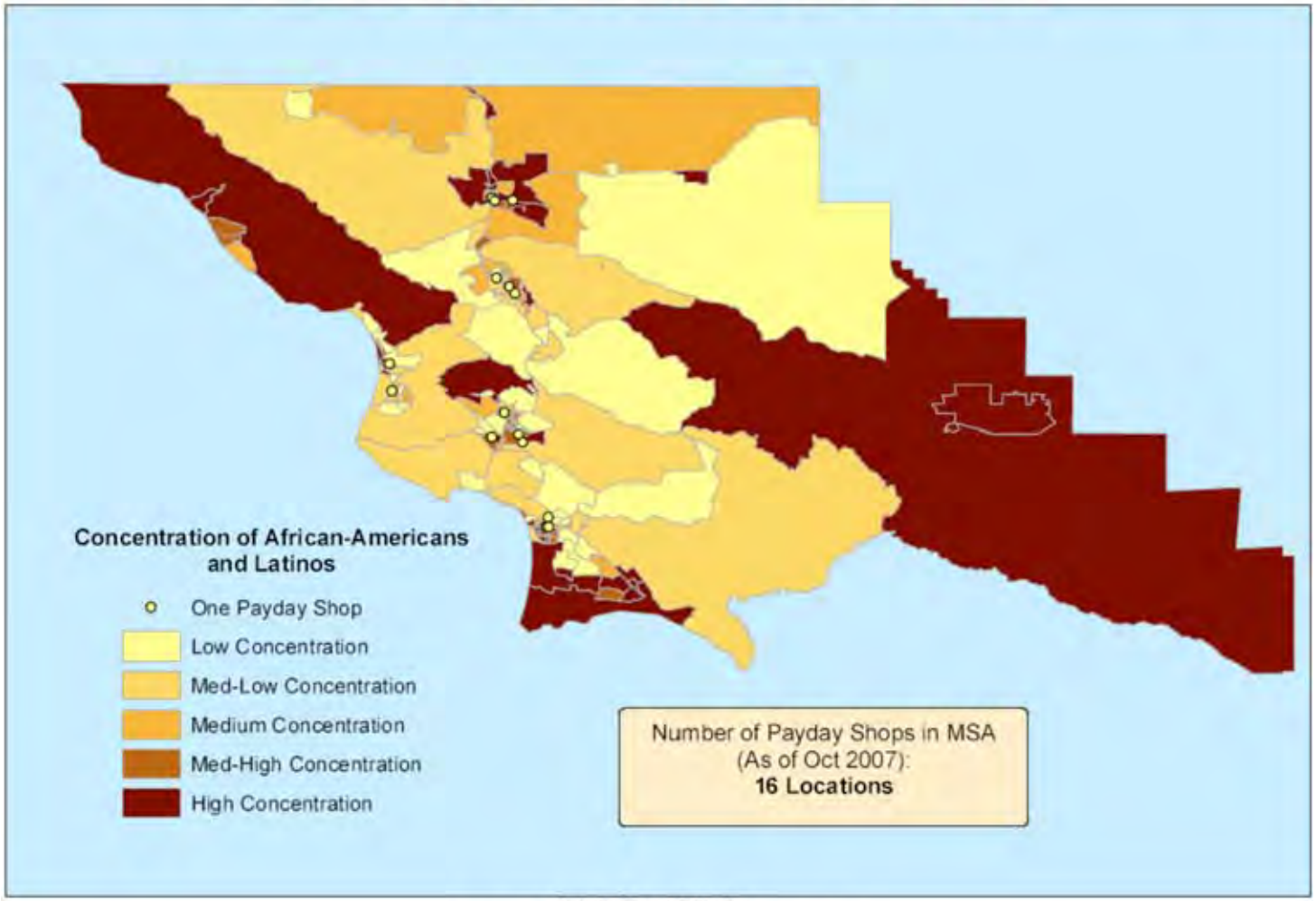
Payday Shop Locations in African-American and Latino Neighborhoods
San Francisco-Oakland-San Jose, CA CMSA



Center for Responsible Lending

Sources: 2000 U.S. Census; Oct 2007 CA Department of Corporations
Note: Concentrations are defined in quintiles relative to MSA.

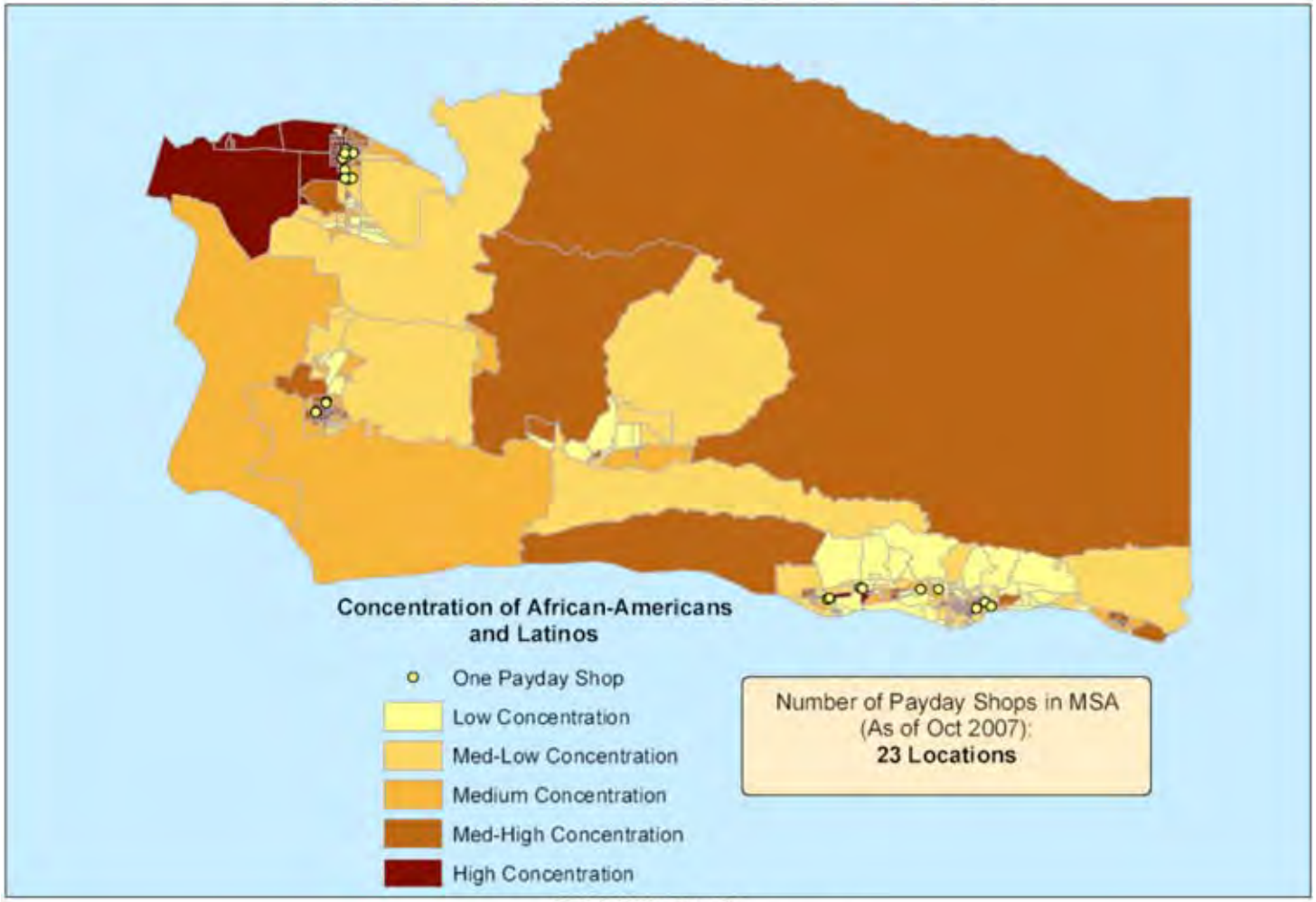
Payday Shop Locations in African-American and Latino Neighborhoods
San Luis Obispo-Atascadero-Paso Robles, CA MSA



Center for Responsible Lending

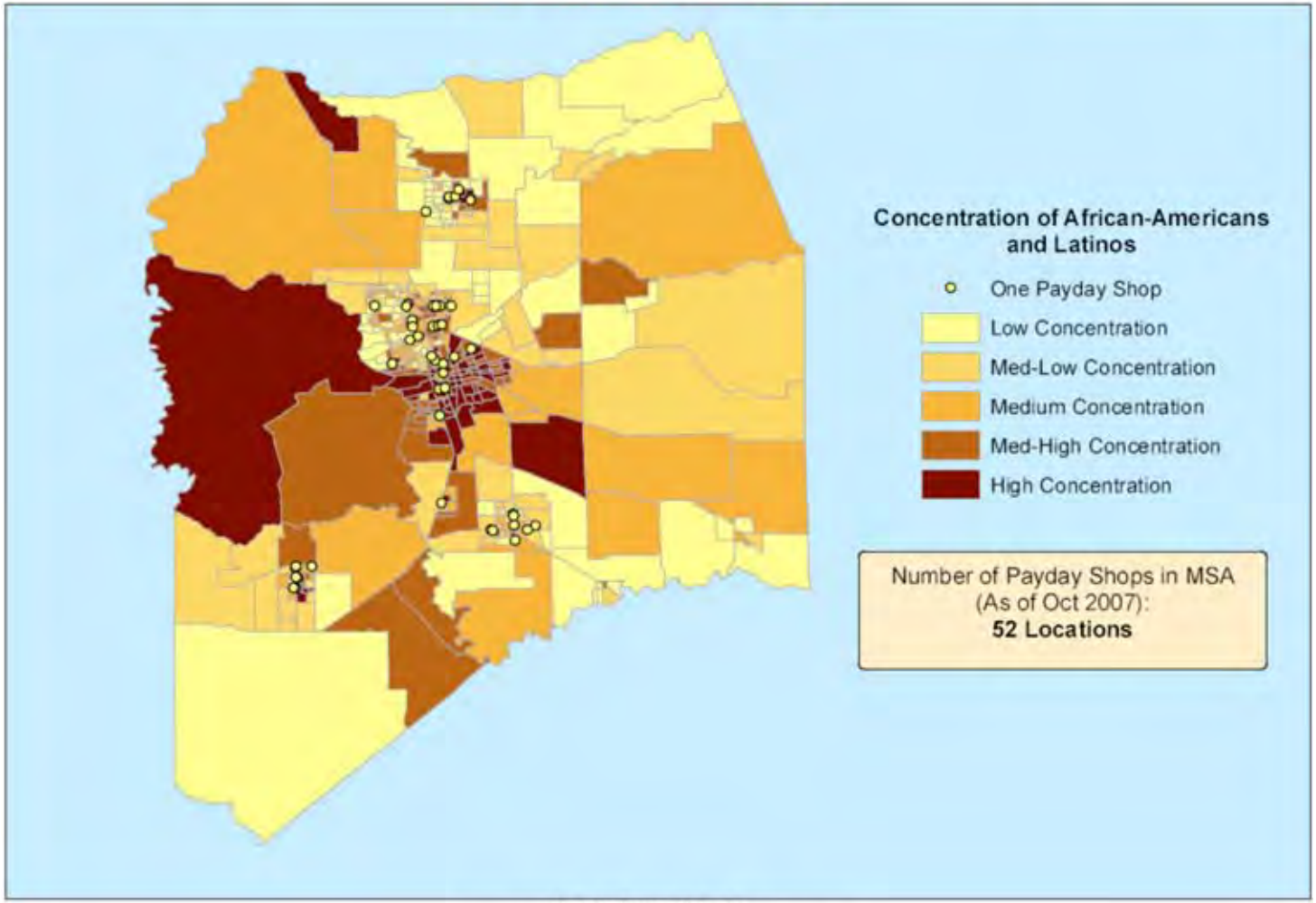
Sources: 2000 U.S. Census; Oct 2007 CA Department of Corporations
Note: Concentrations are defined in quintiles relative to MSA

Payday Shop Locations in African-American and Latino Neighborhoods
Santa Barbara-Santa Maria-Lompoc, CA MSA



Center for Responsible Lending
Sources: 2000 U.S. Census; Oct 2007 CA Department of Corporations
Note: Concentrations are defined in quintiles relative to MSA

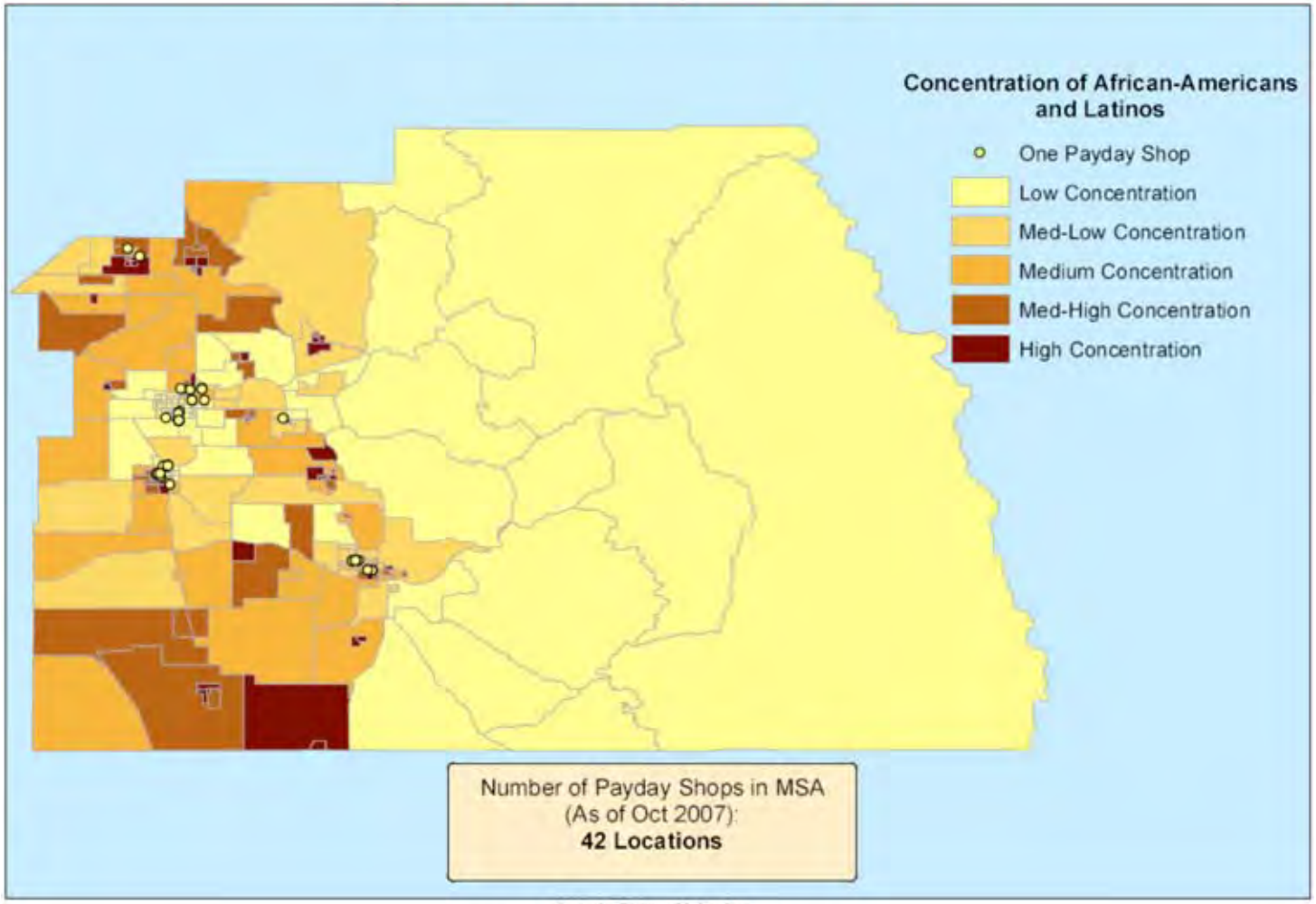
Payday Shop Locations in African-American and Latino Neighborhoods
Stockton-Lodi, CA MSA



