Predatory Profiling:

The Role of Race and Ethnicity in the Location of Payday Lenders in California

Executive Summary

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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.

Visit our website at **www.responsiblelending.org.**

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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 payday lending storefronts are most heavily concentrated in African American and Latino communities in California, even when controlling for other factors which may influence a payday lender's location such as household income. In addition, we find that the racial and ethnic composition of a neighborhood is the primary predictor of payday lending locations. This finding differs with an analysis of mainstream financial institutions such as banks, where the primary explanatory factors of location are not tied to race or ethnicity.

Background

Payday loans are small, short-term loans secured by the borrower's personal check. The typical two-week loan is costly, with lenders allowed to charge up to 459 percent APR. In California and elsewhere, African Americans and Latinos make up a disproportionate share of payday loan borrowers. While these loans are advertised as a quick and easy way to deal with an unexpected expense before payday, borrowers typically have a hard time retiring the debt, taking out one loan after the other and becoming ensnared in a long-term debt trap. The payday lending industry depends on this cycle of repeat borrowing for the bulk of its revenues, with 90 percent of business generated by borrowers with at least five loans per year, and over 60 percent of business generated by borrowers with at least 12 loans a year. Because of this, $247 million is drained annually from California's African-American and Latino communities to service payday loans.

Findings

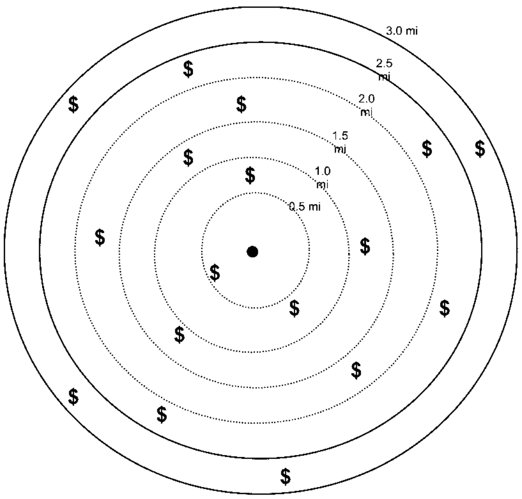
In this paper, we analyze the relationship between the proximity and clustering of payday lending locations and African American and Latino communities in California. In addition, we explore the primary factors influencing payday lenders' locations, as compared to bank branches.

Specifically, we find:

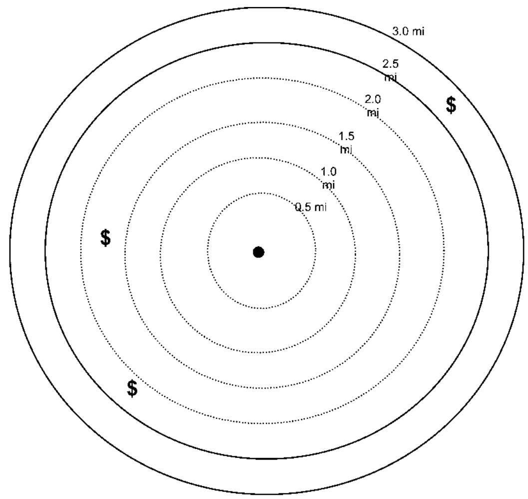
Payday lenders are nearly eight times as concentrated in neighborhoods with the largest shares of African Americans and Latinos as compared to white neighborhoods, draining nearly $247 million in fees per year from these communities.

Payday lenders are located in closer proximity 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 highest levels of white residents.

The figure below provides an example of the variation between the neighborhoods with the highest and lowest shares of African Americans and Latinos. Not only are there fewer payday lenders in the "white neighborhood," which has the fewest African Americans and Latinos; they are also located farther away from the neighborhood's center.



African American/Latino Neighborhood



White Neighborhood

• = center of neighborhood
$ = 1 payday lender

This clustering of payday lending storefronts results in the draining of nearly $247 million in fees from African American and Latino households in California. 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, we assume they then pay approximately 55 percent of the fees, or about $247 million a year.

