Wealth-stripping payday loans trouble communities of color

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- People of color have less wealth than their white counterparts, making them more vulnerable to predatory lending. This, in turn, threatens to further widen the wealth gap.
- Research from several states suggests that people of color are disproportionately impacted by 400 percent APR payday lending. An examination of payday lending storefront locations in Maricopa and Pima Counties—in which over three-quarters of Arizona payday lenders are located—reveals a pattern of these stores clustering in communities of color.
- A measure on Arizona's November ballot, Proposition 200, would allow payday lenders to continue draining dollars from communities of color by trapping borrowers in high-cost payday loans.

Predatory lending and the wealth gap

On the most basic level, families need their earnings to meet daily needs and expenses. To achieve long-term economic stability, however, families must also have opportunities to save and accumulate wealth. Household wealth provides the tools families need to survive short-term financial shocks such as job loss or medical emergencies and to achieve dreams such as financing a child's education, opening a small business, buying a reliable car, or owning a home.

African American and Latino families have lower incomes and less wealth than do white households. On average, African Americans and Latinos earn 70 cents per dollar that whites earn.[1] This income disparity contributes to the even wider gap in net worth. For every dollar of net worth belonging to a white household, African-American and Latino households have just seven and nine cents, respectively.[2] White families have more than ten times the wealth of Latino and African American families. While there is limited data available on their asset holdings, Native Americans have lower incomes than any other racial or ethnic group in Arizona.[3]

Predatory mortgage lending practices in the subprime market, which brought on the current foreclosure crisis, have disproportionately impacted communities of color.[4] The trend holds true in Arizona, where between 2004 and 2007, 34 percent of mortgage loans to African Americans, 39 percent of mortgage loans to Latinos, and 30 percent of mortgage loans to Native Americans were subprime, compared to 16 percent of loans to white borrowers.[5]

Like predatory mortgage lending, payday lending threatens the financial well-being of communities of color. If enacted, Proposition 200 would permanently allow payday lenders to charge up to 391 percent APR on the typical two-week loan. Rather than provide relief for cash-strapped households within these communities, these lenders trap borrowers in a cycle of debt.

Payday lending: short-term loans lead to a high-cost, long-term debt trap

Households without adequate income or savings often seek credit to weather financial shortfalls. While affordable credit can be effective in helping families through a brief shortfall, high-cost payday loans typically lead borrowers into a long-term debt trap, which ultimately leaves them worse off.

A payday loan is a small loan of up to $500 secured by the borrower's personal check. In Arizona, lenders can currently charge up to $17.65 per $100 borrowed, which equates to a cost of 459 percent APR for a loan with a typical two-week term.

While payday loans are marketed as a quick solution to the occasional financial emergency, the vast majority of borrowers cannot walk away after paying off their initial loan, but instead must continue borrowing every pay period to make ends meet. **Nationally, only two percent of loans go to borrowers who can take out a loan once a year and pay it back without returning to the payday lender.[6]** Borrowers have an average of nine transactions per year and an industry-commissioned researcher has noted that the typical borrower stays in payday loans for 18 months.[7] The typical borrower pays back $800 for a $300 loan.

Fees paid for a typical payday loan

$325 Loan	
Fee of $17.65 per $100 borrowed	$57
Total fees paid with nine loans	$516
Total fees plus principal due to payday lender $516 (fees)+ $325 (principal)	$841

This debt trap dynamic of having to take out one loan after the other is driven by two factors: (1) the high cost (typically around 400% APR) of payday loans and (2) the fact that the entire amount is due back in two short weeks.

Households that need a few hundred dollars to get them to their next paycheck are unlikely to be able to pay back those funds in two weeks and still meet their other obligations. As the chart below illustrates, a person with a $35,000 salary will have an after-tax income of $1,227 for a two-week pay period. They will have to pay about $962 during that time on basic necessities such as food and housing. The money left over is not enough to repay a $325 payday loan (which carries a $57 fee).

