

# An Examination of the Payday Lending Industry in the City of Fresno

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Please note recommendations contained at the beginning of this report do not reflect the opinions nor any views held by Dr. Antonio Avalos, the Center for Economic Research and Education of Central California, the Department of Economics or those of California State University, Fresno.

## **B. Key Findings**

Note to readers: Calculations for this paper are made for different scenarios, assuming that different percentages of the population use payday lenders.

- Despite usurious interest rates and the widespread net that catches many middle-class and working-poor Fresno residents into a cycle of debt, without viable financial alternatives beyond mainstream bank and credit unions, and convincing consumers in coordinated financial planning sessions that the payday lending industry is an extremely high-cost manner in which to borrow, the industry can be best characterized as necessary.
- In the City of Fresno, of nearly 160,000 federal tax returns filed in 2004, more than 10 percent of city residents filed for a RAL, larger than the 5.1 percent registered for the whole state of California for the same year. In addition, of the 42,285 residents in the city claiming an ETIC payment, 37.5 percent filed for a RAL, which again is larger than the 31.2 percent registered for California.
- Poor families in zip codes 93701, 93702, 93703, 93706 and 93721 (basically South and West Fresno) show the largest number of RALs filers as percentage of the total tax returns (all significantly above the average of 10.03 percent). In contrast, families living in North Fresno (zip codes 93711 and 93720) show the smallest number of RALs filers as percentage of the total tax returns.
- In addition to the cost of short-term loans and Refund Anticipation Loans (RALs) routinely used by Fresno residents, a negative aspect of these loans is the short time in which borrows are required to repay them. It is important to note that those earning between \$25,000 and \$50,000 are more likely to use payday lenders. Per capita income in the Fresno MSA is \$25,573; 11 percent of residents do not use banks, twice the national average; and given the city's high poverty rates, the collective impact provides a rich marketplace for the industry in Fresno.
- An essential assumption in the economic cost estimation is that 50 percent of the \$51.56 million in short-terms loan fees captured by payday lenders in the City of Fresno is not injected back into the local economy. The reasoning is that not all the money captured in short-term loan fees is kept by payday lenders, since these companies also have operating expenditures and payroll employees.
- Short-term loans are far more expensive than RALs. The assumption is that \$25.78 million is set aside as industry revenue and thus taken out of the local economic stream, however, \$25.78 million is injected into the local economy as a result of payday lenders' operating expenditures.
- A rollover on a \$300 loan costs borrowers \$45 to extend the term of the loan for another two weeks without reducing the amount owed. Moreover, since the loan fee doubled (from \$45 to \$90) as well as the term of the loan (from two to four weeks), the APR remains at 391.07 percent. At week number four, if the borrower still cannot pay the full amount of the loan, the payday lender will offer the same alternatives. This process can repeat for several weeks or even months, which imply that the borrower using a short-term loan of this kind borrows her own money at extremely high interest rates. In fact, by week 12 (after the loan has been extended six times), the borrower

would have paid \$315 in fees but would still owe the original capital loaned of \$300. On a yearly basis, this borrower would pay \$1,170 in loan fees as the cost of borrowing \$255 in cash.

- The estimated annual economic costs of \$25.78 million in lost revenues to the city show that spending resulting from borrowers could create a total of \$35.40 million in business sales in the city (output), support 251 more full-time jobs and create an additional \$8.90 million in labor income paid by city companies, if these borrowers were not paying costly short-term loan fees.
- Assuming 20 percent of the population uses payday loans and that the loan is rolled over an average of 11 times, the annual aggregate cost of payday loan fees in the City of Fresno amounts to \$51.56 million. This figure is used to calculate the economic cost for the City of Fresno.
- In 2004, the total amount received by Fresno City residents in EITC refunds was approximately \$84.90 million, which means that RALs drained more than 2.5 percent of the EITC tax dollars.
- Retail Trade and Health & Social Services industries register the bulk of the economic impact generated by RAL fees spent within Fresno's economy. The impact on these three industries would amount to more than 31 percent of the total business sales and almost 50 percent of the supported jobs if borrowers were not spending dollars on RAL costs.
- In terms of the economic impact incurred by short-term loan fees if the dollars were spent within the city, estimated borrower spending could create a total of \$2.37 additional million in business sales in the city (output), support 23 more jobs and create an additional \$0.81 million in labor income paid by city companies.
- Clearly, the attractiveness of capping the APR at 36 percent in terms of reducing the cost of borrowing money is substantial. Payday lenders, however, have correctly argued that such a measure would be disastrous for the industry, as it has been in states where rates were capped, since the low rate makes payday lending unprofitable, and leaves low-income residents with no options.
- Congress recently enacted the Talent-Nelson Amendment, placing a 36 percent APR cap on loans to service members and their families. The rationale for such policy was simple: The measure was an effective solution to eliminate what legislators view as predatory loans. State legislators also capped rates at 36 percent in Oregon, Georgia and North Carolina. As a result, payday lenders fled the state, and members of the military are now experiencing difficulty in obtaining a payday loan, because of lower profits by lenders.
- If interest rates were capped at 36 percent, on a typical \$300 payday loan, the borrower would pay \$4.14 in fees and receive \$295.86 as a cash advance the same day the contract is signed. Under these conditions, even when the loan is rolled over 11 times, the borrower has paid just \$49.68 in fees (less than 17 percent of the \$300 for a period of 22 weeks). On a yearly basis, this typical borrower would pay just \$107.64 in loan fees as the cost of borrowing \$295.86 in cash.