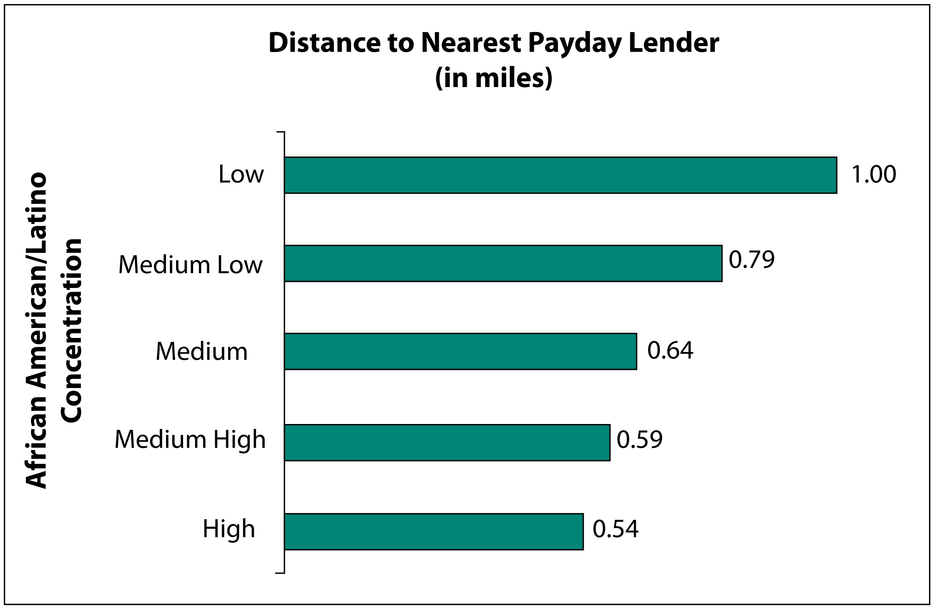
(A) Average fee per loan	$44.83
(B) Total number of loans (2006)	10,048,422
(C) Total fees paid (A*B)	$450,470,758
(D) Total fees paid by African Americans and Latinos	$246,857,976

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.

To determine whether the proximity and concentration of payday lenders in African American and Latino areas can be explained entirely by factors other than race and ethnicity, we explore a variety of different factors that might influence the payday lending locations, such as poverty rate, homeownership rate, educational attainment, household income, availability of retail space and gender.

After controlling for all of these variables and more, we find that payday lending is 2.4 times more concentrated in communities of color, and that the nearest payday lender is located nearly twice as close to a household in an African American or Latino neighborhood than a household in a white neighborhood.

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



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.

Conventional wisdom has suggested that payday lenders moved in to communities of color after these areas were abandoned by mainstream financial institutions, such as banks. However, an examination of the data presents a more complicated story. Our analysis finds that banks' locations can be explained by reasonable supply and demand factors such as the availability of retail space and the presence of a stable base of homeowners. A large share of the variation of payday lending location attributed to neighborhood factors, however, is explained by a neighborhood's racial and ethnic composition.

While a simple mapping of bank locations show that more of these institutions locate in white neighborhoods when compared to African American or Latino neighborhoods, this seems to be the result of factors other than race and ethnicity. After controlling for a variety of factors, we find that banks are only slightly farther away from African American and Latino areas as compared to white neighborhoods.

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 AND POLICY RECOMMENDATION

Once payday lenders locate in communities of color, they attempt to attract underbanked African American and Latino households by tapping into their preferences and fears. Payday lenders market key features of their loan products to these potential borrowers, including (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. Unfortunately, once payday borrowers take out their first loan and find they cannot afford to pay it back without taking out another, they become a captive audience.

If payday loans were a helpful product, we might applaud the increased access to credit that these storefronts provide to communities of color. However, as the subprime mortgage lending crisis has shown, mere access to credit can be harmful if the product itself leaves the borrower ultimately worse off. The emphasis, rather, should be on regulations that encourage a responsible small loan marketplace and strategies to help households increase their emergency savings as an alternative to taking on additional debt altogether.

Policy Recommendation: Enact a comprehensive 36 percent small loan rate cap to protect borrowers from abusive products such as payday loans.

Our primary policy recommendation is to eliminate the abuses of high-cost payday loans by enacting a comprehensive interest rate cap on all small loan products. Fifteen states and the District of Columbia protect their residents from high-cost payday loan debt traps by enforcing reasonable interest rate caps of around 36% APR on all small loan products. In addition, out of concern that military members' payday loan debts were causing so much distress that security clearances and deployment schedules were at risk, Congress passed and President Bush signed into law a 36% APR rate cap for the military. While a return to a more responsible loan law would benefit all Californians, it would especially help African American and Latino households, who make up a large share of payday loan borrowers. In addition, efforts to help low- and moderate-income families to build emergency savings through initiatives such as Bank on California and small loan products with built-in savings features such as those offered by BBVA Bancomer USA and the Golden 1 Credit Union should also be encouraged.

Payday loans offered at triple-digit interest rates are not the answer for vulnerable African American and Latino households facing financial challenges. Rather, California should ensure that credit is offered on reasonable terms, giving struggling families the opportunity to save and begin on a path to a more secure financial future.