Typical borrower cannot afford the balloon payment required for payday loans

	$35,000 annual salary
Before tax income (2 weeks)	$1,346
Minus taxes*	-$120
After tax income	$1,227
Minus two week expenditures on food, housing, transportation, and healthcare*	-$962
Money left over	$265
Payday loan payment due on $325 loan	$382
Deficit	-$117

*Bureau of Labor Statistics 2005 Consumer Expenditure Survey, annual expenditures have been divided into two week intervals.
Note: Median household income in Arizona is $33,922 for African Americans, $31,673 for Latinos, and $24,514 for Native Americans. (Census 2000).

The result is that payday borrowers pay back their initial loan and then take out a new payday loan—either immediately or a few days later. This cycle continues each pay period until the consumer ultimately defaults or receives an infusion of cash that allows them to retire the debt. In fact, the industry depends on borrowers falling into this debt trap cycle for the bulk of their revenues—90 percent of business is generated by borrowers with five or more loans a year and over 60 percent of business is generated by borrowers with 12 or more loans a year.[8]

Arizona's experience with payday lending

Arizona legalized payday lending in 2000 by passing an exemption to the state's interest rate cap on small loans. So instead of only being able to charge 36 percent APR (the limit for other small loan lenders), payday lenders are permitted to charge up to 459 percent APR on a two-week payday loan.[9]

This exemption is scheduled to sunset in July 2010, at which point payday lenders will also be limited to 36 percent APR. However, the payday lending industry-supported ballot measure, Proposition 200, would cancel this sunset, allowing payday lenders to charge a rate of 391 percent APR for years to come; this is only slightly reduced from the current rate.

Other measures in Proposition 200 that the industry claims are reforms have not relieved the debt trap in other states that have tried them.[10] Vulnerable families would continue to be trapped by high-cost payday loan debt under Proposition 200.

Communities of color pay a high price

A Pima County, Arizona survey of payday borrowers found that a significant portion of respondents (65% combined) were African American, Latino, or Native American, compared to about 30% of the overall adult population.[11] This is consistent with data from nearby states showing that African Americans, Latinos, and Native Americans make up a disproportionate share of payday borrowers. For example, in California, while African Americans, Latinos, and Native Americans make up about a third (35%) of the adult population, they represent 56% of all payday borrowers.[12]

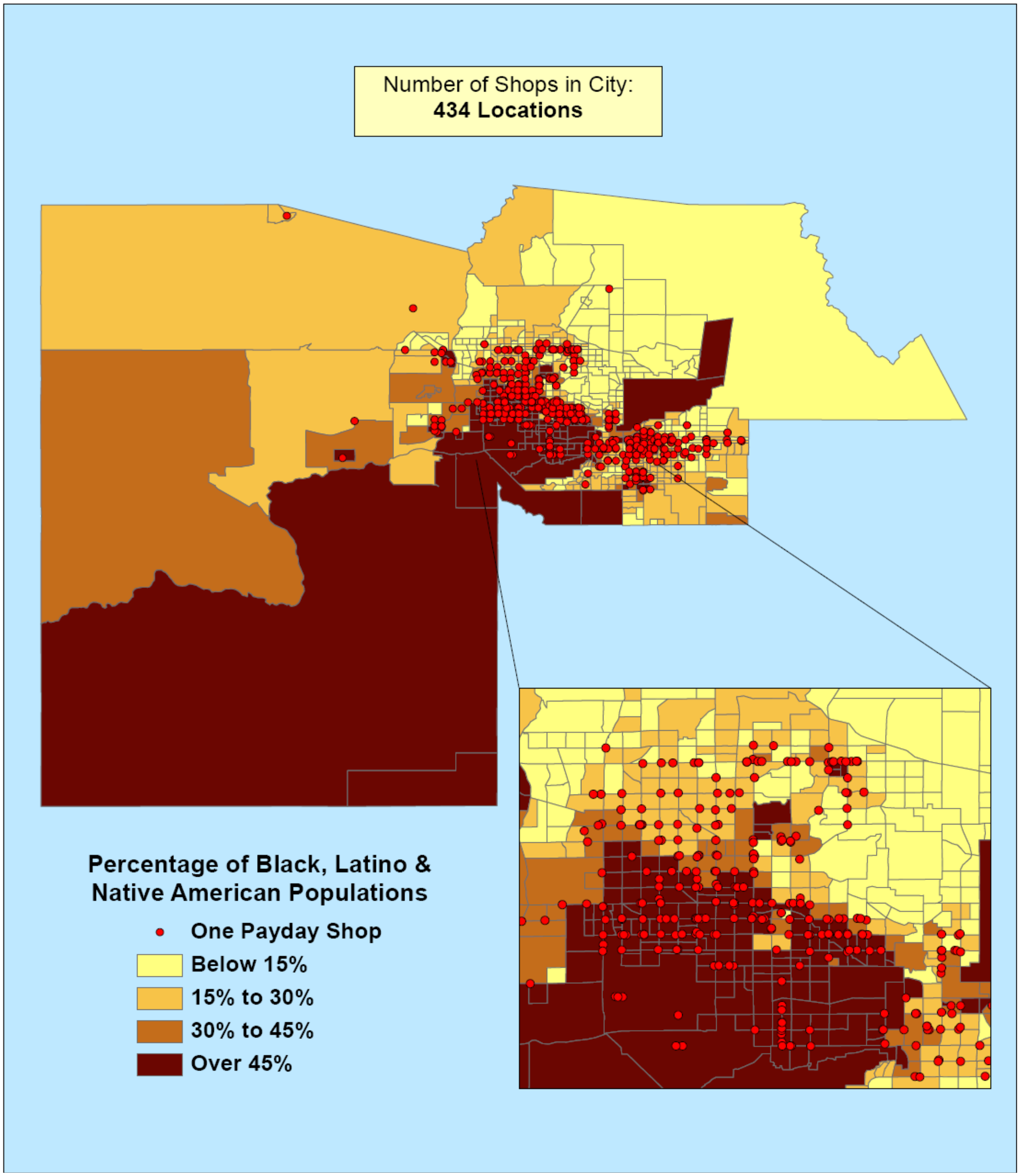
Similarly, researchers with access to the records of one of the largest Texas-based payday lenders found that African Americans and Latinos make up over three-quarters (77%) of all payday customers while they comprise 40 percent of the population.[13] This is disproportionate considering the racial and ethnic make-up of the Texas adult population.