Center for Responsible Lending

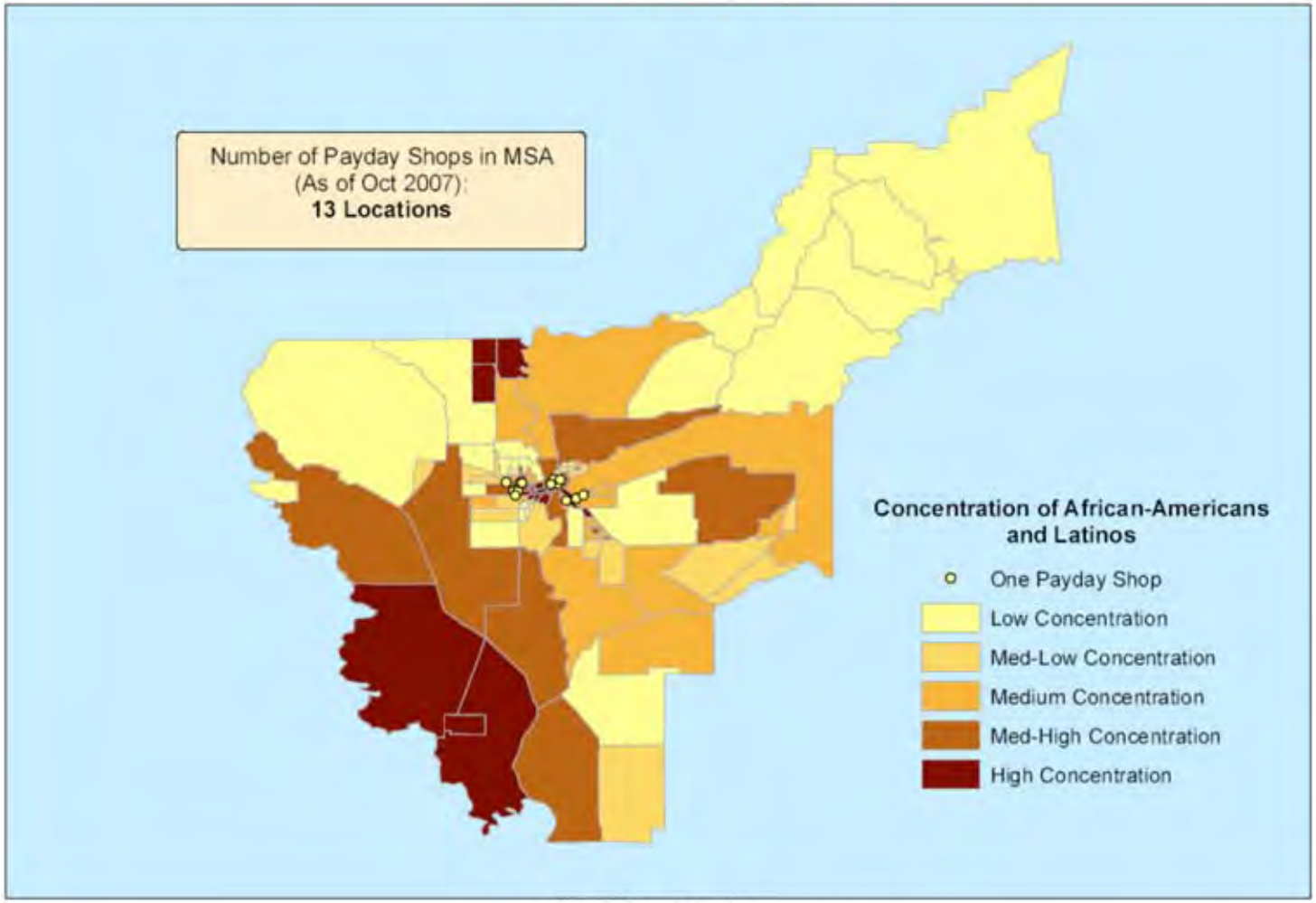
Sources: 2000 U.S. Census; Oct 2007 CA Department of Corporations
Note: Concentrations are defined in quintiles relative to MSA.

Payday Shop Locations in African-American and Latino Neighborhoods
Visalia-Tulare-Porterville, CA MSA



Center for Responsible Lending
Sources: 2000 U.S. Census; Oct 2007 CA Department of Corporations
Note: Concentrations are defined in quintiles relative to MSA.

Payday Shop Locations in African-American and Latino Neighborhoods
Yuba City, CA MSA



Center for Responsible Lending

Sources: 2000 U.S. Census, Oct 2007 CA Department of Corporations

Note: Concentrations are defined in quintiles relative to MSA.

NOTES

1 Regulator data from Florida and Oklahoma (the only states with this level of detailed data available) shows that 45 percent and 59 percent of repeat payday transactions, respectively, are opened at the borrower's first opportunity. In addition, 88 percent and 87 percent of subsequent loans are originated before the borrower receives their next paycheck in two weeks. This data is discussed in further detail in Uriah King and Leslie Parrish, *Springing the Debt Trap*, Center for Responsible Lending (December 13, 2007). In addition, see page 8 of *Springing the Debt Trap*, which illustrates why a borrower making $35,000 a year cannot afford to pay back a two-week payday loan and meet their other obligations.

2 Payday lending was first authorized by SB 1959, signed by the Governor in September 1996. This law was amended in 2002 by SB 898, which required payday lenders be brought under the regulatory and licensing framework of the Department of Corporations. This new law also required enhanced disclosures of fees, including APR, but did not change the maximum fee or loan amount.

3 California Deferred Deposit Transaction Law, Division 10, Sec. 23036 of the California Financial Code.

4 *2006 Annual Report, Operation of Deferred Deposit Originators under the California Deferred Deposit Transaction Law*, California Department of Corporations (September 2007). According to an analysis by the California Reinvestment Coalition, the five lenders with the most locations in California include Advance America, Check N' Go, Check into Cash, Ace America, and Money Mart (Dollar Financial Group).

5 Limited data on the race and ethnicity on payday borrowers has been collected. Using a database of a large Texas-based payday lender, Paige Skiba and Jeremy Tobacman found that African Americans (who make up 11 percent of the total adult population) made up 43 percent of payday borrowers and Latinos (who make up 29 percent of the total adult population) made up 34 percent of payday borrowers. See Table 1 of Paige Skiba and Jeremy Tobacman. *Do Payday Loans Cause Bankruptcy?* (February 19, 2008) and 2000 Census data for Texas population age 18 and older. A survey conducted by Cypress Research Group for the payday lending industry found a disproportionate share of borrowers were African American, however the survey did not find that Latinos made up a disproportionate share of payday borrowers. See *Payday Advance Customer Satisfaction Survey*, Cypress Research Group (May 2004).

6 Brian K. Bucks, Arthur B. Kennickell, and Kevin B. Moore. *Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances*. Federal Reserve Bulletin (February 2006).

7 *Payday Loans: Taking the Pay Out of Payday*. California Budget Project, (September 2008), at page 30.

8 The phrase "democratization of credit" was largely coined by Alan Greenspan as Chair of the Federal Reserve to describe the innovations in the financial services industry that expanded access to credit to previously un- or under-served households. However, Greenspan did note the danger of excess. For an example of Greenspan's views, see Consumer Credit and Financial Modernization, a speech given on October 11, 1997 at the Greenlining Institute, available at http://www.federalreserve.gov/boarddocs/speeches/1997/19971011.htm/

9 For example, Donald P. Morgan and Michael R. Strain conclude in *Payday Holiday: How Households Fare after Payday Credit Bans* that the ban on payday lending in Georgia and North Carolina has led to increased bankruptcy filings, bounced checks, and FTC complaints. Methodological problems with this study are highlighted in a CRL publication available at http://www.responsiblelending.org/pdfs/crl-morgan-critique-12-10.pdf.

10 Reviewing data from state regulators, CRL has found that the typical payday borrower takes out 8-9 loans each year. For more information, see CRL's *Springing the Debt Trap*. Pat Cirillo of Cypress Research Group, who conducts borrower surveys for the payday lending industry, testified that borrowers remain in payday loans for 18 months to the Ohio House Committee on Financial Institutions, Real Estate, and Securities on January 31, 2008. Transcript on file with CRL.

11 The payday lending industry depends on long-term usage of payday loans for the bulk of its revenues. For example, 90 percent of payday lending business is generated by borrowers taking out five or more loans a year, and over 60 percent of payday lending business is generated by borrowers taking out 12 or more loans a year. For more information, see *Springing the Debt Trap*. In addition, the paper *Payday Lending: Do the Costs Justify the Price?* for the FDIC's Center for Financial Research by Mark Flannery and Katherine Samolyk concludes that "high-frequency borrowers account for a disproportionate share of a payday loan store's loans and profits."

12 Several researchers have noted negative effects of payday borrowing. For example, using a database of a large Texas-based payday lender, Paige Skiba of Vanderbilt University and Jeremy Tobacman of Oxford University find that payday borrowers are twice as likely to file for bankruptcy than similarly situated people who were not approved payday loans. In a subsequent paper, these authors also found that half of payday borrowers ultimately end their cycle of payday lending in default. See Paige Skiba and Jeremy Tobacman. *Do Payday Loans Cause Bankruptcy?* (February 19, 2008) and *Payday Loans, Uncertainty and Discounting: Explaining Patterns of Borrowing, Repayment, and Default* (January 21, 2008). In addition, the FDIC ruled that its member banks could no longer partner with payday lenders out of concerns that "when used frequently or for long periods, the costs [of a payday loan] can rapidly exceed the amount borrowed and cause a serious financial hardship for the borrower." See *Press Release: FDIC Revises Payday Lending Guidance* (March 2, 2005).

13 For example, in focus groups of California payday borrowers conducted for the California Department of Corporations, most participants noted that—although they used their first payday loan for a specific unexpected expense-they now used subsequent payday loans to "purchase essentials and maintain their household between pay periods." In addition, half of California payday borrowers responding to a telephone survey noted that they usually took payday loans to pay other bills, and 22 percent used payday loan proceeds to cover household needs such as groceries. Only 10 percent noted that they only use payday loans for emergencies. See *2007 Department of Corporations Payday Loan Study*, Applied Management & Planning Group (December 2007) at page 75 and Table 28 at page 47. Similarly, focus groups of North Carolina pay-

day borrowers revealed that frequent borrowers used payday loans to pay for expected expenses and/or viewed the loans as supplemental income; though most focus group participants noted that they initially took out their first payday loan because of a specific financial setback. See *North Carolina After Payday Lending: Attitudes and Experiences with Credit Options,* University of North Carolina Center for Community Capital (November 2007).

14 Delvin Davis, Keith Ernst, Uriah King, and Wei Li. *Race Matters: The Concentration of Payday Lenders in African-America Communities in North Carolina.* Center for Responsible Lending (March 2005).

15 Ibid.

16 Mark L. Burkey and Scott P. Simkins, "Factors Affecting the Location of Payday Lending and Traditional Banking Services in North Carolina" *Review of Regional Studies,* Fall 2004 Vol. 34 no. 2 pp. 191-205.

17 Assaf Oron. *Easy Prey: Evidence for Race and Military Related Targeting in the Distribution of Payday Loan Branches in Washington State.* Department of Statistics, University of Washington (March 2006).

18 Generally, the term "underbanked" is used to describe a person who has a checking account but, rather than or in addition to using other mainstream financial products, they regularly use alternative products and services such as check cashing and payday loans. For an overview of the preferences and challenges of underbanked consumers see work the Center for Financial Services Innovation (www.cfsinnovation.com) such as *The CFSI Underbanked Consumer Study: Underbanked Consumer Overview and Market Segments Fact Sheet* (June 8, 2008).

19 A survey of California payday borrowers found that the leading way a borrower chose their payday lender was that they "saw a pay-day location and went in," as noted by 24.4 percent of respondents. See.Table 25 on page 44 of *2007 Department of Corporations Payday Loan Study,* Applied Management & Planning Group (December 2007).

20 Matt Fellowes and Mia Mabanta. *Banking on Wealth: America's New Retail Banking Infrastructure and Its Wealth-Building Potential.* Brookings Institution (January 2008).

21 For demographic data on payday borrowers, see P*ayday Advance Customer Satisfaction Survey,* Cypress Research Group (May 2004); *Payday Advance Customer Research: Cumulative State Research Report,* IO Data Corporation (2002); and Advance America 10-K SEC filing for the year ending December 31, 2007.

22 While race and ethnicity are not important explanatory factors for bank branch location, the variable "% non-English speakers" explains 7.3 percent of the proximity of banks and 15.6 percent of the clustering of banks among neighborhoods. There are several potential reasons for this discrepancy. First, non-English speakers are likely among the most recent immigrants to California from other countries, making up only a segment of our African American and Latino population overall. Second, "non-English speakers" captures a variety of races and ethnicities in addition to African Americans and Latinos, which are the focus of this study.

23 *The CFSI Underbanked Consumer Study: Underbanked Consumer Overview & Market Segments Fact Sheet.* Center for Financial Services Innovation (June 8, 2008).

24 *Payday Advance Customer Satisfaction Survey,* Cypress Research Group (May 2004).

25 A survey of California payday borrowers found that the leading way a borrower chose their payday lender was that they "saw a pay-day location and went in," as noted by 24.4 percent of respondents. See.Table 25 on page 44 of *2007 Department of Corporations Payday Loan Study,* Applied Management & Planning Group (December 2007).

26 In Marsha Courchane and Peter Zorn. *Consumer Literacy and Credit Worthiness.* (n.d.), the authors find that African Americans correctly identify that they have good credit 65 percent of the time, compared with 76 percent of the time for whites and 74 percent of the time for Latinos.

27 In a recent survey, 41 percent of California payday lenders noted that "they offered some type of bonus to consumers who referred other customers to their locations." See page 21 of *2007 Department of Corporations Payday Loan Study,* Applied Management & Planning Group (December 2007).

28 A survey of California payday borrowers found that the second most important reason a borrower chose their payday lender (after convenience) was through a "word of mouth" referral by a friend of relative. See.Table 25 on page 44 of *2007 Department of Corporations Payday Loan Study,* Applied Management & Planning Group (December 2007).

29 Edna R. Sawady and Jennifer Tescher. *Financial Decision Making Processes of Low-Income Individuals,* Harvard University Joint Center for Housing Studies (February 2008) and *The CFSI Underbanked Consumer Study: Underbanked Consumer Overview & Market Segments Fact Sheet.* Center for Financial Services Innovation (June 8, 2008).

30 As noted by researchers summarizing various survey of payday borrowers nationally in *North Carolina After Payday Lending: Attitudes and Experiences with Credit Options.* University of North Carolina Center for Community Capital (November 2007), "generally [payday loan borrowers] knew the dollar fee per $100 borrowed but were much less clear on the APR. In one study, 96 percent of respondents could report the finance charge per $100 borrowed, but only 16 percent could report an APR, and 60 percent of those were probably wrong, including 41 percent who reported an APR below 30 percent." Similarly, in the California payday borrower survey, respondents accurately stated the fee per dollar borrowed for a payday loan, but the few who could offer a guess at an interest rate generally reported one well below 100 percent and

typically within the range of a credit card APR. For more information, see discussion on pages 54-56 of 2007 *Department of Corporations Payday Loan Study,* Applied Management & Planning Group (December 2007).

31 CRL has a variety payday lending advertisements on file collected through Mintel Comperemedia which offer free or discounted loans to first-time customers. For example, Check into Cash has a mailer offering a first loan for free, 1-2-3 Cash offers the first $100 of a loan for free, and 1-866-9-Get-Cash promotes a 50% discount.

32 Based on data from the Department of Corporations, the California Budget Project estimates that approximately 1 million Californians took out payday loans in 2006, averaging roughly ten loans per borrower. See slide 5 in *Payday Loans: Taking the Pay Out of Payday*. California Budget Project, (September 2008). Only four percent of loans (or revenues) are generated by borrowers taking out just one loan a year (Slide 19). The California Budget Project also notes that payday lenders reported that 84 percent of business is attributable to "repeat customers" according to the 2007 Department of Corporations Payday Loan Study conducted by Applied Management & Planning Group. See page 2 of *Recent Reports on Payday Lending Should be Used with Caution,* California Budget Project (May 1, 2008).