- Like many states in which the payday lending industry is regulated, California has laws under which payday lenders are governed, and which favor the industry. California law states the maximum allowable loan limit at any one time is \$300, with a term of 31 days. Finance rates and fees are 15 percent of the amount of the check, with a maximum finance charge for a \$100 loan for 14 days at \$17.65, totaling an annual percentage rate of 459 percent. A borrower may take only one loan at a time and rollovers are not permitted. The repayment plan is voluntary and no fees may be charged for extending the life of the loan if the borrower is unable to repay by the due date. Payday lenders may charge \$15 for a bounced check but are not permitted to take any criminal action against the borrower. Notably, California is one of several states protecting the industry with “safe harbor” legislation, which means the state allows lenders to charge triple-digit interest rates, based on checks written against the borrower’s account.
- Research clearly indicates the payday lending industry, the purview of the Federal Reserve nationally and the California Department of Corporations, is ineffective in governing such lenders, although the California Department of Corporations plans to take measures to crack down on the industry, pending the outcome of a comprehensive study of the industry and its tactics.
- As cited previously in *the Economic Effects of the Earned Income Tax Credit in the City of Fresno*, 69 percent of low-income tax filers in the City of Fresno use tax-preparation businesses – payday lenders – to file returns and apply for the EITC, at a loss of \$6.5 million in 2004 to fees and interest refunds, according to the IRS.

### **C. Recommendations by the Fresno Works for Better Health Advocacy Center**

Alternatives to payday lenders are critical to alleviating the cycle of debt in which many borrowers become trapped. Several alternatives are provided in the appendices contained in this report.

Given the variance in research provided among those who support the industry and those who don't; usurious rates; short-term loans and RALs as the staple of profitability among payday lenders; and the large numbers of residents using payday lending services; the primary recommendation by The Fresno Works for Better Health Advocacy Center is that consumer education and alternatives to traditional mainstream financial institutions must be brought to bear to reduce the number of City of Fresno residents from using payday lenders. The recommendation is important, particularly given the high economic losses incurred with the use of short-term loans and RALs. Low-cost financial alternatives are contained in Appendix 1 of this report.

Without such education efforts and alternatives, payday lenders will continue to hold a strong place in the market. Although banks and credit unions generally do not locate branches in lower-income areas, even if they did, that would not ensure the disappearance of the payday lending industry for several reasons: Payday lending clients likely do not understand the high interest rates and fees they are being charged, or may not care, which requires creation of widespread, easy-to-access financial planning counseling, and a means by which individuals will attend. Many families using payday lenders live in crisis. If a utility bill or medical expense arises, for example, payday lenders provide fast, unsecured, short-term loans, and the money to pay bills or other expenses outweighs the costs of fees and interest rates. Note: Authors' were unable to pay the costs of a GIS map, thus, we were unable to conclude whether or if City of Fresno banks and credit unions locate in low-income areas.

Encouraging is the Central Valley Financial Literacy Initiative, an outgrowth of the Fresno Business Council to increase financial education, with an emphasis on K-12 education, and outreach to EITC recipients to use VITA sites and I-CAN sites. The program is designed to ensure disenfranchised residents apply for the EITC do not use payday lenders. California Governor Arnold Schwarzenegger is also planning to introduce an initiative called Bank on California.

