That’s Predatory! How Payday Loans Strangle Working Families

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Roman Catholic social teaching on usury is clear: “those whose usurious and avaricious dealings lead to the hunger and death of their brethren in the human family indirectly commit homicide, which is imputable to them.” Usury, the church continues, “is still tragically widespread,” and is “a scourge that is a reality in our time that has a stranglehold on many peoples’ lives.”1

How does payday lending lead to a “stranglehold on many peoples’ lives”?

There are now over 20,000 payday loan shops in the U.S., more than McDonald’s, Wendy’s, and Burger King restaurants nationwide. Ads for “EZ” or “Quik” cash are deceptively attractive to someone in a financial bind. Payday loans are small, short-term loans that are secured by a borrower’s personal check.

While households may need a loan occasionally to cover unexpected expenses, it is counterproductive for anyone to secure a loan that demands repayment in two weeks to a month at an annual percentage rate (APR) of 390 percent or more. Loans of $300 at 36 percent APR, will only cost the borrower $309, (the loan plus nine dollars per month interest fee). More competitive APR is available through credit cards, banks, and credit unions.

Payday lending preys on the economically vulnerable—it creates a stranglehold on working poor families. In addition to charging triple-digit interest rates, payday lenders harness more revenue with late payment fees, insufficient fund fees, and attorney fees. Payday lenders are widely recognized for the most aggressive debt collection and have utilized public humiliation, threats, and constant harassment to collect fees.4

A comparative location analysis of payday lenders and banks in seven Louisiana parishes and Cook County (Chicago), Illinois, found that economically poor and minority neighborhoods are simultaneously targeted by payday lenders and neglected by traditional banks.3 Similar to Louisiana, the Mississippi Economic Policy Center finds that payday lenders tend to be located in Mississippi communities that are under- or unbanked and economically impoverished.6

Thus, when we look at who payday lenders target for loans, where payday lenders place their stores, and how the business model is designed to create a debt trap through short-term loans that demand multiple repeat loans, we see predatory lending.

The predatory nature of the business model reveals its perversity when payday lenders claim that indebtedness patterns only reveal satisfied, repeat customers, that their loans require high fixed costs because consumers demand geographic proximity to lender locations, and “if a competent adult wants to pay triple-digit interest rates, s/he should not be prevented from doing so.”7

Lenders’ own arguments reveal a perverse self-interest. This is exactly what the church condemns: a business model

Since the loan and fees are due in full within two weeks to a month, the borrower is forced to come up with even more cash than s/he needed in the first place—in this case, if the borrower needs a month to repay the loan, s/he will have to find an additional 30 percent ($90 interest fee or 390 percent APR) plus the loan of $300.

By contrast, a credit card cash advance of $300 at 36 percent APR, will only cost the borrower $309, (the loan plus nine dollars per month interest fee). More competitive APR is available through credit cards, banks, and credit unions.

Payday lenders make most of their income from “churned” loans, loans that are taken out one after another. The churning of existing borrowers’ loans accounts for three-fourths of all payday loan volume and costs payday borrowers $3.5 billion in fees per year.2

The average payday loan borrower takes out 9 loans per year and must pay back the loan and fees for each subsequent loan. The typical payday borrower eventually pays back $793 for an initial $325 loan.

In 2007, the median income for payday borrowers was $30,892. This median income represents the second lowest quintile of income in the U.S., the “working poor.”

The Center for Responsible Lending reports:

Payday lenders are increasingly offering loans on the basis of unemployment checks at rates of 300 and 400 APR. One California lender has stated that one-quarter of new customers are on unemployment.

Even after controlling for income and a variety of other factors, payday lenders are 2.4 times more concentrated in African American and Latino neighborhoods across the state of California.3

CREDIT CARD CASH ADVANCE
with 36-percent interest rate annually:
$300 x 36% ÷12 = $9.00 interest per month
$9 interest paid = 36% APR

PAYDAY LOAN with 15-percent interest rate
paid every 2 weeks
$300 x 15% = $45.00 interest
paid once every 2 weeks
$90 interest paid= 390% APR
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ENDNOTES

4 See Center for Responsible Lending video, “Payday Loans Trap Borrowers,” at http://www.youtube.com/watch?v=B6gDhqmlRAU