33 N*orth Carolina Consumers After Payday Lending: Attitudes and Experiences with Credit Options*. University of North Carolina Center for Community Capital (November 2007).

34 For more details, see *Report on the Implementation of Limitations on Terms of Consumer Credit Extended to Service Members and their Dependents*. Department of Defense (July 22, 2008).

35 A survey of California payday borrowers found that 50 percent took out a payday loan to pay other bills, 22 percent used the funds to cover household needs such as groceries, and only 10 percent take payday loans only for emergency situations. See Table 28 at page 47 of *2007 Department of Corporations Payday Loan Study,* Applied Management & Planning Group (December 2007).

36 Non-credit strategies reported to be used by households facing financial shortfalls in North Carolina include working with a creditor to renegotiate a debt or pay a few days late, borrowing from friends, family, or an employer, or receiving assistance from a charitable source. See *North Carolina Consumers After Payday Lending: Attitudes and Experiences with Credit Options*. University of North Carolina Center for Community Capital (November 2007).

37 Testimony of Jean Ann Fox, Director of Consumer Protection, Consumer Federation of America before the Subcommittee on Domestic Policy of the House Committee on Oversight and Domestic Reform (March 21, 2007).

38 Golden 1 Credit Union offers a $300 Lifeline Advance at 15 percent APR with the only requirement being an account and direct deposit. Californians living or working in 28 counties across the state are eligible for membership. In addition, BBVA Bancomer USA, a bank with 30 locations primarily serving California's Latino households, is part of the FDIC's small loan pilot program. Banks participating in this program offer small loans costing no more than 36 percent APR with a built-in savings component to borrowers who might otherwise consider a payday loan.

39 R.W. Sinnott "Virtues of the Haversine", *Sky and Telescope,* vol. 68, no. 2, 1984, p.159

40 Kleinschmidt I., Sharp B.L., Clarke G.P., Curtis B., Fraser C. (2001). "Use of generalized linear mixed models in the spatial analysis of small-area malaria incidence rates in Kwazulu Natal, South Africa." *American Journal of Epidemiology.* 2001 Jun 15;153(12):1213-21.

About the Center for Responsible Lending

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

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Report on the Status of Payday Lending in California

by

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Commissioned by
Silicon Valley Community Foundation

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SERVING SAN MATEO AND SANTA CLARA COUNTIES

A MESSAGE FROM SILICON VALLEY COMMUNITY FOUNDATION

At a time when more individuals and families began to lose their homes or jobs, Silicon Valley Community Foundation determined that building economic security would fulfill a critical need for many residents in San Mateo and Santa Clara counties.

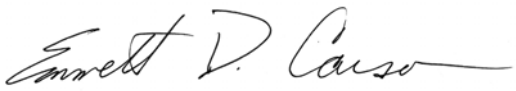
We knew that those caught in the foreclosure crisis needed housing counseling and legal help. We knew that supporting financial education and asset building would help low-wage earners create a better future. And we had anecdotal information that those who lacked access to traditional banking and lending services had few choices but to turn to payday lenders who charge interest rates that can be as high as 400 percent.

To better inform our understanding of how these practices came about, and to have factual and documented information upon which to act, we asked the Public Interest Law Firm to research the history of payday lending and the existing laws and regulations governing the industry. The resulting report provides a thorough analysis of current policies and proposals and suggests steps for policy makers, funders and others interested in curbing these abusive lending practices.

What they found surprised and shocked us. It also helped us to see how payday lending in its current form contributes to creating a growing circle of debt that is difficult for people to escape.

We hope this report will raise awareness and build understanding about the negative impact of payday lending on our communities. We also hope it will prompt interest in public policies to restrict excessive interest and service fees.

The corrosive effects of predatory lending are hurting families and communities in our region. At Silicon Valley Community Foundation, we look forward to building partnerships with government, banking and financial institutions, and nonprofit organizations who want to change that.



Emmett D. Carson, Ph.D.
CEO and President
Silicon Valley Community Foundation

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Executive Summary

Payday lending, the practice by which a lender makes a relatively small, short-term loan to a borrower, using a post-dated check as security, drains wealth from low-income communities and communities of color.

- Payday lending began in California in the 1990's as an extension of the check cashing industry.
- The usual repayment period for a payday loan is two weeks. At the end of that term, the entire loan amount plus the finance charge must be paid in full.
- Because payday lenders charge extremely high interest rates—an average of 400 % on a two-week loan—the typical borrower in California pays $800 for a $300 loan.
- Payday lenders are disproportionately concentrated in predominately African American and Latino neighborhoods. They are also more prevalent in communities where low- and very low-income families live.
- In California, nearly half of borrowers take out payday loans at least once a month, and more than one third have taken out loans from multiple payday lenders simultaneously.

While state and federal laws impose some restrictions on payday lending practices, payday lenders are currently largely unregulated. Because a nationwide lending cap does not appear to be imminent, we believe:

- State and local policy changes should be considered;
- Access to credit and banking resources and non-predatory alternatives should be increased; and
- Consumers should be educated about payday lending and its consequences.

Introduction

The purpose of this report is to provide an update to policymakers and stakeholders interested in consumer protection in California — both on a state and local level — regarding the status of the payday lending laws and practices in the state.

Payday loans are lending transactions in which a borrower provides a lender with a post-dated check and receives immediate cash from the lender. The borrower's check includes not only the principal loan amount, but also any interest and fees charged by the lender. The lender then cashes the borrower's check on the borrower's next payday. Payday loans, sometimes called deferred deposit transactions or cash advances, comprise one corner of a larger universe of "alternative financial services," which also include check cashing services, pawn brokers, and rent-to-own stores.[1] In California, these loans are typically small — between $100 and $300 — and are capped at $300.[2] According to Consumers Union, the "fees for payday loans are extremely high: up to $17.50 for every $100 borrowed."[3] The average annual percentage rate (APR) in 2006 for such loans was a staggering 429%, according to the California Department of Corporations.[4] All of this means that the cost of these small loans quickly balloons to a staggering amount.[5]

By surveying the many research studies and reports that have been published in recent years addressing payday lending, this report: 1) examines the negative effects of payday lending on individuals; 2) discusses the unfortunate reality that many low-income families use check-cashing and payday lending outlets as their primary means of financial management because their neighborhoods have inadequate banking choices but high concentrations of these outlets; 3) summarizes efforts in California, in other states, federally, and, most recently, locally, to address and try to prevent these negative effects by regulating the industry; and 4) provides recommendations for policymakers and stakeholders about the potential policy changes that could alleviate this problem as well as barriers to accomplishing these changes.

The Predatory Nature of Payday Lending in California

Store-front Payday Lending

Payday lending is widespread in California. In 2006, approximately 1 million Californians were issued payday loans (at an average of 10 loans per borrower).[6] The Department of Corporations estimated that there were approximately 2,500 payday lending stores by the end of 2006.[7]

Not surprisingly, representatives of the payday lending industry contend that they offer a useful product that responds to consumer demand for this type of loan. The industry's national association, the Community Financial Services Association of America, portrays a payday loan as a convenient and beneficial product if it is used for short-term needs, saying:

> A payday advance is a small, unsecured, short-term loan that is usually repaid on the borrower's next payday. Typically, a customer uses a payday advance to cover small, unexpected, expenses between paydays to avoid expensive bounced-check fees, late bill payment penalties, and other less desirable short-term credit options. . . .
>
> The payday advance application process is fast and simple. It usually requires only a few supporting documents, including proof of a regular income, a personal checking account and identification.[8]

According to the California Department of Corporations, payday loans have some positive aspects:

> Payday loans provide an immediate source of short-term credit to meet emergency cash needs of consumers that may not have access to traditional sources of credit or elect not to use other sources of credit available to them. Payday loan stores are located in close proximity to the customers. Many times, the transaction can be completed in 15 minutes or less. Payday lenders rarely perform time-consuming credit checks or evaluate the borrower's ability to repay the loan on the due date. Instead, the borrowers are required to provide information easily available to them, such as identification, proof of residence, recent pay stub and checking account information.[9]

Consumer advocates acknowledge that payday loans are easy to obtain and that, by obtaining such a loan, some borrowers can avoid the damage to their credit scores that a delinquent payment to, say, a credit card can cause.[10] However, payday loans, as they are currently structured and permitted in California, harm families and certain fragile communities in ways that outweigh the benefits of the product.

First, payday loans are exceedingly expensive. In California, a 14-day loan has an average annual percentage rate of more than 400%.[11] According to a 2008 issue brief by the Center for Responsible Lending, the typical payday loan borrower ultimately has to pay $800 for a $300 loan.[12] The Center for American Progress explains that these loans are so costly because:

> . . . many borrowers are unable to pay off their loan plus lender fees in full when they are due and still have enough money left to cover their expenses until their next payday. This means they begin a cycle of borrowing . . . that lasts much longer and costs much more than they had originally anticipated.[13]

Payday lending costs Californians an estimated $757 million annually in finance charges.[14]

Moreover, payday loans encourage those who are already struggling to make ends meet to further compromise their financial health. As the California Budget Project has stated,

"Payday loans encourage chronic borrowing."[15] Payday loans carry a very short repayment term, usually only until the next payday — or about two weeks — at which point the full amount of the loan and the finance charge must be paid at once.[16] Since most borrowers take out payday loans to cover a chronic shortage of income over expenses, rather than to cover emergencies,[17] many cash-strapped borrowers experience another shortfall after their first loan. That shortfall is compounded by the finance charge. Payday lenders do not determine the ability of borrowers to repay the balloon payment that becomes due on their next payday. Although "roll-over" loans — where a borrower can renew the loan and pay another fee — are prohibited in California, neither taking out "back-to-back" loans nor taking out payday loans from multiple sources is prohibited. As a result, nearly half of California borrowers take out payday loans at least once a month and more than one third of borrowers have taken out loans from multiple payday lending companies at the same time.[18]

The profoundly negative consequences of borrowers' reliance on payday loans are well documented. A March 2009 letter from the National Consumer Law Center to the Chairman of the National Credit Union Administration provided a short summary of recent research-based findings about the downstream harms of payday lending. For example, researchers recently showed that payday borrowers are twice as likely to file for bankruptcy in the two years after first getting a payday loan as applicants whose applications for a payday loan are rejected.[19] These findings "are consistent with the interpretation that payday loans and interest payments on them might be sufficient to tip the balance into bankruptcy for a population that is already severely financially stressed."[20] Other researchers have found that the use of payday loans increases the incidence of involuntary closure of bank accounts.[21] Still others determined that consumers who use payday loans encounter more hardship and have trouble paying other bills, getting health care, and staying in their home or apartment.[22]

According to an FDIC press release in 2005:

> When used frequently or for long periods, the costs [of a payday loan] can rapidly exceed the amount borrowed and can create a serious hardship for the borrower. The FDIC believes that providing high-cost, short-term credit on a recurring basis to customers with long-term credit needs is not responsible lending.[23]

While these negative consequences are harmful to all sectors of society, they are even more troubling because they disproportionately affect already vulnerable and disadvantaged families and communities. In two separate reports issued in March 2009, the Center for American Progress and the Center for Responsible Lending identified common characteristics of payday borrowers. Up until the issuance of these reports, the understanding that payday borrowers tended to be low income was based largely on anecdotal information.[24] The Center for American Progress' report "Who Borrows from Payday Lenders? An Analysis of Newly Available Data," analyzes recently released data from the Federal Reserve Board and confirms that payday borrowers tend to have less income, lower wealth, fewer assets, and less debt than families without payday loans.[25] The report made these additional findings:

- "Families who borrowed from a payday lender in the past year were more likely to be minorities and single women than their counterparts. They also tended to be younger and had less educational attainment."
- "Approximately 4 out of 10 families who borrowed from a payday lender within the past year owned their own home, while nearly 7 out of 10 families who had not taken out a payday loan were homeowners."
- "Roughly one-quarter of families who had borrowed from a payday lender within the past year identified themselves as savers, compared to nearly half of families who did not withdraw a payday loan."
- "Payday loans are taken out primarily for convenience, to cover an emergency, and to pay for basic consumption needs, such as gas and food."[26]

The California Budget Project recently produced maps of payday lender locations for each of California's legislative districts. The maps set out a vivid portrait of California's two-tier finance system by clearly demonstrating that, while high-income communities in California house very few payday lenders, low-income communities attract them. In Santa Clara County, for example, Assembly Member Ira Ruskin's District 21 is categorized almost entirely as "high income" or "moderate income" territory and houses only 4 payday lenders.[27] Assembly Member Jim Beall's District 24, however, has several "low" and "very low" income areas and is home to 25 payday lenders.[28]

In addition to income, studies have shown that race plays a strong and disturbing role in the location of payday lending. A new analysis by the Center for Responsible Lending finds that California's payday lenders are overwhelmingly located in African American and Latino neighborhoods, even after controlling factors such as household income.[29] Strikingly, Center for Responsible Lending found that the racial and ethnic composition of a particular neighborhood is actually the primary predictor of payday lending locations.[30] African Americans and Latinos make up a disproportionate share of payday loan borrowers in California.[31] The Center's specific findings include:

- "Payday lenders are nearly eight times as concentrated in neighborhoods with the largest shares of African Americans and Latinos as compared to white neighborhoods, draining nearly $247 million in fees per year from these communities."[32]
- "Even after controlling for income and a variety of other factors, payday lenders are 2.4 times more concentrated in African American and Latino communities. On average, controlling for a variety of relevant factors, the nearest payday lender is almost twice as close to the center of an African American or Latino neighborhood as a largely white neighborhood."[33]
- "Race and ethnicity play a far less prominent role in the location of mainstream financial institutions, such as bank branches. While race and ethnicity account for over half of the variation in payday lender location explained by neighborhood factors, they explain only one percent of the variation in bank branch locations."[34]

Payday lending should also be considered in context with the pricing of other household amenities and financial products in lower-income and minority neighborhoods. In its 2006 report "From Poverty, Opportunity: Putting the Market to Work for Lower Income Families," the Brookings Institution found that lower-income families pay higher prices for a wide array of basic household necessities and financial products — including short-term credit — than higher income households do for the same or similar products.[35] According to the Brookings Institution's survey and findings, high-priced alternative financial services, such as payday lenders, check cashers, and pawnshops, tend to be more densely concentrated in lower-income areas.[36] The report pointed to 1) lack of banks and credit unions in lower-income neighborhoods; 2) unscrupulous business practices and the failure of states to regulate the "astronomical rates" of these products; and 3) consumer misinformation as the factors that cause lower-income customers to buy such high-priced products.[37]

The macroeconomic harm of the clustering of payday lending in lower-income and minority communities is clear. Payday lending has drained an estimated $247 million in fees from African American and Latino households in California.[38] As the Center for Responsible Lending points out, "[t]he funds drained from these communities by payday lending could be saved or better spent on food, car repairs, medicine, housing, child care, education or other needs."[39]

Internet Payday Lending

Payday lending has expanded from check cashing outlets, pawn shops and payday loan outlets to the Internet. In fact, one estimate pegs the volume of online lending in 2008 at $7.1 billion, almost 20 percent of the volume of traditional outlets.[40] Taking out a payday loan over the Internet exposes borrowers to all the same predatory practices they would face if they took out a payday loan from a traditional store-front lender. In addition, these borrowers are even more at risk of harm due to the ever-changing and largely unregulated nature of the Internet itself. Even a lobbyist for the payday industry referred to Internet payday lending as "the Wild West."[41]

No single federal law addresses the practice of Internet payday lending, creating a sizeable hole in the regulation of such loans. As the Consumer Federation of America points out, the lack of any federal law governing Internet payday lending exposes borrowers of Internet payday loans to greater risk.[42] However, several states have created laws to address the practice; some have limited or barred Internet payday lending, while others have allowed it to take place with few restrictions.[43] The regulatory inconsistencies created by the differing state laws have allowed Internet payday lenders to thwart state efforts to regulate their practices by registering in the states with few or no restrictions and selling their product to people throughout the country, regardless of the protections in place in the state in which the borrower resides.[44]

Some Internet payday lenders even operate without any state licensure or by basing the company outside of the United States. In California, Internet payday lending operations have

been able to thwart state laws regulating in-state payday lenders by claiming to be owned by Indian tribes in Oklahoma or Nebraska and thus not subject to state law.[45] Unfortunately, even after years of efforts by the California Department of Corporations, these online-only lenders continue to operate under loose federal law, leaving consumers without state-law protections.[46]

Further, Internet payday lenders may claim to be licensed, but offer no proof of licensure on the site to allow consumers the assurance that they are dealing with a legitimate vendor. Unfortunately, there does not appear to be any consistent oversight or regulation of websites that claim to be licensed. To complicate matters even further, many Internet payday lenders are licensed under one business name, but operate under a different domain name.[47] This practice, combined with the series of referral sites that a borrower may click through before actually taking out a loan, creates confusion as to who the lender is and, therefore, who borrowers should contact with complaints or requests for changes to their loans.[48]

The process of taking out an Internet payday loan is fairly simple. According to the Consumer Federation of America:

> The typical Internet payday loan involves an online or faxed application in which the borrower provides extensive personal and financial information, direct deposit of the loan proceeds into the borrower's bank account through the Automated Clearing House system on the same or next day, and an agreement to permit the payday lender to withdraw the loan and finance charge electronically from the consumer's bank account on his/her next payday.[49]

Unfortunately, this process exposes borrowers to many additional risks that they would not encounter at a traditional payday loan store. For example, because borrowers submit applications for payday loans online, their personal financial information is vulnerable to identity theft and other Internet scams.[50] Claims that a site is secure and private may be false, and borrowers do not have a way of verifying that a site is secure.[51]

In addition to increased security risks, Internet payday lenders may not properly disclose the finance charges associated with taking out one of their loans. While the Federal Truth in Lending Act requires lenders to post the annual percentage rate (APR) for loans offered through their websites, Internet payday lenders do not always comply.[52] Consequently, many borrowers have no idea that their payday loan may carry an APR over 500%, as is frequently the case with such loans. In addition to the interest and finance charge on Internet payday loan, borrowers are charged overdraft fees, also known as NSF fees, if the funds are not available in their checking account when the borrower's account is debited on payday.[53] These fees vary greatly and are often not disclosed by the lenders.[54]

Finally, Internet payday borrowers can more easily be trapped in the cycle of debt that is a feature of all payday loans than those who use more traditional means to take out loans.[55] Some Internet payday lenders create loan agreements that are automatically set to refinance the

loan at the end of the loan period; these loans will do so unless the borrower reads the fine print and changes the setting. [56] Borrowers may not notice this detail until their loan is rolled over and they have incurred the additional finance fees.