Alternative financial options could include options such as Bank on San Francisco. City and business leaders worked with financial institutions to:

- Develop a checkless, low-cost product that meets the needs of unbanked consumers. The structure of many accounts—with high minimum balances and fees—is a key factor keeping the unbanked out of the financial mainstream.
- Adapt internal systems to allow customers on ChexSystems to open “second chance” checking accounts.
- Accept alternative forms of identification, such as consular identification cards. For many immigrants, the barrier to opening an account is having the proper documentation.
- Expand marketing in targeted, low-income neighborhoods. Increase the visibility of appropriate products and develop new strategies to reach unbanked customers in low-income neighborhoods.
- Partner with nonprofits in San Francisco to identify customers ready to enter the financial mainstream.

## SECTION I.

### A. Introduction

This research paper is specifically intended to examine the economic effect of payday lending products, specifically short-term loans and Refund Anticipation Loans (RALs), on residents and the City of Fresno; to inform policy makers and residents about the practices of the payday lending industry; to examine the lack of oversight by the California Department of Corporations in industry governance; to assess the role of banks and credit unions in providing competing products and financial alternatives to servicing low-income neighborhoods; and to identify challenges associated with those unwilling, for strongly embedded reasons of trust or financial reasons, to avail themselves of coordinated, easily accessible, financial-planning services.

When *The Effects of the Earned Income Tax Credit on the City of Fresno* was released in November 2007, authors reasoned a paper on the payday lending industry was relevant to the Earned Income Tax Credit (EITC.) At tax time, thousands of Fresno residents turn to tax-preparation services offered by the payday lending industry to file taxes and claim the EITC refund. Many also take advantage of one of the payday lending industry's most popular products, the Refund Anticipation Loan, in which the borrower, for a fee, receives a tax refund immediately. The loan is paid, at an extra cost, when the refund is received.

Far more expensive are short-term loans, in which a maximum of \$300 may be borrowed for up to 31 days, along with fees and high interest rates, especially if the loan is "rolled over" into a new loan when the borrower cannot repay the original loan.

With high interest rates many correctly term as usurious, a focus primarily on economically disadvantaged residents in the City of Fresno, the middle class (those earning as much as \$50,000 a year) and those with poor credit histories, and, importantly, absent access to mainstream financial institutions and personal biases toward banks and credit unions, the answer to whether the payday lending industry is predatory is an unqualified yes. But is it reasonable for states to eliminate payday lenders by capping interest rates? Not necessarily.

Payday lenders require no collateral and loans are easy to obtain. All that is needed by the consumer are steady employment, a monthly salary of at least \$1,000, a valid checking or savings account, an age of at least 18 years old, and no outstanding cash-advance balances. The population of the Fresno MSA is about 917,000 and per capita income in the Fresno-Madera MSA is about \$25,800, fertile ground for payday lenders.

Compounding the controversy surrounding the industry, and despite efforts such as the Regional Jobs Initiative, jobs in the City of Fresno are comparatively low paying, which is compounded by a huge pool of unskilled labor. For decades, the region has suffered double-digit unemployment rates, which fell to an all-time low of 7 percent in 2005-06, but which are starting to creep slowly into the 10 percent range, due largely to the slowdown of the construction industry, as well as the subprime-lending debacle.

Poverty is also very much about race-based economic divisions. African-Americans and Hispanics are overrepresented in poverty figures, compared to their general representation in the community. Minorities, then, are more likely to use payday lenders.

In addition, the general absence of banks and credit unions within close proximity to economically disenfranchised neighborhoods is most frequently cited for the disparity in the use of traditional

financial services. A common rationale for not locating banks and credit unions in poorer areas of the city is that such a move is simply unprofitable.

If traditional financial institutions did have a ubiquitous presence in low-income and communities of color, their presence would not translate into a mass failure of the payday lending industry. Significant reasons play into why borrowers are reluctant to use banks and credit unions, even when they have access, essentially making payday lenders a necessary evil in the City of Fresno.

Those reasons include unfamiliarity with banking and savings services, a belief by consumers that they do not write enough checks to justify an account, and lack of trust of the mainstream financial services providers. In addition, mainstream financial services can also be very expensive for households that do not have a relationship with those institutions, when customers cannot fulfill minimum-balance requirements, or when poor management of an account results in bounced checks or related fees. In fact, fringe lenders [such as the payday lending industry] attribute their rapid growth to large, unmet consumer financial services needs among many lower-income households.<sup>1</sup>

High interest rates and the short time in which borrowers can fully repay a loan are characteristic of the industry. It is important to remember that the industry captures a sizable market for those residents living in the City of Fresno, especially among low- and middle-income borrowers, who, left with no reasonable alternatives when they need a quick, unsecured loan, turn to the fringe lending industry, such as payday lenders.