Communities of color make up higher proportions of borrowers in California and Texas

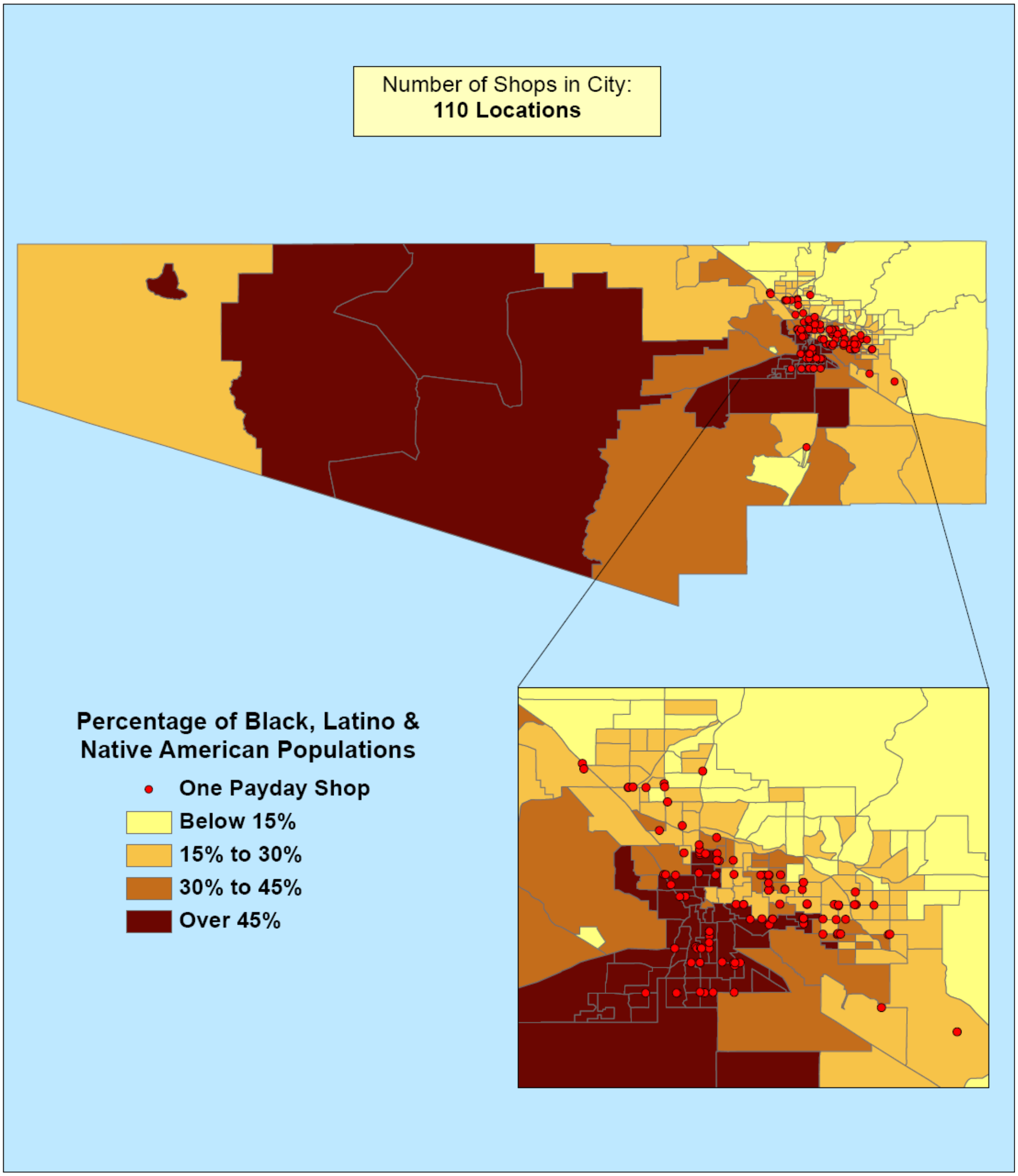
	California		Texas	
	% of total payday borrowers	% of total adult population	% of total payday borrowers	% of total adult population
African American	18%	6%	43%	11%
Latino	36%	28%	34%	29%
Native American	2%	<1%	Not available	