Why Borrowers Obtain Payday Loans

With such well documented, negative impacts, a natural question is why people utilize such expensive, problematic products in the first place. According to the Center for American Progress, people take out payday loans for three main reasons: convenience, emergency expenses, and to cover basic consumption needs.[57] The Federal Reserve's triennial Survey of Consumer Finances found that 34% of payday loan borrowers chose a payday loan for "the convenience factor."[58] In a survey of payday customers in California, the main reason the customer chose a particular payday lending outlet was because the customer "saw a payday location and went in."[59] Most borrowers take out payday loans to cover regular bills or groceries.[60] Contrary to the assertions of the payday lending industry, only 10.3% of borrowers obtained such loans for an emergency.[61]

The greatest market for payday loans appears to be prior borrowers who are unable to pay off their previous loans. One study found that 90% of payday lenders' business is generated by individuals who take out at least five loans per year; 60% of their business comes from borrowers averaging at least one payday loan per month.[62] Despite payday lending industry claims that the product they offer is meant to be a last resort in times of emergency, the reality is that low-income borrowers obtain these loans repeatedly to cover both their basic needs and the increasing debt created by their prior payday loans.

Payday loans are prevalent in low-income communities largely because these communities tend to have fewer affordable credit options than do their wealthier counterparts.[63] In unbanked or under-banked communities, individuals may not be aware that more affordable loan products are available and, in turn, may not realize the relative costs of payday loans in comparison.[64] For individuals who lack experience with banks or who have bad credit, the time-consuming and complex process of applying for more mainstream forms of credit can be daunting.[65] This discomfort, compared with the prospect of getting a fast loan in a convenient location, often steers individuals who might qualify for more affordable financing into expensive payday loans.[66] Even low-income individuals who do use mainstream banks may obtain payday loans because their banks do not offer smaller, short-term loan products or because the process of obtaining such products is too cumbersome.[67]

Additionally, many low-income individuals obtain payday loans as a response to variable or unreliable earnings. Unlike the predictable salaried employment held by many upper- or middle-class individuals, low-wage jobs often vary in income from week to week or month to month.[68] Low-wage jobs also carry with them a greater risk of outright job loss than do their higher paid counterparts, increasing the likelihood that low-income, less educated individuals will find themselves suddenly unemployed.[69] This income instability, coupled with a greater

likelihood of instability in residence and family composition, exacerbates the financial challenges facing low-income households.[70] As such, low-income households are unlikely to have savings to tide them over during times of job loss or wage reduction, forcing them to turn to payday loans and similar products to cover their basic necessities.

Finally, language or cultural issues may also contribute to low-income households obtaining payday loans as opposed to other types of loan products.[71] Anecdotal evidence suggests that, relative to the general population, immigrants often assume that they will not be able to obtain loans. This misimpression, in turn, makes it less likely that they will apply for a bank account and begin to establish a credit history, which is the key to obtaining mainstream credit.[72] Having limited proficiency in English may also increase borrowers' reluctance to use mainstream banks, making them more likely to use payday loans and other alternative sources of financing; these language barriers may also prevent borrowers from understanding the terms of the loans they obtain.[73] And banks in many immigrants' home countries are not always trustworthy places for low-income people to put their money (shown by, for example, Mexico's 1990s bank crisis), making it still less likely for them to access the mainstream financial system.[74]

California Legislative Responses to Payday Lending

Given these profoundly negative consequences of payday loans and the well-documented disparate impact of those consequences on low-income and minority communities, it is not surprising that the state of California has taken steps to address its pernicious effects. However, as discussed below, these efforts have not significantly reformed the problematic practices of payday lenders; indeed, California is regarded by national advocates as significantly failing to enact meaningful consumer protections.

Payday lending began in California in the 1990s as an extension of the burgeoning check cashing industry.[75] Because payday lending was a new practice, California law did not govern the practice of payday lending specifically. Indeed, the check cashers who offered payday loans argued that they were not subject to the California Finance Lenders Law because they were merely deferring deposit of a check, not making a loan.[76]

The lenders law strictly regulates the interest rate that consumer finance lenders may charge for installment loans under $2,500.[77] The interest rate limits provided by that law are: 2.5% per month on amounts up to $224; 2% per month on amounts between $226 and $900; 1.5% per month on amounts between $901 and $1650; and 1% per month on amounts between $1651 and $2500.[78]

Senate Bill 1959 (Calderon)

As a result of the lobbying efforts of the check cashing industry, California resolved the ambiguity surrounding the lenders law's applicability to payday loans in the industry's favor,

becoming one of 35 states that specifically permit payday lending. In 1996, the California Legislature passed SB 1959 (Calderon), which essentially exempted payday lenders from the lenders law.[79] The assumption that "many individuals face an occasional emergency [need] for small amounts of money for a short term" was used as justification for the passage of this bill.[80]

However, SB 1959 did establish limited restrictions on payday lending, including a $300 limits on the loan amount and 15% limit on fees as well as procedural protections for borrowers.[81]

California Deferred Deposit Transaction Law

After these products became legal in 1997 under SB 1959, the industry boomed: by 2002, some estimates were that over one million deferred deposit transactions per month were completed in California.[82] However, with this growth came controversy. As noted by the Legislature, numerous consumer groups "have long argued that deferred deposits involve excessive charges and fees and too often exacerbate the debt treadmill or 'cycle of debt' confronting many consumers who use deferred deposits."[83]

These concerns led to the passage of the California Deferred Deposit Transaction Law, which became effective in 2003. This statute is currently the primary law governing the practice of payday lending in California.[84]

Passage of the statute (introduced as SB 898 [Perata]) was tremendously hard-fought and contentious as consumer advocates and payday lending industry lobbyists battled over the terms of the bill. This description of the debate was supplied in the Senate Floor Analysis:

> Following the [Assembly Business and Professions] committee's informational hearing, the committee chair initiated negotiations with all stakeholders, including representatives of the author's office, consumer groups, deferred deposit businesses, regulatory agencies, and committee staff. These complex negotiations have been underway for approximately eight months; the result is the current version of this bill. All parties involved in the negotiations made serious and good faith efforts to resolve issues, and there were significant concessions.[85]

The statute established both licensure and regulation of persons making deferred deposit transactions ("licensees").[86] The licensure provisions are rather extensive, requiring, among other things: applications for licensure; surety bonds; submission and maintenance of financial records and statements; fingerprinting of customers and key personnel; fees and assessments for applications, licensure, and administration of oversight; records examination and net worth requirements; advertisement disclosures; and posting of fee information.[87] The statute also established oversight by the Department of Corporations persons engaged in the business of making deferred deposit transactions.[88]

The regulatory features of the statute, however, are not significantly broader than those established by SB 1959. The law made changes to the existing regulatory requirements, including requiring that licensees inform borrowers regarding charges and fees, of the fact that the borrower cannot be prosecuted for returned check in connection with the transaction, and of the prohibition against licensees' demanding collateral.[89] The law also requires licensees to provide borrowers with the Department of Corporations' toll-free number.[90] In addition, the law allows licensees to defer the deposit of a customer's personal check for up to 31 days (rather than 30 days as previously allowed),[91] and allows them to extend the repayment period or to create a payment plan, so long as additional fees are not charged.[92] The law does not, however, limit the number of payday loans a payday lender may make to a borrower in any given period of time.[93]

During the negotiations concerning SB 898, the payday lending/check cashing industry representatives were quick to point out that the new law would subject deferred deposit businesses "to substantially higher charges and fees compared to the [then-] current annual $50 fee."[94] As explained in the Senate Floor Analysis:

> These new charges and fees include an initial non-refundable fee of $100 for investigating the application, plus $200 as an application fee, plus the cost of fingerprint processing, plus an annual assessment, as determined by the Department of Corporations, of the pro rata share of all costs and expenses reasonably incurred in the administration of the provisions of this bill, plus the costs of being periodically audited by DOC.[95]

These concessions by the industry were cited—juxtaposed with concessions by consumer advocates regarding fees and installment plans—as evidence that this bill embodied a compromise that all parties could live with. But, as set out below, this compromise has not fulfilled its promise.

Efforts to Reform Payday Lending in California

Unfortunately, despite the tremendous efforts put into reaching the compromises embodied in the California Deferred Deposit Transaction Law, it has fallen short as a consumer protection measure. For one thing, it leaves California significantly behind some states' protections against some of the worst aspects of payday loans. Other states respond to payday lending in one of three ways:

- "[Enforcing] an interest rate cap at or around 36% on small loans, inclusive of payday lending;"[96]
- "[Allowing] payday lenders to charge interest rates in the hundreds of percent while making some restrictions on lending practices and licensure requirements;"[97] or
- "[Allowing] payday lenders to operate with virtually no legal restrictions."[98]

As of the March 2009, fifteen states and the District of Columbia require payday lenders to comply with an annual interest rate cap of 36%.[99] If Arizona's exclusion for payday lenders from its 36% cap expires in 2010, it will be the sixteenth state to adopt a rate cap.

California falls in the third category of largely ineffectual regulation on the margins. Three consumer advocacy organizations recently graded California an "F" in their "Small Dollar Loan Product Scorecard," based on, among other things, the staggering 460% APR allowed under California law on 2-week payday loans.[100] In contrast, in recent years, Arizona, Arkansas, Georgia, New Hampshire, North Carolina, Ohio, and Oregon have passed usury caps or prohibitions on payday loans.

And the Department of Corporations' reports on the statute's performance make clear that at least one of the most pernicious aspects of payday loans — that they trap repeat borrowers in a lengthy cycle of debt — is still very much a feature of these products.[101] The Department of Corporations found that repeat borrowers make up 73% of payday borrowers statewide.[102]

California legislators have introduced several bills that would have increased regulation of and limits on deferred deposit transactions and/or the payday lending industry. However, despite these attempts, and despite pressure from consumer advocacy organizations for California — and other states — to adopt a "Model Deferred Deposit Loan Act,"[103] most of the legislation has stalled or failed, as detailed below.

Changes to California payday lending law since the passage of the California Deferred Deposit Transaction Law include increasing regulators' reporting requirements regarding advertising,[104] requiring payday lenders to comply with federal law regarding loans to military personnel,[105] and exempting auto dealers from coverage.[106]

Proposed changes that failed include efforts to limit APR to 36%,[107] to lower the fee cap,[108] to ease the burden of payday lenders' collection practices on military personnel beyond federal requirements,[109] and to require regulators to create a comprehensive report on the demand for payday lending.[110] Three bills in the current legislative session appear to be stuck in committees and unlikely to pass until next year, if at all; these bills would consolidate regulatory agencies,[111] legalize Internet payday loans,[112] and authorize payday lenders to receive specified information regarding would-be borrowers' payday loan history.[113]

In short, no significant changes to regulation of the payday lending industry have occurred since passage of the California Deferred Deposit Transaction Law in 2002.[114]

Current Federal Law Related to Payday Lending

Historically, states have borne the responsibility for regulating payday lenders. However, some federal laws that speak to loans and other consumer transactions, generally, apply to payday lending practices and provide some level of uniform protection for consumers.

Additionally, the federal government has established a 36% rate cap for a variety of loan products — including payday loans — when those products are offered to military service members and their dependents. A brief discussion of these federal law protections follows.

Truth in Lending Act

The federal Truth in Lending Act seeks to ensure that consumers receive accurate information about credit products.[115] With respect to payday lending, the Truth in Lending Act and its implementing regulation, "Reg Z," require lenders to disclose finance charges and APRs to consumers "clearly and conspicuously in writing" at or before the time of the transaction.[116] Likewise, Truth in Lending prohibits lenders from utilizing incorrect or incomplete information about the terms of the loan product in order to entice consumers; advertisements must accurately describe the loan product available and must make certain disclosures regarding the loan terms.[117] If a payday lender — or any other lender — fails to meet the technical requirements of this law, the consumer may be entitled to money damages, as well as attorney fees and costs.[118] A lender who knowingly misleads consumers by failing to make the required disclosures may also be subject to criminal liability.[119] A bank financing a loan will be subject to Truth in Lending Act liability even if the loan was provided through a third-party agreement.[120] The Act does not, however, cover state-regulated financial institutions where the state has a parallel statute, underscoring the importance of ensuring that states enact laws that are equally or more protective of credit consumers' right to receive accurate and complete information about the loan products they obtain.[121]

Military Lending Act of 2006

The Military Lending Act of 2006 provides specific protections to military personnel in credit transactions, including payday loans.[122] Specifically, the Act caps the APR of loans offered to service members or their dependents after October 1, 2007, at 36%.[123] Prior to providing the loan, the lender must disclose the APR, the payment obligations, of the borrower, and any other information required by the Truth in Lending Act, in writing.[124]

Community Reinvestment Act

Congress passed the Community Reinvestment Act in 1977 to prevent redlining and to encourage financial institutions to help meet the credit needs of their communities, including the needs of low- and moderate-income neighborhoods.[125] Congress has reauthorized and revised the Act several times since 1977, and the FDIC, the Federal Reserve Board, the Office of Thrift Supervision, and the Office of the Comptroller of the Currency share the responsibility of implementing and enforcing the Act.[126] The federal agency that regulates a particular bank will conduct a Community Reinvestment Act Public Performance Evaluation of that bank on a cycle determined by the applicable regulations.[127] While only illegal credit practices adversely affect a bank's Community Reinvestment Act rating, payday lending activities that are "questionable" (as opposed to strictly illegal) suggest that the bank is not best meeting the credit needs of its

community; this may impact the bank's Public Performance Evaluation, and will be included in the bank's public file.[128]

Additional Federal Protections for Consumers

Federal laws such as the Fair Debt Collection Practices Act,[129] the Federal Trade Commission Act,[130] and the Fair Credit Reporting Act[131] also protect consumers in credit transactions, including payday loans. These laws limit the ways in which a creditor may seek to collect on a loan and provide remedies for both consumers and the general public when lenders engage in behavior that is deceptive, harassing, or otherwise abusive. Along the same lines, the Electronic Funds Transfer Act provides limited protection to consumers obtaining payday loans via the Internet or otherwise utilizing electronic funds transfers.[132] Finally, federal privacy laws, such as the Gramm-Leach-Bliley Act, help protect consumers' personal and financial information.[133]

Federal Agency Regulation of Payday Lending Practices

With the exception of the above-referenced statutes, the federal government has largely refrained from regulating payday lending. However, to the extent that mainstream banks, thrifts, credit unions, or other federally chartered financial institutions may become involved in payday lending, the federal regulatory bodies that oversee those institutions can exert control over those institutions' payday lending practices.