As expected, payday lending supporters and critics are sharply divided. Thousands of consumer advocates and critics of the payday lending industry characterize such lenders as the devil incarnate, characterizing the industry as “predatory.” Supporters maintain the payday lending industry fulfills a market niche for those with bad credit and those with no options for needed short-term loans.

Despite high interest rates, short repayment periods and the likelihood of costly rollovers, from the consumer’s perspective, getting the money is likely more important than interest rates.

Drive through Southeast Fresno and West Fresno – nearly everywhere, in fact - and one can count dozens of payday lenders, often located across the street from one another. With the exception of the downtown area and a presence in specific zip codes, one will not find many banks, or worse, no banks at all, including automated tellers. For a variety of reasons, 11 percent of the city’s population does not use any financial institution.

Sixty-nine percent of low-income residents file taxes with tax-preparation services, losing \$6 million annually in payment in fees and interest, according to the Internal Revenue Service. The State of California does not maintain a tracking mechanism in which the number of borrowers can be calculated; thus, the exact number of payday-lender users is unknown. Readers should note calculations for this paper are made for different scenarios, assuming that different percentages of the population use payday lenders.

The definition of borrowers varies widely, making the argument the industry preys solely on the economically disadvantaged somewhat of a misnomer. Payday lending industry services, including short-term loans and RALs, are charged with targeting the city’s economically disenfranchised residents, particularly minorities, but are also used by middle-class consumers, defined as those earning \$50,000 a year.

The growth of the industry's market is generated by repeat borrowers (those who consistently roll over loans), and those consumers are the least likely to have the financial ability to repay rollovers as interest rates and fees mount. The authors of *Payday Lending: A Business Model that Encourages Chronic Borrowing*, state: "If the near-term growth in demand by consumers who have never taken out a payday loan is insufficient to meet the industry's dramatically expanded capacity to originate them, the only way to make up the deficit in new demand is for lenders to encourage existing customers to borrow more frequently. This means developing marketing and other strategies to convert occasional users of payday loans into habitual borrowers."

The report also noted, "Payday borrowers are more likely to have poor credit histories and to have worked with credit counselors in the past, and are more likely to have had one or more bounced checks in the previous five years."<sup>2</sup> Several research papers point out payday-loan borrowers are extremely high-risk clients. They are four times more likely to file for bankruptcy, compared to all other adults filing, and more than half of current payday-loan borrowers report that they already have an outstanding payday loan.

"The core demand for payday loans originates from households with a poor credit history, but who also have checking accounts, steady employment, and an annual income under \$50,000." The report notes Advance America's average customer is "38 years old with a median household income of just over \$40,000; in addition, 42 percent are homeowners, and 84 percent are high school graduates."<sup>3</sup>

A Georgetown University study describes the typical payday-lending consumer, which may surprise those who believe the industry targets only the poor. The study's findings are quoted verbatim.<sup>4</sup>

- Most customers earn between \$25,000 and \$50,000 annually;
- 68 percent are under 45 years old; only 4 percent are over 65, compared to 20 percent of the population;
- Ninety-four percent have a high school diploma or better, with 56 percent having some college or a degree;
- Forty-two percent own their own homes;
- The majority are married and 64 percent have children in the household; and
- One hundred percent have steady incomes and active checking accounts, both of which are required to receive a payday advance.

The Center for Responsible Lending (CRL), among the most vociferous anti-payday lending organizations, emphatically defines payday lenders as predatory on its website and in all of its expansive research. The CRL reports most research supports the allegation that "the payday lending business model is designed to keep borrowers in debt, not to provide one-time assistance during a time of financial need."

If payday lenders are indeed predatory, CRL's argument makes the issue of rampant economic disenfranchisement in the City of Fresno central to the business plan for payday loan companies, which, the CRL maintains, target customers who are disproportionately minority, with a household income of less than \$25,000, a high school or GED education or less, ages ranging from 18 to 59 years, and female heads of household with dependents.<sup>5</sup>

Conversely, however, the New York Federal Reserve's controversial study, *Payday Holiday: How Households Fare After Payday Credit Bans*, compared households in states with payday loans with households in Georgia, which eliminated payday loans in May 2004, and North Carolina, which

eliminated payday loans in December 2005. “Households in Georgia and North Carolina bounced more checks, complained more to the Federal Trade Commission about lenders and debt collectors, and filed for Chapter 7 (“no asset”) bankruptcy at a higher rate. These findings indicate that households without access to payday loans are forced to use costlier credit and suffer greater financial difficulties,” the report said.