To get a better understanding of why people of color are more likely to be payday borrowers, we map the location of payday lending storefronts in the two most populated counties in Arizona—Maricopa and Pima. Over three-quarters of all payday lenders in Arizona are located in these two counties.[14] Not surprisingly, these maps show that payday lenders largely locate in urban areas. However, they also provide evidence that within these population centers, these storefronts tend to cluster in neighborhoods with greater concentrations of people of color (see two maps below).

Payday Shops in Communities of Color
Maricopa County, AZ



Payday Shops in Communities of Color
Pima County, AZ



These maps do not control for household income and other variables that can impact the location decisions of payday lenders. However, the presence of payday lenders in these neighborhoods may entice greater shares of people of color to take out a payday loan. Once the initial loan is taken, many of these borrowers will then become ensnared in a long-term debt trap.

Civil rights leaders express concerns with payday lending

In an earlier report, CRL estimated that Arizona payday borrowers pay nearly $149 million in fees annually.[15] A disproportionate share of these fees is likely drained from communities of color.

Prominent civil rights groups such as the NAACP have condemned the practice of payday lending. The NAACP refuses to accept money from payday lenders for any of its programs. As Julian Bond of the NAACP explains:

> "A drive through any low-income neighborhood clearly indicates people of color are a target market for legalized extortion….Visits to payday stores…are threatening the livelihoods of hardworking families and stripping equity from entire communities."[16]

The Mexican-American Legal Defense and Educational Fund (MALDEF) also warns:

> "Even if you have a bank account, you can get into trouble if you use payday lenders as a quick solution rather than building a solid relationship with a bank or credit union that you can rely on in times of trouble. These merchants prey upon those who are short of money, but don't feel comfortable asking a bank for a loan."[17]

Proposition 200 will not stop the drain of wealth from communities of color

Through exorbitant fees and keeping borrowers trapped in a cycle of debt, payday loans extract millions of dollars. Evidence suggests these funds come disproportionately from communities of color. If passed, Proposition 200 will permanently legalize triple-digit annual interest rates on payday loans, which we could expect to contribute to worsening the historic wealth disparity between white families and African-American, Latino, and Native American families.