Because federal law allows federally and state chartered institutions to "export" favorable interest rates to borrowers in states other than the state where they are located, and because states cannot effectively regulate federally chartered banks due to federal pre-emption issues, many payday lenders used "rent-a-bank" partnerships with mainstream lending institutions to circumvent state restrictions on loan amounts and interest rates.[134] This practice was especially prevalent in the 1990's.[135] However, in 2000, federal regulatory agencies began to tighten controls on the extent to which the institutions they oversee can engage in payday lending.

In 2000, the Federal Reserve published a rule clarifying that Reg Z, the implementing regulation of the Truth in Lending Act, applies to payday lenders.[136] Soon thereafter, the Office of the Comptroller of the Currency and the Office of Thrift Supervision issued advisory letters regarding the participation of national banks and national and state chartered thrifts in payday lending.[137] These agencies cautioned institutions against the inherent risks of participating in short-term, unsecured, high-interest lending and cautioned banks and thrifts against aligning themselves with less reputable payday lenders, who might be engaging in illegal collections activities or otherwise abusing consumers.[138] Since issuing this guidance, both agencies have taken enforcement actions to stop institutions from engaging in abusive payday lending practices and deterred numerous others.[139]

Although actions by the two agencies effectively limited the participation by federally chartered banks and thrifts in payday lending, state chartered banks remained involved until the FDIC revised its guidance in 2005. The FDIC, which insures both federally chartered and state-chartered banks, recognized the significant risks that payday lending poses to financial institutions.[140] The FDIC's primary concern in issuing this guidance was to guarantee that the banks it insures do not engage in unacceptably risky lending practices either directly or through third-party affiliates.[141] Payday loans are unsecured and often made to individuals who lack the financial resources to repay them; though usually small in amount when made, these loans represent a very tangible risk for lending institutions.[142] As such, the FDIC has noted that payday lending threatens, not only the stability of the individual institution that engages in it, but also the reputation of the banking industry generally. Through its guidance, the FDIC was able to influence the behavior of both federally chartered banks and state-chartered banks, even though it does not regulate state-chartered banks directly.[143]

As with the subprime mortgage lending industry, mainstream banks have often engaged in payday lending through their affiliates; in some instances, payday lending subsidiaries belong to the same corporate structure as does the mainstream bank itself. [144] In its 2005 guidance the FDIC confirmed that a bank's board of directors and management are responsible for the bank's payday lending practices, even if those practices are conducted through a third party.[145] FDIC examiners are instructed to review, not only the arrangements between banks and third-party lending agencies, but also the practices of the third parties themselves.[146] Examiners include these inherently risky loans when evaluating whether banks have sufficient capital to absorb the potential losses associated with payday lending.[147] Additionally, because payday lending practices often raise consumer protection issues and attract the attention of consumer advocates, participation in payday lending exposes banks to potential litigation.[148] By explicitly considering these factors as it evaluates financial institutions for insurance, the FDIC actively discourages mainstream banks from participating in payday lending.

However, as mainstream banks have ceased payday lending activities, credit unions have begun to fill that gap, and consumer organizations have petitioned the National Credit Union Administration, the federal body that oversees credit unions, follow the lead of FDIC and other federal agencies in restricting the ability of credit unions to engage in such practices.[149] Credit unions have long been a resource for low-income and minority communities to obtain more affordable alternatives to payday loans.[150] Many credit unions provide small loans with reasonable interest rates and payment terms. However, credit unions have recently become involved in payday lending.[151] Some credit unions have begun to make payday loans themselves, while others operate through affiliated credit union service organizations or other third parties.[152] Although federal credit unions are subject to an 18% usury cap, meaning they cannot charge more than 18% APR, some credit unions have circumvented this limit by referring to the costs of the loan as "application fees" or "participation fees."[153] Protective federal regulation could help to curb these practices — hopefully without deterring federally chartered credit unions from offering more affordable small loans to their customers — and parallel state regulation could have the same effect on state-chartered credit unions.

Pending Federal Legislation Related to Payday Lending

The Pay Day Loan Reform Act of 2009, H.R. 1214, was introduced to Congress by Representative Luis Gutierrez (D-Ill.) in February 2009.[154] This bill would expand payday lenders' duty to make certain disclosures to consumers beyond what is now required by the Truth in Lending Act.[155] It would require payday lenders to offer "extended" repayment plans involving a minimum of 6 payments spaced at least 13 days apart.[156] It would limit fees and charges to 15 cents on the dollar and would limit the types of actions the lender can take to collect the loan.[157] However, while Congressman Gutierrez was instrumental in the passage of the Military Lending Act of 2006, and while the purported purpose of the bill is to protect consumers, leading consumer advocacy organizations have expressed their strong opposition to the bill.[158] Consumer advocates point out that the bill would essentially give the federal government's seal of approval to payday lenders' charging triple-digit interest rates: 290% APR for a two-week repayment arrangement or 780% APR for one week.[159] Additionally, while the bill requires payday lenders to offer extended repayment plans only twice a year, the typical payday borrower takes out nine loans per year, making the extended payment plan provisions largely ineffective.[160] While the bill would not compromise any states' more protective interest rate caps, it would preempt state statutes regarding extended payment plans.[161]

Two additional bills — The Consumer Lending Education and Reform Act (H.R. 1846)[162] and the Payday Lending Reform Act of 2009 (H.R. 2563)[163] — also purport to add protections for consumers in payday loan transactions, but these bills would actually offer fewer protections than would H.R. 1214, discussed above. Both would endorse triple-digit interest rates, and both have less generous repayment plan provisions than does H.R. 1214.[164]

As discussed further below, many consumer advocates argue that, short of outlawing deferred deposit lending altogether, the only way to prevent predatory payday lending activities is to cap the allowable APR at 36% nationwide, just as the Military Lending Act did for military personnel.[165] A competing Senate Bill, Protecting Consumers from Unreasonable Credit Rates Act of 2009, S. 500, better addresses these concerns.[166] This bill would cap the allowable APR at 36%, as well as clarifying which types of fees and costs are included in that limit.[167] Over one hundred consumer protection organizations across the country have endorsed this bill.[168]

The following pending federal bills could also impact payday lending practices if passed:

- Interest Rate Reduction Act (S. 582), which would require an 15% APR cap on all forms of credit for banks, state credit unions, and other lenders;[169]
- Consumer Credit Fairness Act (S. 257), which would disallow claims in bankruptcy court for debts arising from "high cost consumer credit transactions," including any transaction whose APR exceeds 36%;[170]

- Financial Product Safety Commission Act (S. 566), which would create a federal Financial Product Safely Commission (FPSC) that would ensure the fairness, safety, and sustainability of credit and payment products;[171]
- Consumer Financial Protection Agency Act (H.R. 3126), which would create a federal Consumer Financial Protection Agency to regulate the provision of consumer financial products and services;[172]
- Improving Access to Mainstream Financial Institutions Act (S. 786), which would establish grants to federally insured depository institutions and other entities to create banking options (including payday loan alternatives) for previously unbanked low- and moderate-income individuals.[173]

Recommendations

The following three strategies for addressing the problem of payday lending are discussed in greater detail below:

- **Policy approach:** adopting legal limits on payday lending at the local, state, and/or federal level;
- **Banking access approach:** creating alternative credit and/or banking products that are more accessible to payday lending customers or assisting customers in transitioning to the mainstream banking or credit industries; and
- **Consumer education approach:** teaching potential payday lending customers how to avoid the debt trap of payday lending and how to utilize other alternatives.

Policy Approach

Policy Reform Approaches in California Laws Regarding Payday Lending

In late 2008, the Center for Responsible Lending issued its report, "Springing the Debt Trap: Rate caps are the only proven payday lending reform," which makes an extremely persuasive case for the adoption of 36% interest rate caps for all small loans as the only effective solution to the payday lending problem.[174] The report sets forth the experience of state-law reform efforts, demonstrating that any reforms short of such a cap are ineffective in preventing the debt trap. In states which attempted reforms but did not impose a cap, 90% of payday loans still went to consumers who were taking five or more loans per year.[175] These ineffective reforms of payday lending included:

- Loan renewal bans or "cooling-off" periods;
- Limits on the number of loans outstanding;
- Requiring payment plans to be offered;
- Loan amount caps based on borrower's income;
- Database tracking of borrowing; and
- Limits on payday lending that don't extend to other loan products.[176]

As discussed in the report, an experience with reinstating a 36% rate cap in North Carolina confirmed the beneficial effects of enforcing such an interest rate cap on small loans.[177] North Carolina had previously permitted payday lending by exempting payday lenders from its extant 36% interest rate cap; that exemption had a four-year sunset provision so that lawmakers could analyze the impact of payday lending before reauthorizing the exemption.[178] After seeing the documented effects of payday lending on residents, legislators declined to reauthorize the exemption.[179] From 2002-2006, after the exemption expired, the number of consumer finance loans made for $600 or less increased by 37%, demonstrating that the market would develop other non-payday lending options to help cash-strapped families.[180] As the report describes, in place of payday loans, "small loans from consumer finance companies, credit unions, and other financial institutions have flourished while charging rates at or below the rate cap."[181]

Similarly, after the passage of the Military Lending Act of 2006, the Department of Defense found that "affordable loan options to the military increased after the cap and that military debt relief societies were able to reduce assistance given to indebted members of the military because of the reduction in payday loan usage."[182]

A small loan cap of 36% has a long history in the United States; most states adopted a small loan cap of 36% in the mid-twentieth century to respond to loan-sharking.[183] As of March 2009, fifteen states and the District of Columbia require payday lenders to comply with an annual interest rate cap of 36%.[184] As explained in greater detail above, in 2006, Congress enacted a similar 36% cap for lending to members of the military and their dependents.

Voters across the country appear to support two-digit rate caps. The Center for Responsible Lending conducted a nationwide telephone survey between March 19 and 22, 2009, and found that three quarters of Americans who stated an opinion believe that Congress should cap interest rates, while 72% think that the interest rate cap should be no higher than 36% annually.[185] The survey results are consistent with the outcomes of two ballot measures, in Ohio and Arizona, in last November's election.[186] In Ohio, voters confirmed, by 3 to 1, a 28% rate cap passed by the state legislature.[187] In Arizona, voters rejected, by 3 to 2, a payday lending industry-backed ballot measure that would have made 391% interest rates legal.[188]

The National Consumer Law Center has developed a "Model Deferred Deposit Loan Act" for states to adopt.[189] This Model Act was introduced in the California Senate by Senator Perata as SB 834 in 1999 but failed to pass.[190] This Model Act seeks to provide broad protections for consumers in a range of deferred deposit loan transactions.[191]

The Model Act would apply not only to lenders, but also to other individuals or organizations that facilitate the making of deferred deposit loans, ensuring that payday lenders do not flout the law by enlisting the assistance of out-of-state banks or other financial institutions that might be exempt from other payday lending protections.[192] The Model Act requires licensure and bonding of deferred deposit lenders, in turn creating administrative oversight over such businesses.[193] The licensing process would include both an inquiry of whether the applicant

has been convicted of a crime and an opportunity for public hearing and comment.[194] As such, community members would have a voice in determining whether a deferred deposit lender would be located in their neighborhood.

The Model Act would limit the amount, nature, and terms of deferred deposit loans to prevent unscrupulous lenders from making loans with usurious or abusive terms. First, the Model Act would require that the term of a loan be at least two weeks for every $50 and would cap the total deferred deposit loan amount at $300.[195] The Model Act would also require more thorough written disclosures of the loan's terms, as well as the consequences of non-payment, than does the federal Truth in Lending Act.[196] The Model Act would clarify that each of these written disclosures must be made to borrowers in both English and in the language in which the loan was negotiated.[197]

Most significantly, the Model Act would limit the charges to borrowers, including a 36% APR cap and a cap on how much the lender can charge for a bounced check.[198] The Model Act would also prohibit a variety of other practices by lenders, including using the proceeds of one deferred deposit loan to pay off another earlier loan, threatening debtors with criminal process for failure to repay loans, and engaging in various other unfair or deceptive acts.[199]

Finally, the Model Act would establish administrative, civil, and criminal remedies for violations. Since lenders would be subject to licensing and administrative oversight, consumers would have the right to file licensing complaints, as well as to access information about complaints made by other members of the public.[200]

In addition to the rate cap, the Center for Responsible Lending also recommends that states adopt:

- Caps on the number of loans a borrower can receive annually to ensure that payday loans are only used occasionally in the short-term;
- Bans on the holding of a check or bank access as collateral or security for a loan to prevent the payday loan taking precedence over all other debts and basic needs; and
- Increased incentives for small loans and emergency savings.[201]

With respect to Internet payday lending, the Consumer Federation recommends that states strengthen state usury laws and/or small loan rate caps and prohibit loans based on electronic access to consumers' bank accounts.[202] Short of an outright ban on such loans, the Consumer Federation advises that states should amend small loan and payday loan laws to apply to Internet-based loans; prohibit choice-of-law provisions that make the laws of other countries or states applicable to loans issued to borrowers within that state; and require state credit regulators to investigate the Internet payday loan industry to enforce state credit laws and interest rate limits.[203]

Despite concurrence among consumer advocates that a rate cap is the most effective legislative remedy for payday lending, efforts to adopt such a rate cap in California have not be successful and appear to have stalled. AB 2845 — a rate cap bill proposed by Assemblyman Dave Jones in the 2007-2008 Session — is currently inactive and faced strenuous and well-funded opposition by the California Financial Services Association. As a result of the anemic response of California legislators to enact meaningful payday lending reform, at least one California-based advocacy organization has largely re-directed its limited resources over the past year or so to work towards the adoption of local ordinances that would restrict the location or proliferation of payday lending outlets — discussed further below.[204]

Policy Reform Approaches in Federal Law Regarding Payday Lending

Three pending federal bills would create additional protections for consumers in payday lending transactions.[205] Many of the policy reforms discussed for statewide implementation above could be effective on the federal level as well.[206] With respect to Internet payday lending, the Electronic Fund Transfers Act could be updated to extend consumer protections to credit transactions not envisioned when the law was enacted.[207] However, passage of any of the pending federal bills or any other payday lending reforms is in no way guaranteed, and additional advocacy will likely be needed in coming years to ensure nationwide, comprehensive protection for consumers in small loan transactions.

Consumer advocates at the national level believe that there is work to be done to build on the surprisingly successful federal legislative effort to pass the Military Lending Act; for instance, advocates point out that there has been no comprehensive study — either nationally or looking only at bases in a state with no statewide rate cap — to examine the effects of the Act.[208] Such a study could certainly bolster efforts to pass a federal rate cap; however, it does not appear that this type of study is currently being undertaken.

Another important element on the federal scene is the new President's stated support of a federal rate cap. Barack Obama and Joe Biden have publicly stated that they believe that the protection extended to the military by the Military Lending Act must be extended to all Americans, "because predatory lending continues to be a major problem for low and middle income families alike."[209]

Additionally, opportunities remain for existing federal regulatory bodies, such as the National Credit Union Administration, to protect consumers and to discourage the entities they oversee from engaging in predatory payday lending practices. For Internet-based payday lending, the Consumer Federation of America recommends that the Federal Trade Commission investigate the Internet payday loan industry to enforce federal credit and financial privacy laws.[210] However, any regulatory action should be taken with an eye toward preserving affordable small loans for the consumers who need them, where possible.