“This negative correlation—reduced payday credit supply, increased credit problems—contradicts the debt trap critique of payday lending, but is consistent with the hypothesis that payday credit is preferable to substitutes such as the bounced-check “protection” sold by credit unions and banks or loans from pawnshops,” the report noted.<sup>6</sup>

In a telephone interview, The Federal Reserve Bank of New York’s Donald P. Morgan, a researcher and economist, said, “Usurious rates are in eye of beholder and there may be no better rate,” although borrowers do compare rates and can try to form better relationships with payday lenders. The issue, he said, is that based on studies conducted in Georgia and North Carolina, which enacted legislation that drove payday lenders out of state, the result was skyrocketing bounced checks.

“Don’t take away choices until low-income residents have better alternatives,” he said. “Let the market determine the middle ground. What I would suggest is, ‘Well, if you think you can open a [payday lending] store at a rate lower than a payday lender, then why don’t you do it?’”

The CRL vehemently disagrees with Morgan’s assessment. The organization has been steadfast in its assertion that “Traditional mainstream banks have abandoned lower-income communities and communities of color while their role is being filled by predatory check cashers, payday lenders and finance companies that prey on consumers with few financial alternatives. Millions of dollars are being taken out of the pockets of the working poor in predatory fees.”<sup>7</sup> The Federal Reserve of New York stands by its findings and did not issue a response to CRL’s criticisms.

The payday lending industry, like any for-profit or not-for-profit organizations, “want people to take advantage of their products,” said Dr. Pat Cirillo in a telephone interview. Cirillo is a statistician, researcher and president of Cleveland, OH-based Cypress Research. “Unless a business honestly believes its product is harmful -- cigarette manufacturers, for example -- the people operating payday lenders do believe that their product is not harmful, and, in fairness that is exactly what most research supports.”

Further, Cirillo cited studies conducted by four accounting firms, which looked at profits, costs and after-tax revenues; all concluded “payday lenders are right in the pack of the financial services sector.” Payday lending is a “transaction-based business (consumers are paying for the labor, not the cost of the money) ... payday lenders earn \$7 per transaction (revenue, not profit). That is not really that much, since each transaction, on average, takes 10-15 minutes. The average storefront earns about \$250,000 in revenues (not profits) per year. I’ll bet that is no different than the local 7-11” convenience store, she said.

Additionally, The Community Financial Services Association of America (CFSA), which bills itself as the only payday-lender trade association promoting best practices within the industry, naturally argues payday lending has a place in the market. Darrin Andersen, president of CFSA, said, “There is a growing body of evidence by objective, independent researchers that validates what we have learned from our own customers. Taken together, these studies demonstrate that people need access to short-term, low-denomination loans, and deprived of these, they are forced

into other, less-desirable alternatives. This research demonstrates that state-regulated payday advances are an important credit option."

A CFSA brochure cautions consumers the industry should be used to fill the financial gap in the event of a short-term emergency. "Since a payday advance is a short-term solution to an immediate need, it is not intended for repeated use in carrying an individual from payday to payday. When an immediate need arises, we're here to help. But a payday advance is not a long-term solution for ongoing budget management. Repeated or frequent use can create serious financial hardships."

If consumers do indeed need access to "short-term, low denomination loans," the reality is the payday-lending industry is deliberately reticent regarding information to their customers that could be helpful. An example is telling consumers the real cost of the loan: "A \$300 loan will not cost \$45 in fees and interest. It will cost two to five times that amount because you, as the borrower, probably won't be able to pay the loan off in two weeks," Cirillo said.

"That piece of information, assuming it is absorbed by all consumers (and it wouldn't be), would create an even playing field. The consumer would have full disclosure of the 'real' cost of the loan. In the long term, the cost will not make a difference because the consumer needs \$300 right now and is not looking past to the two weeks when the loan is due," she said.

The industry itself is very outspoken, with much of its wrath centered on the Center for Responsible Lending, the California Reinvestment Corporation and other advocacy centers. Alan Jones, chairman and CEO of Check Into Cash, lashed out at a report issued by the CRL, saying, "You cannot call payday companies predatory unless you compare their bottom-line percentage profits to other industries' bottom-line profits ... If CRL wants to label the payday industry as predatory, then by golly, they've gotta call Jack in the Box, Steak & Shake and PetSmart predatory as well, because they earn a higher bottom-line percentage than QC Holdings' 560 payday centers. I wonder why CRL doesn't try to figure out how much of what they would describe as 'hard-earned cash siphoned out of the wallets of hard-working American citizens' is spent buying those over-priced predatory dog collars and fish bowls at PetSmart? You would only make that statement if your information is fishy, fishy, fishy." <sup>8</sup>

## **Section II.**

### **A. Payday Lending Products**

Online, billboard and television advertisements by payday lenders are tempting. “Cash in One Hour!” or “\$300 Payday Loan!” sound as if potential consumers could fill out a form and win the lottery. The payday-lending industry’s presence clearly resonates with those requiring a short-term, unsecured credit line for financial emergencies, such as unexpected medical costs or paying a utility bill, products which are not offered by mainstream financial institutions.