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[1] Thomas Shapiro, *The Hidden Cost of Being African American: How Wealth Perpetuates Inequality*. Oxford University Press (2004).
[2] Melvin Oliver and Thomas Shapiro, "Sub-Prime as a Black Catastrophe," *The American Prospect* (Sept. 22, 2008).
[3] According to the 2000 Census, white households in Arizona had a median household income of $42,463, compared to $24,514 for Native American households, $31,673 for Latino households, and $33,922 for African American households.

[4] *Unequal Burden: Income and Racial Disparities in Subprime Lending in America*, U.S. Department of Housing. & Urban Development (April 2000) finds that subprime loans were five times more likely in African American neighborhoods than white neighborhoods. See also *Predatory Lending in Native American Communities*. First Nations Development Institute (May 2003) which finds that Native Americans had a significantly higher share of loans from high-cost lenders than whites. Finally, see *Income is No Shield Against Racial Differences in Lending: A Comparison of High-Cost Lending in America's Metropolitan Areas*, National Community Reinvestment Coalition (July 2007).

[5] CRL analysis of HMDA data, on file with authors.

[6] In the four states that report this data—Florida, Michigan, Oklahoma, and Washington—the percent of loans going to borrowers with one transaction a year ranges between 1.1 to 2.1 percent. See Uriah King and Leslie Parrish, *Springing the Debt Trap*, Center for Responsible Lending (December 13, 2007) for more information.

[7] Summarizing all available state regulator data, we find a national average of 8.7 loans per borrower per year. See Uriah King and Leslie Parrish, *Springing the Debt Trap*, Center for Responsible Lending (December 13, 2007). Pat Cirillo of Cypress Research Group, in testimony to the Ohio House Committee on Financial Institutions, Real Estate and Securities, January 31, 2008 noted that "…if you look at the cycle, the amount of time that folks tend to use this product, they are in and out of it really for about 18 months." Transcript on file with the Center for Responsible Lending.

[8] Uriah King and Leslie Parrish, *Springing the Debt Trap*, Center for Responsible Lending (Dec. 13, 2007). Available at http://www.responsiblelending.org/issues/payday/reports/springing-the-debt-trap.html

[9] For more details on Arizona's payday lending law, see Ariz. Rev. Stat. § 6-1251 et seq.

[10] Leslie Parrish, *High Cost Payday Lending Traps Arizona Borrowers*, Center for Responsible Lending (Sept. 18, 2008). Available at http://www.responsiblelending.org/pdfs/high-cost-of-payday-in-arizona.pdf

[11] A survey of Pima County payday borrowers found that 54% were Latino, 7% were African American, and 2% were Native American. For more information see Amanda Sapir and Karin Uhlich, Payday Lending in Pima County Arizona. Southwest Center for Economic Integrity (December 2003). Statewide data on payday loan usage by race and ethnicity is not available in Arizona. Census 2000 data for Pima County shows that people reporting their race/ethnicity as black alone, Native American alone, or Latino make up about 30% of the total adult population.

[12] See *2007 Department of Corporations Payday Loan Study*, Applied Management & Planning Group (December 2007) prepared for the California Department of Corporations, at page 65. California adult population by race is 2000 Census data.

[13] See Table 1 of Paige Skiba and Jeremy Tobacman. *Do Payday Loans Cause Bankruptcy?* Vanderbilt University (February 19, 2008) and 2000 Census data for Texas population age 18 and older.

[14] Maricopa County has 434 and Pima County has 110 of the total 708 payday lending licensees in Arizona. Licensee data as reported by the Arizona Department of Financial Institutions as of August 2008.

[15] Leslie Parrish, *High Cost Payday Lending Traps Arizona Borrowers*. Center for Responsible Lending (September 16, 2008).

[16] This 2003 quote by Julian Bond in Dave Anderton, "Payday lending fees add up: $3.4 billion" Deseret News (Dec. 13, 2003). http://findarticles.com/p/articles/mi_qn4188/is_20031219/ai_n11418408).

[17] *Making the Most of Your Money: A Guide to Family Finances for Latinos Living in the United States*, Mexican American Legal and Educational Defense Fund & National Endowment for Financial Education (2007).