Possible Changes in Local Laws Regarding Payday Lending

Local governments also have the power to restrict payday lending through zoning ordinances. In "Controlling the Growth of Payday Lending through Local Ordinances and Resolutions: A Guide for Advocacy Groups and Government Officials,"[211] consumer advocates suggest the following types of local ordinances designed to reduce or stamp out the presence of predatory payday lending within a city's borders:

- **Moratorium during Study Period.** Such a temporary moratorium could be enacted to prevent new payday lenders from setting up shop while the local government evaluates other, more permanent options.[212]
- **Permanent Moratorium.** Cities may enact a permanent moratorium. They can choose to grandfather in existing stores or make a plan for phasing those stores out.[213]
- **Limits on Density and/or Distance.** Cities may limit the number of payday lending outlets in a geographic area either based on distance or population density.[214]
- **Special Zoning**. Cities can "limit payday lending outlets to special zoning districts or a limited number of existing zoning districts."[215]
- **Special Permits**. Cities may require payday lenders to obtain conditional use permits, or other special permits.[216] Cities should ensure that such permits are subject to a public notice and comment period.

Many cities have used one or more of these methods to address predatory payday loan practices in their communities.[217] In the Bay Area, both San Francisco and Oakland have passed ordinances restricting payday lending activities. Oakland requires a special use permit for check cashers and payday lenders and sets minimum distances between such establishments, as well as a minimum distance between these businesses and schools, banks, credit unions, churches, community centers, and liquor stores.[218] San Francisco first enacted a temporary moratorium on check cashing and payday lending businesses in 2006 and has since enacted permanent controls, including a ban on all new payday lending outlets in certain districts and a requirement that, anywhere in the city, a new payday loan outlet may not locate within a quarter mile of an existing one (or of another "fringe financial service," such as a check cashing store).[219]

The City of Sacramento recently adopted an ordinance limiting the activity of check cashers and payday lenders. Although the ordinance, which became effective April 27, 2009, will not close existing stores, it places restrictions on new stores.[220] Check cashers and payday lenders must now obtain conditional use permits before opening any new stores.[221] Additionally, these types of business may not open within 1000 feet from a church, school, bank, or credit union; nor may they open within 500 feet of a residentially zoned area.[222]

Sacramento first instituted a moratorium on new payday lending and check cashing stores in October 2007 in order to explore strategies for addressing these types of business and the problems they cause for the communities where they locate.[223] Sacramento currently has 55 payday lending stores, most of which are located in predominantly African American or Latino

neighborhoods.[224] The new ordinance ends the moratorium but includes provisions to help ensure that payday lenders and check cashers who do locate in Sacramento conform to certain requirements, including a "'good neighbor policy' and . . . other specifications around lighting, signs and security."[225] The City Council passed the ordinance unanimously on March 3, 2009, following a long battle between consumer advocates and the payday lending industry.[226] A broad coalition of local community organizations, including Sacramento ACORN, the Sacramento Housing Alliance, Villa San Juan Owners Association, the Interfaith Service Bureau, the Sacramento Central Labor Council, along with the California Reinvestment Coalition, advocated for the ordinance and were instrumental in its passage.[227]

Advocates in other cities — such as Los Angeles, San Diego, Bakersfield, and San Jose — that have large numbers of payday loan locations should consider mounting similar efforts.[228] Of course, the payday lending industry is likely to mount political or legal challenges — or both — to any proposed zoning ordinance that limits its ability to do business in a given community.[229] Preparations for these potential challenges should involve an array of community groups and strategies. Politically, advocates can encourage payday borrowers who have suffered from predatory practices to testify before their local government body about their experiences; advocates should also help mobilize voters to tell their elected officials that they support regulation of payday lenders.[230] Legal services organizations can also play a role in advising the city or county about potential legal challenges, as well as responses to those challenges.

Local governments can also combat payday lending indirectly by supporting policies that decrease the market for payday loans. Cities can fund financial education programs to help low-income families learn about their credit options, as well as the consequences of accruing consumer debt. They can also support programs that make food and healthcare more accessible to the working poor, including campaigns to educate families about public assistance programs such as the Supplemental Nutrition Assistance Program (formerly Food Stamps) and Medicaid (Medi-Cal, in California). Cities and counties can also provide funding for free or low-cost health care to low-income families to help them avoid taking out payday loans to cover medical expenses.[231] While local governments cannot — and should not — force poor families to pursue these alternatives to payday loans, making these options available will help to ensure that families do not resort to payday lenders because they have no other choice. City and county governments can pass resolutions supporting state and federal reforms of payday lending laws.[232]

Banking Access Approach

Many borrowers take out payday loans because of lack of access to or familiarity with mainstream banking products. In many neighborhoods, payday lending establishments see little to no competition from mainstream banks.[233] A number of authors have noted the barriers that mainstream financial businesses face in reaching lower-income customers, as well as the importance of removing those barriers.[234] The recommendations below provide a guide for how lending institutions could attract would-be payday loan consumers by offering alternative and

affordable finance products and tailoring business practices to the needs of low-income populations.

In order to successfully serve low-income and minority communities, lending institutions must be accessible and usable to the customers who live in those communities. Mainstream banks should consider the following strategies to attract and maintain currently unbanked communities:

- **Bilingual bank workers.**[235] Banks should employ bilingual bankers fluent in the languages most spoken within a given community; in communities with a high percentage of non-native English speakers, banks should consider hiring additional bilingual workers.
- **Specialized customer service training.** Reports show that some payday loan consumers opt for a payday loan because they feel welcomed, rather than intimidated, by payday lending stores.[236] Banks and credit unions should train employees to relate with customers in a culturally appropriate way, and to be welcoming and conscious of potential fears and concerns that customers may have.

Mainstream lending institutions can also compete with payday lenders by providing banking products that better meet the needs of potential borrowers. They should develop a range of alternative finance products, in addition to the traditional finance products.

- **Small consumer loans (a.k.a. small dollar loans).**[237] These loans are around $1,000 or less, with interest rates capped at 36% or lower, without prepayment penalties. These loans should also have an automatic savings component, limited maintenance fees and an extended repayment period of up to 36 months.[238]
- **Credit union installment loans.**[239] Many credit unions offer unsecured installment loans with 18% APR or less. These loans are generally structured so that the principal and interest are repaid in equal installments at fixed intervals (usually once a month).
- **Low-cost check-cashing (a.k.a. "ethical" check-cashing).**[240] Would prohibit financial institutions from charging exorbitant fees to cash personal checks, even if the customer does not have an account at that bank.
- **No-minimum-balance debit accounts that do not allow overdrafts.**[241]

Many different variations on the basic checking account exist and banks can offer accounts with any of the following components: initial deposit requirement, monthly account maintenance charge, minimum account balance requirement, overdraft protection, limit on the number of withdrawals per month, limits on the number of transactions per month, etc.[242] In order to attract lower-income customers, banks and credit unions should offer banking products that have limited or no fees or charges and that have combined checking and savings components.[243]

Often, would-be borrowers do not have the credentials (i.e., credit history, property for collateral, etc.) necessary to access the finance products available at mainstream banks. As such, many organizations and programs working to pull low-income populations out of the cycle of debt have developed tools to prepare low-income people to access traditional finance products. The following is a list of recommendations for transitioning low-income people from the informal economy to participation in mainstream banking arena, as well as for non-predatory alternatives to mainstream banking.

- **Lending circles.**[244] These lending arrangements solve the problem of unmet banking needs in low-income communities through the informal economy. Participants contribute an amount of money to the "pool" and then each contributor can borrow from it when necessary; over time, each person repays the amount that they borrowed.
- **Alternative credit reporting.**[245] Community organizations should develop ways to incorporate non-traditional credit references and scoring for borrowers with little or no credit history into credit reports in order to enable creditors to more accurately assess a person's credit history and decide whether to qualify that person for a loan or credit card. Such non-traditional credit could be built through lending circles or other non-traditional credit sources.
- **"Starter" Bank Account.** These accounts, often provided through mainstream banks, are designed to help account-holders build personal savings and establish a credit history in order to be prepared to access more affordable credit sources later.[246]
- **Financial services pre-paid debit cards.** With these cards, the cardholder determines the quantity of money to add or reload onto the card, which can be equipped with direct deposit, automatic bill pay and automatic savings features, in order to enable the cardholder to easily manage finances. These types of cards have very few restrictions.[247]

Both mainstream banks and community groups have already begun to implement some of the above strategies. "Bank on San Francisco," a program pooling the efforts of local government agencies, key non-profits, banks and credit unions, works to connect new, lower-income customers with banks and mainstream financial products. Key components of Bank on San Francisco's model include: working with financial institutions to make more "starter" bank accounts available; educating consumers—especially low-income people—about finance management, the benefits of bank accounts and how to open a starter bank account; and discouraging new check cashing and payday lending stores from opening.[248]

In 2008, the success of Bank on San Francisco led Governor Schwarzenegger to launch Bank on California, a program aimed to provide low-income Californians with "starter" bank accounts through collaborative relationships with banks, community financial organizations and local governments. Bank on San Jose is a pilot program of the Bank on California initiative. Currently, Bank on San Jose is working with seven banking partners and one credit union partner on key priorities of the program, such as connecting unbanked people with starter bank accounts

and providing "second chance" bank accounts in conjunction with financial education for people who have mismanaged accounts in the past.[249] Additionally, Bank on San Jose is working with financial institution partners to begin a practice of accepting alternative forms of identification from customers interested in opening a new bank account.[250]

Local community groups have also sought creative ways to build credit in low-income and minority neighborhoods. For example, in 2005, the Mission Asset Fund was created when the Levi Strauss & Company donated $1 million for the "economic development" of San Francisco's Mission neighborhood. In deciding on a strategy for using the funds, a steering committee comprised mostly of community leaders first assessed the needs and desires of the community through community outreach and interviewing, then developed a mission and structure that was tailored to the community's expressed needs. The Mission Asset Fund now connects Mission neighborhood residents with alternative financial products and provides financial education in order to help build wealth and personal assets that make those residents more financially secure.[251] Currently, Mission Asset Fund is partnering with One California Bank to house and track payments into lending circles in order to allow community member participants to establish and develop credit ratings.[252]

Consumer Education Approach

Incentives to mainstream financial business to enter lower-income neighborhoods and to offer appropriate products should be made in tandem with efforts to educate consumers "to dispel myths and misperceptions" about these business.[253] And as many have suggested, consumers should be provided with information and tools to make the best financial choices they can.[254] Presumably, an increased understanding about financial and banking options could help would-be payday loan consumers to make a different, perhaps less expensive, choice when faced with the question of how to cover an emergency expense. [255]

For example, adjusting the amount of income tax withheld from a paycheck temporarily could provide additional income for an emergency. Educating people about the logistics of making an income tax change, especially the potential benefits and consequences of that change, equips them with one more option to consider when assessing finances. Increased accessibility of information about banking and finance options available to people would likely increase the likelihood that they will make good decisions about how to manage their money, including whether or not to accept a payday loan.[256]

The Brookings Institution noted that the need for financial education for lower-income consumers comes at a time when numerous entities, such as "banks, employers, public schools, community colleges, faith-based groups, community groups, and the military," are providing financial education services.[257] An abundance of financial education information designed for lower-income families can be found online — Brookings cites to www.beehive.org — and most states have recently considered legislation related to financial education.[258]

It should be noted that the effectiveness of financial literacy programs has been questioned,[259] apparently due to the difficulty in creating a sound methodology for assessing them.[260] It is also important to recognize that some experts in financial literacy programs believe that such programs are of limited value without incentives for participants, which are "as important as program content and structure in attracting students and in influencing their behavior."[261]

However, there is certainly support for the thesis that financial education is beneficial.[262] Brookings recommends that community leaders can improve the availability and quality of financial education to help lower-income families avoid "unscrupulous business that charge higher-than-necessary prices" by:

- Finding and analyzing the gaps, both in delivery and quality, in consumer financial education delivery in specified jurisdictions;
- Researching and publicizing the best practices in consumer financial education that will best fill those gaps; and
- Ascertaining a methodology for setting outcome goals to measure the impact of financial education efforts, both in general financial education programs and in those that are targeted towards a particular consumer purchase.[263]

Another Brookings author agreed that "well-evaluated demonstration programs would greatly advance our knowledge of best practices around financial education."[264] Locally, adding the strategies described above — including a research component and/or an outcome-measurement element — to existing Bank on San Jose efforts, described above, would be useful and advisable.

Conclusion

Payday lenders have capitalized on low-income communities' demand for small-dollar credit products that respond to emergency needs or day-to-day income shortfalls. Recent years have seen a marked increase in the amount of information available about payday lending patterns, as well as the ways in which the payday lending industry strips wealth from families and communities by creating a cycle of escalating debt.

Although information about the effectiveness of various strategies to combat predatory payday lending practices is less plentiful, a multi-faceted approach seems warranted. Efforts should continue to develop policies at the federal, state, and local level to impose rate caps or other controls to protect consumers. However, given the challenges of mounting these policy efforts against strong and well-funded industry opposition, these policies should be complimented by on-the-ground efforts to create more affordable credit products that meet the same needs as payday loans. Since the need of low-income families for readily available small loans is not likely to abate, creating and sustaining non-predatory alternatives to payday lending — whether from mainstream banks or from less "traditional" sources like lending circles — is

imperative. Further, education and organizing efforts can help empower members of low-income and minority communities to make informed financial decisions, to build wealth in their neighborhoods, and to participate in policymaking.

Appendix: Legislative Efforts to Reform Payday Lending in California, 2003-2009

2003-2004 Legislative Session

- AB 2156 (Reyes): Requires the Commissioner of Corporations' report regarding the implementation of the California Deferred Deposit Transaction Law to include specified information on the advertising practices of payday lenders and recommendations regarding additional regulation of those practices.[265]

2005-2006 Legislative Session

- AB 207 (Dymally): Would have: (1) prohibited fees on payday loans from exceeding an effective annual rate of 10%; (2) required that a post-dated check written in exchange for a payday loan be made out to the licensed payday lender; and (3) rendered void any check held by the lender for longer than 31 days.[266]

- AB 1965 (Lieu): Would have (1) authorized service members and reservists, and their spouses, to defer payments on payday loans; (2) prohibited payday lenders from garnishing wages or contacting military superiors for collection on a payday loan; and (3) required payday lenders to honor repayment agreements made through negotiation.[267]

2007-2008 Legislative Session

- AB 7 (Lieu): Requires payday lenders to comply with the federal law relating to terms of consumer credit extended to armed services members and dependents of armed services members as required by the Military Lending Act.[268]

- AB 634 (Calderon): Redefines "deferred deposition transaction" to exempt auto dealers from coverage when they accept checks as deposits.[269]

- AB 1534 (Nunez): Would have required an additional report to be provided to the Governor and the Legislature by December 1, 2008. The report would have included specified information on payday loan consumers and the advertising practices of payday lenders.[270]

- AB 2845 (Jones): Would 1) prohibit the interest on a payday loan from exceeding an annual percentage rate of 36%; 2) require the informational notice and written agreement for a payday loan to include a notification of the interest rate limit; and, 3) prohibit a payday lender from acting to evade these requirements.[271]

2009-2010 Legislative Session

- AB 33 (Nava): Would consolidate portions of three existing state departments to create a single operations and licensing framework that would cover licensing and regulation of finance lenders, among other entities.[272]

- AB 377 (Mendoza): Would make amendments to the California Deferred Deposit Transaction Law related to advertising regulations for licensed payday lenders.[273] This bill would also legalize Internet payday loans made to Californians and would offer Californians who borrow Internet payday loans only one repayment plan option, forcing them to pay additional finance fees as a result.