Payday lenders offer two primary products discussed at length in this report: RALs and short-term loans. Both are costly -- especially short-term loans -- and the ever-present danger to consumers rests not only with high interest rates and fees, but the inability to fully repay the full amount of the loan within the required period, resulting in rolling over a loan as many as 11 to 14 times, depending on the source, along with obligatory fees and interest payments. A \$300 loan can quickly become exponentially higher. Payday-lender tactics are unsavory, but that fact does not, in and of itself, require legislation banning the industry from California, as a handful of other states have done.

Consider the industry’s explosive growth: 15 years ago, almost no payday-lending establishments existed. Industry analysts estimate more than 22,000 payday lenders are located throughout the country. To place the number into perspective, “there are more payday loan and check cashing stores nationwide than there are McDonald’s, Burger King, Sears, J.C. Penney, and Target stores combined.”<sup>9</sup>

An initial report issued by the Federal Reserve Bank of New York, *Defining and Detecting Predatory Lending*, termed payday lending “as a welfare-reducing provision of credit,” which means “that while two parties are involved in a lending transaction, the terms place one side at a clear disadvantage.” The Federal Reserve Bank researcher Donald Morgan, one of the report’s authors, also said, however, such loans “may be the best source of short-term, easily available credit. A payday loan could help a borrower avoid missing a house, utility or car payment, for example.”<sup>10</sup>

On its website, the Center for Responsible Lending says the industry is simply a rip-off. “Every year, payday lenders strip \$4.2 billion in excessive fees from Americans who think they’re getting a two-week loan and end up trapped in debt. [The Financial Quicksand report] finds that across the nation payday borrowers are paying more in interest, at annual rates of 400 percent, than the amount of the loan they originally borrowed.”

### **B. California Law**

Like many states in which the payday lending industry is regulated, California has laws under which payday lenders are governed, and which heavily favor the industry. Regulation by the California Department of Corporations is questionable, although to its credit, it has investigated several payday lenders and provides a broad range of information regarding the payday-lending industry.

The law states the maximum allowable loan limit at any one time is \$300, with a term of 31 days. Finance rates and fees are 15 percent of the amount of the check, with a maximum finance charge for a \$100 loan for 14 days at \$17.65, totaling an annual percentage rate of 459 percent. A borrower may take only one loan at a time and rollovers are not permitted. The repayment plan is voluntary

and no fees may be charged for extending the life of the loan if the borrower is unable to repay by the due date. Payday lenders may charge \$15 for a bounced check but are not permitted to take any criminal action against the borrower.<sup>11</sup>

Notably, California is one of several states protecting the industry with “safe harbor” legislation, which means the state allows lenders to charge triple-digit interest rates, based on checks written against the borrower’s account.

The California Reinvestment Coalition’s (CRC) CEO Alan Fisher, who holds a seat on the Department of Corporations’ Board, said in a telephone interview that the Department of Corporations is increasing enforcement, but called efforts “insufficient” compared to the size of the problem of regulating the industry. Fisher said several CRC studies have found that many payday lenders flout the law by not posting appropriate disclosures on the law, and that many borrowers had taken several loans in an effort to repay an original loan (rollovers) and were paying high interest rates and fees for extensions.

Despite very recent advertisements by the industry cautioning borrowers such funds should be used for emergencies, according to Center for Responsible Lending’s research, borrowers who receive five or more loans a year account for 90 percent of the lenders’ business. The center terms industry governance by the California Department of Corporations as “minimal” and “laissez-faire,” charging that in California, “there are 2,501 payday lending licensees and Californians spend more than \$757 million annually on payday loan fees.”<sup>12</sup>

The Department of Corporations recently posted a request for bids to conduct an in-depth examination of the industry.

### **C. The Nelson-Talent Act and Capping Interest Rates**

Because payday lenders tend to cluster around military bases, Congress passed the Nelson-Talent law that went into effect Oct. 1, 2007, capping short-term loans at 36 percent for service members and their dependents. Its goal was the elimination of payday lenders located near military bases. *Militarytimes.com* termed enforcement “uncertain.” The result, however, is that the military are excluded by the industry for loans because the cap is unprofitable for the industry.

A natural question is how a similar 36 percent APR cap on all short-term loans would impact borrowers and payday lenders in the City of Fresno.