- AB 545 (Salas): Would authorize the Commissioner of Corporations to develop and implement a system that would enable a payday lender to receive specified information regarding a consumer's history with payday loans.[274]

ENDNOTES:

[1] *See, e.g.*, Sharon Hermanson and George Gaberlavage, "The Alternative Financial Services Industry," AARP Public Policy Institute (Aug. 2001), available at http://www.aarp.org/research/credit-debt/credit/aresearch-import-198-IB51.html. The San Francisco Municipal Code also uses the term "fringe financial services" to refer to these types of establishments. San Francisco Muni. Code § 790.111.
[2] Consumers Union, "Fact Sheet on Payday Loans" (1999), available at http://www.consumersunion.org/finance/paydayfact.htm.
[3] *Ibid.*
[4] California Department of Corporations, "Report to the Governor and the Legislature: California Deferred Deposit Transaction Law" (Dec. 2007), 6, available at http://www.corp.ca.gov/pub/pdf/CDDTL07_Report.pdf.
[5] Center for Responsible Lending, "Wealth-stripping payday loans trouble communities of color," CRL Issue Brief (Oct. 2008), available at http://www.responsiblelending.org/pdfs/az-payday-communities-of-color-10-2-final.pdf, *cited by* Logan and Weller, *infra* note 10 at 3.
[6] California Budget Project, "Payday Loans: Taking the Pay out of Payday" (Sept. 2008), 5, available at http://www.cbp.org/pdfs/2008/080926_paydaychartbook.pdf.
[7] California Department of Corporations, "Report to the Governor and the Legislature," *supra* note 4 at 19.
[8] Community Financial Services Association of America, "About the Payday Advance Service," http://www.cfsa.net/about_payday_advance_product.html.
[9] California Department of Corporations, "Report to the Governor and the Legislature," *supra* note 4 at 5.
[10] Amanda Logan and Christian E. Weller, "Who Borrows From Payday Lenders? An Analysis of Newly Available Data," Center for American Progress (Mar. 2009), 2, available at http://www.americanprogress.org/issues/2009/03/pdf/payday_lending.pdf
[11] California Budget Project, *supra* note 6 at 5. Consumers Union makes the following argument that such high fees are unnecessary:

> The industry claims its extremely high fees are necessary on account of the risk being taken and its high loss ratio. In fact, in Colorado, one of the few places in the country that collects actual data from the industry, **payday lenders charge-off only 3%** of the loans made from 1996-1997, while their loans had an average APR of 485.26%. **Conversely, California banks charged off 2.7% of credit card debt** in those same years, while having an APR of 15-22%. Thus, the payday loan industry's claim of risk and loss simply does not stand up to close scrutiny and does not justify the high rates charged.

Consumers Union, "Fact Sheet on Payday Loans," *supra* note 2 (citations omitted) (emphasis in original).
[12] Center for Responsible Lending, "Wealth-stripping payday loans trouble communities of color," CRL Issue Brief (Oct. 2008), available at http://www.responsiblelending.org/pdfs/az-payday-communities-of-color-10-2-final.pdf, *cited by* Logan and Weller, *supra* note 10 at 3.
[13] Logan and Weller, *supra* note 10 at 3.
[14] California Reinvestment Coalition, "The Financial Divide: An Uneven Playing Field, Bank Financing of Check Cashers and Payday Lenders in California Communities" (Mar. 2005), 2, available at http://www.calreinvest.org/system/assets/17.pdf.
[15] California Budget Project, *supra* note 6 at 5.
[16] *Id.* at 7. In 2006, the average repayment period in California was just 16 days, even though state law allows a repayment period of up to 31 days. *Id.* at 10.
[17] A 2007 survey of California borrowers found that only 10.3% used payday loans to cover financial emergencies. *Id.* at 25. However, the Federal Reserve's 2007 Survey of Consumer Finance Services found that 29% of borrowers took out payday loans for emergencies. *See* Logan and Weller, *supra* note 10 at 11 (citation omitted). This discrepancy may be a result from the survey sample, the definition of "emergency" used by surveyors, or other differences in survey methodologies.
[18] California Budget Project, *supra* note 6 at 5.
[19] Paige Marta Skiba and Jeremy Tobacman, "Do Payday Loans Cause Bankruptcy?" (Oct. 2008), http://www.law.vanderbilt.edu/faculty/faculty-personal-sites/paige-skiba/publication/download.aspx?id=2221, *cited*

in Letter from Lauren K. Saunders, Managing Attorney, National Consumer Law Center, to Michael E. Fryzel, Chairman, National Credit Union Administration (Jan. 29, 2009), 2.
[20] Skiba and Tobacman, *supra* note 19 at 3.
[21] Dennis Campbell, *et al.*, "Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures" (June 2008) (paper presented at the Federal Reserve Bank of Boston Summer Workshop, Consumer Behavior and Payment Choice, July 2008), available at www.box.frb.org/economic/eprg/conferences/payments2008/campbell_jerez_tufano.pdf, cited in letter from Lauren K. Saunders, *supra* note 19 at 2.
[22] Bart J. Wilson, *et al.*, "An Experimental Analysis of the Demand for Payday Loans," (April 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1083796; Brian T. Melzer, "The Real Costs of Credit Access: Evidence from the Payday Lending Market" (Nov. 2007), available at http://home.uchicago.edu/~bmelzer/RealCosts_Melzer.pdf, cited in letter from Lauren K. Saunders, *supra* note 19 at 2.
[23] FDIC Press Release, "FDIC Revises Payday Lending Guidance" (Mar. 2005), available at http://www.fdic.gov/news/news/press/2005/pr1905.html.
[24] Brookings Institution, "From Poverty, Opportunity: Putting the Market to Work for Lower Income Families," (2006), available at http://www.brookings.edu/reports/2006/07poverty_fellowes.aspx.
[25] Logan and Weller, *supra* note 10 at 1.
[26] *Ibid.*
[27] Available at http://www.cbp.org/pdfs/2008/PaydayMaps/AD%2021.pdf.
[28] Available at http://www.cbp.org/pdfs/2008/PaydayMaps/AD%2021.pdf. Ninety-one payday lending stores operate in Santa Clara and San Mateo Counties, with just over half of those stores are located in San Jose—the most populated city in the Bay Area with 939,889 residents. California Department of Corporations, "2007 Payday Loan Study" (December 2007; updated June 2008), 31-32, available at http://www.corp.ca.gov/pub/pdf/PDLStudy07.pdf.
[29] Wei Li, *et al.*, "Predatory Profiling: The Role of Race and Ethnicity in the Location of Payday Lenders in California," Center for Responsible Lending (Mar. 26, 2009), 25, available at http://www.responsiblelending.org/payday-lending/research-analysis/predatory-profiling.pdf.
[30] *Ibid.*
[31] *Ibid.*
[32] *Id.* at 10.
[33] *Id.* at 14.
[34] *Id.* at 20.
[35] *See* Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 20-24. Other high-priced "alternative financial services" include car title lenders, pawnshops, and remittance sellers.
[36] *Id.* at 26.
[37] *Id.* at 4-7.
[38] Li, *et al.*, *supra* note 29 at 12.
[39] *Id.* at 24.
[40] Arthur Delaney, "Online Loan Sharks Trap People into Debt — Then Disappear," Huffington Post, May 21, 2009 (available at http://www.huffingtonpost.com/2009/05/21/online-loan-sharks-trap-p_n_205832.html), *citing* Consumer Federation of America, "Payday Loan Consumer Information — Facts" (available at http://www.paydayloaninfo.org/facts.cfm).
[41] *Ibid.*
[42] Jean Ann Fox and Anna Petrini, "Internet Payday Lending: How High-priced Lenders Use the Internet to Mire Borrowers in Debt and Evade State Consumer Protections," Consumer Federation of America (Nov. 30, 2004), 5, available at http://www.consumerfed.org/pdfs/Internet_Payday_Lending113004.PDF.
[43] *Id.* at 9-13; see also "Pennsylvania to Require Licenses For Internet Payday Lenders," July 29, 2008 (describing state's effort to bring Internet payday lenders under its credit laws) (available at http://www.consumeraffairs.com/news04/2008/07/payday_lending_internet.html); Jim Siegel, "Payday-lending bill advances," The Columbus Dispatch, May 1, 2008 (describing Ohio House passage of HB 545, a bill banning Internet payday lending) (available at http://www.dispatchpolitics.com/live/content/local_news/stories/2008/05/01/payday01.ART_ART_05-01-08_B1_TQA32FU.html?sid=101).
[44] See Fox and Petrini, *supra* note 42.

[45] Marc Lifsher, "Internet payday lenders with ties to Indians dodge California regulators," Los Angeles Times (April 13, 2009), available at http://articles.latimes.com/2009/apr/13/business/fi-internet-loans13?pg=1
[46] *Ibid.*
[47] Fox and Petrini, *supra* note 42 at 12.
[48] *Ibid.*; *see also* Delaney, *supra* note 40 (describing futile effort of attorney representing online payday consumer who was subjected to thousands of dollars in illegal fees to track down individuals behind payday lending sites).
[49] Fox and Petrini, *supra* note 42 at 13.
[50] *See id.* at 25-6, 30-1.
[51] *See id.* at 31.
[52] *See id.* at 23.
[53] *See id.* at 28-30.
[54] *See* id. at 29.
[55] *See id.* at 26-30.
[56] *See id.* at 27-8.
[57] Logan and Weller, *supra* note 10.
[58] *See, e.g.*, Li, *et al.*, *supra* note 29 at 23.
[59] Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 7.
[60] California Budget Project, *supra* note 15 at 25.
[61] *Ibid. But see* Logan and Weller, *supra* note 10 at 11 (citation omitted) (citing to the Federal Reserve's Survey of Consumer Finance, which found that 29% of those borrowers surveyed used payday loans for emergencies).
[62] Li, *et al.*, *supra* note 29 at 2.
[63] *See, e.g.*, Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 34.
[64] *See, e.g.*, Rebecca M. Blank, "Public Policies to Alter the Use of Alternative Financial Services among Low-Income Households," Brookings Institution and University of Michigan (2008), 2, available at http://www.brookings.edu/papers/2008/0416_low_income_blank.aspx.
[65] Li, *et al*, *supra* note 29 at 23.
[66] *Ibid.*
[67] Blank, *supra* note 64 at 2.
[68] *Id.* at 4.
[69] *Ibid.*
[70] *Ibid.*
[71] Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 7.
[72] Anna Paulson, *et al.*, "Financial Access for Immigrants: Lessons from Diverse Perspectives," Brookings Institution (May 2006), 22, available at http://www.brookings.edu/reports/2006/05demographics_paulson.aspx.
[73] Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 7.
[74] Paulson, *supra* note 69 at 18-19.
[75] California Budget Project, *supra* note 6 at 8.
[76] *Ibid.*
[77] Cal. Fin. Code § 22303.
[78] *Ibid.*
[79] SB 1959, 1995-96 Leg. Sess. (Cal. 1996).
[80] SB 1959, Assembly Floor Analysis (Aug. 1996).
[81] SB 1959, *supra* note 62.
[82] *See* SB 898, 2001-2002 Leg. Sess. (Cal. 2002), Senate Floor Analysis (Aug. 2002).
[83] *Ibid.*
[84] *See* Cal. Fin. Code §§ 2300-23106; 10 Cal. Code Regs §§ 2020, et seq. (regulations under the CDDTL). Note that the CDDTL does not address, or even mention, Internet payday lending per se.
[85] SB 898 Senate Floor Analysis, *supra* note 82.
[86] *See* Cal. Fin. Code §§ 23000-23106.
[87] *See* California Department of Corporations, "California Deferred Deposit Transaction Law," available at http://www.corp.ca.gov/FSD/CDDTL.asp, for a summary of some of the licensure requirements of the CDDTL.
[88] California Department of Corporations, "Report to the Governor and the Legislature," *supra* note 4 at 4.
[89] Cal. Fin. Code §§ 23035(c).
[90] *Ibid.*
[91] Cal. Fin. Code §§ 23035(a).

[92] Cal. Fin. Code §§ 23036(b).
[93] Cal. Fin. Code §§ 23000-23106.
[94] SB 898, Senate Floor Analysis, *supra* note 82.
[95] *Ibid.*
[96] Uriah King and Leslie Parish, "Springing the Debt Trap: Rate caps are only proven payday lending reform," Center for Responsible Lending (Dec. 2007), available at http://www.responsiblelending.org/pdfs/springing-the-debt-trap.pdf.
[97] *Ibid.*
[98] *Ibid.*
[99] Li, *et al.*, *supra* note 29 at 3.
[100] Consumers Union, National Consumer Law Center, and Consumer Federation of America, "Small Dollar Loan Products Scorecard" (*last updated* August 2008), available at http://www.consumerfed.org/pdfs/small_loan_scorecard_08.pdf.
[101] California Budget Project, "Recent Reports on Payday Lending in California Should Be Used with Caution" (May 1, 2008), 1, available at http://www.cbp.org/pdfs/2008/080501_PaydayReportCautionMemo.pdf.
[102] *Id.* at 3. Indeed, as consumer groups have noted, "[d]ue to a major factual error and a methodological flaw, . . . [DOC's] report highlights data that understate the number of Californians who repeatedly use payday loans. In addition, the DOC report understates the average number of payday loans per borrower." *Id.* at 4.
[103] See National Consumer Law Center, "Model Deferred Deposit Loan Act," available at http://www.consumerlaw.org/initiatives/payday_loans/paydayac.shtml.
[104] AB 2156, 2003-2004 Leg. Sess. (Cal. 2004); Cal. Fin. Code § 23057.
[105] AB 7, 2008-2008 Leg. Sess. (Cal. 2008); Cal. Fin. Code § 1241; Cal. Fin. Code § 14960; Cal. Fin. Code § 22345; Cal. Fin. Code § 23038; Cal. Mil. & Vet. Code § 394.
[106] AB 634, 2007-2008 Leg. Sess. (Cal. 2008); Cal. Fin. Code § 23001.
[107] AB 2854, 2007-2008 Leg. Sess. (Cal.), would amend Cal. Fin. Code §§ 23001; 23005; 23035; 23036; 23039.
[108] AB 207, 2005-2006 Leg. Sess. (Cal.), would have added Cal. Fin. Code §§ 23038-23042.
[109] AB 1965, 2005-2006 Leg. Sess. (Cal.), would have added Cal. Fin. Code § 23038.
[110] AB 1534, 2007-2008 Leg. Sess. (Cal.), would have amended Cal. Fin. Code § 23057.
[111] AB 33, 2009-2010 Leg. Sess. (Cal.), would amend various sections of Cal. Bus. & Prof. Code, Corp. Code, and Gov't Code.
[112] AB 377, 2009-2010 Leg. Sess. (Cal.), would amend Cal. Fin Code §§ 23001, 23027, and 23035, and add Cal. Fin. Code §§ 23005.5, 23010.5, and 23036.5.
[113] AB 545, 2009-2010 Leg. Sess. (Cal), would add Cal. Fin. Code § 23024.5.
[114] For more detail regarding these changes and attempted changes to state law, see Appendix, "Legislative Efforts to Reform Payday Lending in California, 2003-2009."
[115] 15 U.S.C. § 1601. The Truth in Lending Act may be found at 42 U.S.C. §§ 1601 et seq., and its implementing regulation ("Reg Z") is located at 12 C.F.R. § 226.
[116] 12 C.F.R. § 226.5.
[117] 12 C.F.R. § 226.16.
[118] 15 U.S.C. § 1640.
[119] 15 U.S.C. § 16.11.
[120] FDIC, "Guidelines for Payday Lending," FDIC Financial Institution Letters, FIL-14-2005 (Mar. 2005), available at http://wwww.fdic.gov/news/news/financial/2005/fil1405a.html.
[121] 15 U.S.C. § 1633.
[122] 10 U.S.C. § 987.
[123] 10 U.S.C. § 987 (b).
[124] *Ibid.*
[125] Office of the Comptroller of the Currency, "Community Reinvestment Act Information," available at http://www.occ.treas.gov/crainfo.htm. The Community Reinvestment Act may be found at 12 U.S.C. §§ 2901 et seq.
[126] FDIC, "Guidelines for Payday Lending," *supra* note 119.
[127] 12 U.S.C. §§ 2901(b), 2903; 12 C.F.R. § 228.21.
[128] FDIC, "Guidelines for Payday Lending," *supra* note 119.
[129] 15 U.S.C. §§ 1692 et seq.
[130] 15 U.S.C. §§ 41-58.