On a typical \$300 payday loan, the borrower pays \$4.14 in fees and receives \$295.86 as cash advance the same day the contract is signed at an APR of 36 percent.<sup>13</sup> Under these conditions, even when the loan is rolled over 11 times, the borrower has paid just \$49.68 in fees (less than 17 percent of the \$300 for a period of 22 weeks). On a yearly basis, this typical borrower would pay just \$107.64 in loan fees as the cost of borrowing \$295.86 in cash.

According to estimates in Table 1, the economic impact that the dollars spent in short-term loan fees would have if the dollars were spent within the city could create a total of \$2.37 additional million in business sales in the city (output), support 23 more jobs and create an additional \$0.81 million in labor income paid by city companies. Clearly, the attractiveness of capping the APR at 36 percent in terms of reducing the cost of borrowing money is substantial. Payday lenders, however, have argued that such a measure would be disastrous for the industry, since the low rate would put payday lenders out of business, as evidenced in Oregon and other states where interest rates were capped at 36 percent.

**Table 1: Annual Economic Costs of Short-Term Loans in the City of Fresno with 36 percent APR**

<b>Short Term Loan Fees</b>	\$4,744,122
<b>% of Fees Kept by Payday Lenders Spent Locally</b>	50% 50%
<b>Local Spending Lost</b>	\$2,372,061
<b>Economic Cost:</b>	
<b>Output</b>	\$3,257,004
<b>Employment</b>	23
<b>Labor Income</b>	\$819,479

Source: IMPLAN and authors' calculations

Importantly, capping the APR at 36 percent significantly changes the conditions under which both payday lenders and borrowers operate, just as it changes the price of borrowing money. (See Table 2 on the next page) Although individuals would greatly benefit from lower borrowing prices, payday lenders will suffer a negative impact by charging a lower price. The reason is that, according to the law of demand, as the price of borrowing money declines, the amount of loans applications should increase.

Payday lenders would see a significant reduction in the profit margin per loan, but the losses could be counterbalanced with an increase in the number of loans -- that is, the bulk of industry profits would be made through the volume of loans. Calculating the net profit effect for payday lenders of capping the APR at 36 percent requires estimating the responsiveness of borrowers to changes in borrowing prices. Unfortunately, due to a lack of data, this estimation is not possible.

**Table 2: The Cycle of Debt of a Typical Borrower with 36 percent APR**

Week	Rollover	Amount Owed Amount	Fees Paid	Accumulated Fees Paid	Cash Received	APR
0	0	\$300	\$4.14	\$4.14	\$295.86	36%
2	1	\$300	\$4.14	\$8.28	\$0	36%
4	2	\$300	\$4.14	\$12.42	\$0	36%
6	3	\$300	\$4.14	\$16.56	\$0	36%
8	4	\$300	\$4.14	\$20.70	\$0	36%
10	5	\$300	\$4.14	\$24.84	\$0	36%
12	6	\$300	\$4.14	\$28.98	\$0	36%
14	7	\$300	\$4.14	\$33.12	\$0	36%
16	8	\$300	\$4.14	\$37.26	\$0	36%
18	9	\$300	\$4.14	\$41.40	\$0	36%
20	10	\$300	\$4.14	\$45.54	\$0	36%
22	11	\$300	\$4.14	\$49.68	\$0	36%
24	12	\$300	\$4.14	\$53.82	\$0	36%

Source: Authors' calculations based on averages reported in several sources (see endnotes).

Note: Since the \$4.14 fee does not change, the APR remains the same throughout the loan term.

#### D. Where Are the Banks?

According to *Where Are the Bank Branches in My Community?* (published in 2005), economic development is stymied in communities with no banking access. Banks and credit unions generally do not locate in low-income areas because of the fear of low profits, and the City of Fresno is no exception. A report by the Center for Responsible Lending surveyed bank branches in 11

metropolitan statistical areas: Oakland (Alameda and Contra Costa counties), Fresno (Fresno/Madera MSA), Los Angeles (Los Angeles County), Sacramento (Sacramento, Placer, El Dorado and Yolo counties) and San Diego (San Diego County). Data was collected from 11 banks within the following metropolitan statistical areas (MSAs) and metropolitan and divisions (MDs): The 11 major banks included in this report are Bank of America, Bank of the West, California Bank & Trust, Citibank, City National Bank, Comerica, Union Bank of California, US Bank, Wells Fargo, Washington Mutual and World Savings.