[131] 15 U.S.C. §§ 1681 et seq.
[132] 15 U.S.C. § 1601. The Electronic Funds Transfer Act regulates transactions where the consumer allows the other party to the transaction access to the consumer's bank account, such as through debit card or direct deposit transactions. While neither the Act nor its implementing regulation, "Reg E," was designed with Internet payday loans in mind, both pertain to arrangements where the borrower provides a check or other account information to the lender as a source document, but, rather than cashing the check (as happens in in-person payday lending) the lender uses the bank account information to access the account directly.
[133] *See, e.g.*, 15 U.S.C. §§ 6801-6809; Federal Trade Commission, "The Gramm-Leach Bliley Act," available at http://www.ftc.gov/privacy/privacyinitiatives/glbact.html.
[134] *See, e.g.*, Jean Ann Fox and Edmund Mierzwinski, "Rent-A-Bank Payday Lending: How Banks Help Payday Lenders Evade State Consumer Protections," Consumer Federation of America and U.S. Public Interest Research Group (Nov. 2001), available at http://www.consumerfed.org/pdfs/paydayreport.pdf; Pauline Smale, "Payday Loans: Federal Regulatory Initiatives," CRS Report for Congress (May 2005), 3-4, available at http://digital.library.unt.edu/govdocs/crs/permalink/meta-crs-9204:1.
[135] Smale, *supra* note 134 at 3.
[136] *Ibid.* (citation omitted).
[137] *See* Office of the Comptroller of the Currency, OCC Advisory Letter AL 2000-10 (Nov. 27, 2000) available at http://www.ffiec.gov/ffiecinfobase/resources/retail/occ-al-2000-10_payday_lending.pdf; Office of Thrift Supervision, "Agencies Urge Banks and Thrifts to Evaluate Risks with Vendors Engaged in Practices Viewed as Abusive to Customers" (Nov. 27, 2000), available at http://files.ots.treas.gov//77099.html.
[138] *See, e.g.*, OCC Advisory Letter AL 2000-10, *supra* note 137.
[139] Smale, *supra* note 134.
[140] FDIC, "Guidelines for Payday Lending," *supra* note 120 at 1-2.
[141] *Id.* at 2.
[142] *Id.* at 5.
[143] Letter from Lauren K. Saunders, *supra* note 19 at 13.
[144] California Reinvestment Coalition, "The Financial Divide," *supra* note 14.
[145] FDIC, "Guidelines for Payday Lending," *supra* note 120 at 4.
[146] *Ibid.*
[147] *Id.* at 4.
[148] *Id.* at 6.
[149] *See* letter from Lauren K. Saunders, *supra* at note 19.
[150] *See, e.g.*, Hon. Johann Johnson, Chairman, National Credit Union Administration, "Financial Services for Disadvantaged Communities" (statement before the Appropriations Subcommittee on Financial Services and General Government, U.S. House of Representatives, Mar. 1, 2007), 12, available at http://www.ncua.gov/news/speeches/2007/Johnson/Testimony07-0301.doc.
[151] Letter from Lauren K. Saunders, *supra* note 19 at 1.
[152] *Ibid.*
[153] *Id.* at 1-3.
[154] H.R. 1214, 111th Cong. (2009).
[155] *Id.* at § 2 (a).
[156] *Id. at* § 2 (b).
[157] *Ibid.*
[158] ACORN, Americans for Fairness in Lending, Consumer Action, Consumer Federation of America, Consumers Union, National Association of Consumer Advocates, National Consumer Law Center, National Fair Housing Alliance, National Community Reinvestment Coalition, and U.S. PIRG signed a joint statement opposing the bill on March 23, 2009. ACORN, *et al.*, "Please Don't Co-Sponsor or Support HR 1214, 'Payday Lender Protection Act,'" (Mar. 23, 2009) available at http://www.affil.org/uploads/pI/Nw/pINwPM5OS3qeu0gZh8WV0A/Oppose-HR-1214-23march09.pdf. To view the April 2, 2009, testimony before the House Committee on Financial Services, go to http://www.house.gov/apps/list/hearing/financialsvcs_dem/HR04022009.shtml.
[159] ACORN, *et al.*, "Please Don't Co-Sponsor or Support H.R. 1214," *supra* note 158.
[160] *Ibid.*
[161] *Ibid.*
[162] H.R. 1846, 111th Cong. (2009).
[163] H.R. 2563, 111th Cong. (2009).

[164] *See* H.R. 1846, *supra* note 162 at §§ 2(a)(3), 2(b)(1), 2(b)(5); H.R. 2563, *supra* note 163 at §§ 2(a)(3), 2(b)(3), 2(b)(4)(A).
[165] *See, e.g.*, King and Parrish, *supra* note 98 at 22.
[166] S. 500, 111th Cong. (2009), was introduced in the Senate by Sen. Richard Durbin (D-Ill.) in February 2009. A companion bill, H.R. 1608, 111th Cong. (2009), was introduced in the House of Representatives by Jackie Speier (D-Cal.) in March.
[167] S. 500, *supra* note 166 at § 3.
[168] Letter from Jean Ann Fox, Consumer Federation of America, *et al.*, to Senator Richard Durbin (Mar. 2, 2009), available at http://www.consumersunion.org/pub/core_financial_services/009581.html.
[169] S. 582, 111th Cong. (2009). A companion bill, H.R. 1640, 111th Cong. (2009), has been introduced in the House of Representatives.
[170] S. 257, 111th Cong. (2009).
[171] S. 566, 111th Cong. (2009). A companion bill, H.R. 1705, 111th Cong. (2009), has been introduced in the House of Representatives.
[172] H.R. 3126, 111th Cong. (2009).
[173] S. 786, 111th Cong. (2009).
[174] King and Parrish, *supra* note 98.
[175] *Id.* at 9.
[176] *Id.* at 12.
[177] *Id.* at 20.
[178] *Ibid.*
[179] *Ibid.*
[180] *Ibid.*
[181] *Ibid.*
[182] Li, *et al.*, *supra* note 29 at 26, *citing* United States Department of Defense, "Report on the Implementation of Limitations on Terms of Consumer Credit Extended to Service Members and their Dependents," (July 2008). Consumer advocates have noted that insufficient data to fully document the benefits of the Military Lending Act was available at the time this report was generated. Telephone interview, Jean Ann Fox, Consumer Federation of America (May 6, 2009).
[183] "Small Dollar Loan Products Scorecard," *supra* note 100, citing "The Cost of Credit: Regulation, Preemption, and Industry Abuses" § 2.3.3.2 (3d ed. 2005).
[184] Li, *et al.*, *supra* note 29.
[185] Center for Responsible Lending, "Congress Should Cap Interest Rates" (Mar. 2009), available at http://www.responsiblelending.org/issues/payday/reports/interest-rate-survey.html.
[186] Center for Responsible Lending, "Voters Reject 400 percent interest payday loans" (Nov. 7, 2008), available at http://www.responsiblelending.org/media-center/press-releases/archives/voters-reject-400-percent-interest-payday-loans.html.
[187] *Ibid.*
[188] *Ibid.*
[189] NCLC, "Model Deferred Deposit Loan Act," *supra* note 102.
[190] SB 834, 1999-2000 Leg. Sess. (Cal.).
[191] NCLC, "Model Deferred Deposit Loan Act," *supra* note 102.
[192] *Id.* at §§ 1-2.
[193] *Id.* at § 4.
[194] *Ibid.*
[195] *Id.* at § 6 (c).
[196] *Id.* at § 7 (b).
[197] *Ibid.*
[198] *Id.* at § 8.
[199] *Id.* at § 6.
[200] *Id.* at § 4.
[201] King and Parrish, *supra* note 98 at 22-23.
[202] Fox and Petrini, *supra* note 42 at 37.
[203] *Ibid.*
[204] Telephone interview, Liana Molina, California Reinvestment Coalition (Apr. 30 & May 5, 2009).

[205] *See* H.R. 1214, *supra* note 153; S. 500, *supra* note 166; H.R. 1608 *supra* note 166.
[206] Specifically, federal policy makers and regulatory bodies could cap the number of loans a borrower can receive annually, ban the use of bank account access for loan collateral, and create incentives for federally chartered banks and credit unions to engage in non-predatory small loans as an alternative to payday lending. King and Parrish, *supra* note 98 at 22-23.
[207] Fox and Petrini, *supra* note 42 at 37.
[208] Fox interview, *supra* note 182; telephone interview, Lauren Saunders, National Consumer Law Center (May 5, 2009).
[209] Organizing for America, "Plan to Stimulate Urban Prosperity," available at http://www.barackobama.com/issues/urban_policy/index_campaign.php.
[210] Fox and Petrini, *supra* note 42 at 37.
[211] Kelly Griffith, *et al.*, "Controlling the Growth of Payday Lending through Local Ordinances and Resolutions: A Guide for Advocacy Groups and Government Officials" (Nov. 2007), available at http://www.consumerfed.org/pdfs/PDL%20Local%20Ordinance%20Handbook%2012%2007%20Final.pdf. Local efforts have largely focused on nuisance-type issues presented by payday lending outlets in order to avoid possible state or federal pre-emption issues.
[212] *Id.* at 10.
[213] *Ibid.*
[214] *Ibid.*
[215] *Ibid.*
[216] *Ibid.*
[217] *See, e.g., id.*.; Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 61.
[218] Oakland Planning Code § 17.102.430.
[219] *See* San Francisco Planning Code § 249.35; Office of Treasurer and Tax Collector, "San Francisco Supervisors Unanimously Pass 45-day Moratorium on Check Cashing and Pay Day Lending Businesses" (Jan. 10, 2006), available at http://www.sfgov.org/site/treasurer_page.asp?id=36902.
[220] City of Sacramento Ord. 2009-017.
[221] *Ibid.*
[222] *Ibid.*
[223] City of Sacramento Ord. 2007-080, available at http://cityofsacramento.org/dsd/planning/zoning/ordinances/check-cashing-moratorium.cfm. This ordinance created a 45-day moratorium, which was extended by Ord. 2007-089 and Ord. 2008-048.
[224] Bill Lindelof, "Sacramento council looks to limit quick cash stores," *The Sacramento Bee* (Mar. 27, 2009), available at http://www.sacbee.com/government/story/1732962.html.
[225] California Reinvestment Coalition, "Victory in the Fight against Predatory Payday Lending," The CRC Blog (Apr. 6, 2009), http://www.calreinvest.org/blog#blog-entry-66.
[226] *Ibid.*
[227] *Ibid.*
[228] See California Department of Corporations, "2007 Payday Loan Study," *supra* note 28 at 31.
[229] *See* Griffith, *et al.*, *supra* note 211 at 11.
[230] *Ibid.*
[231] Blank, *supra* note 64 at 11.
[232] Griffith, *et al.*, *supra* note 211 at 12.
[233] California Department of Corporations, "Report to the Governor and the Legislature," *supra* note 4 at 24.
[234] Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 53.
[235] Inter-American Dialogue Taskforce on Remittances Report, "Making the Most of Family Remittances" (May 2007), 10, available at http://www.fdic.gov/about/comein/handout1.pdf.
[236] Blank, *supra* note 64 at 3.
[237] FDIC, "Small Dollar Loan Pilot Program" (May 2009), available at http://www.fdic.gov/smalldollarloans.
[238] In telephone interviews, Alan Fisher of the California Reinvestment Coalition and Carolina Reid of the Federal Reserve Bank of San Francisco both emphasized the need for these finance products as alternatives to payday loans.
[239] California Budget Project, *supra* note 6.
[240] Blank, *supra* note 64 at 6.
[241] *Ibid.*

[242] State of New York Banking Department, "Basic Banking Accounts," available at http://www.banking.state.ny.us/brbba.htm.
[243] Telephone interview with Jim Dale, Bank on San Jose (Apr. 29, 2009).
[244] Alexandra Hernandez, "MAF launches innovative Cestas Populares," Mission Asset Fund (October 8, 2008), available at http://missionassetfund.org/node/112.
[245] Telephone interview with Haydee Moreno, Self-Help Credit Union (Apr. 30, 2009).
[246] *See, e.g.*, Bank on California, http://www.bankoncalifornia.ca.gov.
[247] FDIC, "Alternative Financial Services: A Primer" Vol. 3, No. 1 FDIC Quarterly 43 (2009), available at http://www.fdic.gov/bank/analytical/quarterly/2009_vol3_1/FDIC140_QuarterlyVol3No1_AFS_FINAL.pdf.
[248] Anne Stuhldreher, "Traditional Lending Goes Mainstream," San Francisco Chronicle (Apr. 8, 2009), available at http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2009/04/07/EDHI16UMQH.DTL.
[249] Dale interview, *supra* note 243.
[250] *Ibid.*
[251] Mission Asset Fund, "How can we help low-income Mission residents build a more secure economic future for themselves and their families?", available at http://missionassetfund.org/ourstory.
[252] Stuhldreher, *supra* note 248.
[253] Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 53-54.
[254] *Id.* at 54.
[255] Dale interview, *supra* note 243.
[256] In its recent report, the California Budget Project provides a compendium of alternatives to payday lending that should be considered as potential content for a financial education course designed to help consumers avoid payday borrowing. *See* California Budget Project, *supra* note 6 at 41-47.
[257] Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 69.
[258] *Ibid.*
[259] Blank, *supra* note 64 at 10, citing John P. Caskey, "Can Personal Financial Management Education Promote Asset Accumulation by the Poor?" Networks Financial Institute Policy Brief #2006-PB-06 (2006).
[260] Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 76, n.141.
[261] Katy Jacob, et al., "Tools for Survival: An Analysis of Financial Literacy Programs for Lower-Income Families," Woodstock Institute, 50 (2000) (available at http://www.woodstockinst.org/publications/download/tools-for-survival%3a-an-analysis-of-financial-literacy-programs-for-lower%11income-families). For example, Individual Development Accounts ("IDAs") offer low-income families a powerful incentive to save (*id.* at 54-57), which should reduce their reliance on high-cost forms of credit like payday loans. *See, e.g.*, Pearl Chin, "Payday Loans: The Case for Federal Legislation," 2004 U. Ill. L.R. 752, Nov. 19, 2004 (stating that "[b]y focusing on asset accumulation rather than short-term cash needs, IDAs address the underlying conditions that create reliance on payday cash outlets and other predatory lenders") (available at http://lawreview.law.uiuc.edu/publications/2000s/2004/2004_3/Chin.pdf).
[262] *Id.* at 69, citing Elizabeth Bell and Robert I. Lerman, "Can Financial Literacy Enhance Asset Building?" The Urban Institute, Opportunity and Ownership Project, No. 6 (2005) and Saundra Braunstein and Carolyn Welch "Financial Literacy: An Overview of Practice, Research, and Policy" (2002).
[263] Brookings Institution, "From Poverty, Opportunity," *supra* note 24 at 69, 76, n.146, citing Douglas B. Bernhein, *et al.*, "Education and Savings: The Long Term Effects of High School Financial Curriculum Mandates," Journal of Public Economics, Vol. 80 (2001), 435-65.
[264] Blank, *supra* note 64 at 10. Given that this Brookings paper dates back over a year, conducting an updated survey of the current literature about the effectiveness of financial education with respect to payday lending is warranted for policy-makers and funders seeking to address the payday lending problem, but is beyond the scope of this report.
[265] AB 2156, 2003-2004 Leg. Sess. (Cal. 2004); Cal. Fin. Code § 23057.
[266] AB 207, 2005-2006 Leg. Sess. (Cal.), would have added Cal. Fin. Code §§ 23038-23042.
[267] AB 1965, 2005-2006 Leg. Sess. (Cal.), would have added Cal. Fin. Code § 23038.
[268] AB 7, 2008-2008 Leg. Sess. (Cal. 2008); Cal. Fin. Code § 1241; Cal. Fin. Code § 14960; Cal. Fin. Code § 22345; Cal. Fin. Code § 23038; Cal. Mil. & Vet. Code § 394.
[269] AB 634, 2007-2008 Leg. Sess. (Cal. 2008); Cal. Fin. Code § 23001.
[270] AB 1534, 2007-2008 Leg. Sess. (Cal.), would have amended Cal. Fin. Code § 23057.
[271] AB 2854, 2007-2008 Leg. Sess. (Cal.), would amend Cal. Fin. Code §§ 23001; 23005; 23035; 23036; 23039.

[272] AB 33, 2009-2010 Leg. Sess. (Cal.), would amend various sections of Cal. Bus. & Prof. Code, Corp. Code, and Gov't Code.
[273] AB 377, 2009-2010 Leg. Sess. (Cal.), would amend Cal. Fin Code §§ 23001, 23027, and 23035, and add Cal. Fin. Code §§ 23005.5, 23010.5, and 23036.5.
[274] AB 545, 2009-2010 Leg. Sess. (Cal), would add Cal. Fin. Code § 23024.5.

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