The purpose of the study was to test what the report termed “the equality benchmark,” described as “the percentage of low-income census tracts within a particular geographic area. The equality benchmark was compared to the percentage of bank branches located within those low-income communities.”

Notably, the Fresno/Madera MSA did not have a single bank exceeding the equality benchmark; three banks had a presence in middle- and high-income areas of the city.

- According the report, which is quoted verbatim, World Savings is the only bank that consistently ranks low in all five markets. World Savings ranks the lowest in four geographic areas: Los Angeles, Oakland, Fresno and San Diego. In Fresno, World Savings has branches only in middle- and upper-income census tracts in Fresno and Madera counties.
- The combined population of Fresno and Madera counties is 972,000 residents. Fresno County is the 10th most-populated county in California and contains the largest city in rural California. In Fresno and Madera counties, the equality benchmark is 35.5 percent. Not one bank exceeds the equality benchmark.
- California Bank & Trust, Comerica and World Savings have no branches in low-income communities, but do have branches in higher-income neighborhoods.
- Only Bank of America, at 31.8 percent, and Wells Fargo, at 30.8 percent, were close to the benchmark.
- Of the banks that do have branches in low-income communities, Citibank and Union Bank rank the lowest with only 20 percent.
- City National Bank and US Bank do not have branches in Fresno.

“Wealthier communities have higher percentages of branches in their communities and in some cases are the only areas where branches exist,” the report said.<sup>14</sup>

At least 1,600 banks nationwide have devised products to attract consumers, who are over their heads in debt, but the costs are just as high, and the consumer debt can snowball just as easily. Many larger banks are offering a product called “courtesy overdraft,” which uses the bank’s money, not the consumer’s, to cover from \$100 to \$1,000 in bounced checks. But in addition to a per-check charge, banks also will add on a daily fee of \$2 to \$5 until the bounced checks are covered. The money must be paid back within two to four weeks or the account is turned over to a collection agency. Bounced-check protection differs from overdraft protection:

The bounced-check protection is extended to some customers; overdraft protection requires a customer to sign up.

Coverage is at the bank's discretion, so the consumer is never certain if a bounced check will be covered. With overdraft protection, the check is automatically covered under the terms of a contractual agreement.

Finally, like payday lenders, consumers' use of courtesy overdrafts is expensive, averaging between \$25 and \$40 per check, with an APR of 200 percent to 500 percent or more.<sup>15</sup>

### **Section III.**

#### **A. Refund Anticipation Loans**

One of the primary and most popular products proffered by the industry is the Refund Anticipation Loan (RAL). RALs are short-term loans for immediate cash secured by a taxpayer's tax refund. These RALs also include loans to taxpayers expecting a check from the Earned Income Tax Credit (EITC) program.

Sixty-nine percent of low-income tax filers in the City of Fresno use payday lenders offering tax-preparation services to file returns and apply for the EITC. Fresno consumers using payday lenders lost a total of \$6.5 million in 2004 to refund anticipation loans and preparation fees, according to the IRS.

Like the industry's short-term loans, the short duration of RALs by payday lenders entails sizeable annualized interest rates. RALs can substantially reduce the cash taxpayers would have available to spend if they did not have to pay excessive fees. Further, RALs are generally targeted toward the working poor and middle class, including a large percentage of minorities, particularly those who receive EITC refunds.

RALs have a negative impact on individuals and their families, and also reduce the effectiveness of anti-poverty programs, such as the EITC, by diminishing the consumer's expendable cash. In addition, when adding up the reduction in expendable cash due to RALs made to those taxpayers expecting an EITC check and those expecting a regular tax refund, the aggregate economic cost can be significant.

For the City of Fresno, this means the large sums of funds captured by payday lenders through RALs, rather than residing in the pockets of residents, prevent the local economy from benefiting from these annual infusions of cash. Since residents must pay considerable fees to payday lenders, rather than spending these refunded dollars among local business, the amount of fresh funds that could be annually injected into the local economy are diminished. Consequently, the economic benefits for the city in terms of employment and income are also lessened. One of the goals of this report is to quantify the economic cost that RALs produce in the City of Fresno.

#### **B. The Economic Cost of Refund Anticipation Loans (RALs) in the City of Fresno**

In the City of Fresno, of nearly 160,000 federal tax returns filed in 2004, more than 10 percent of city residents filed for a RAL, larger than the 5.1 percent registered for the whole state of California for the same year. In addition, of the 42,285 residents in the city claiming an EITC payment, 37.5 percent filed for a RAL, which again is larger than the 31.2 percent registered for California. Table 3 presents RALs made to city residents by zip code for Tax Year (TY) 2004, which means returns filed in 2005, the latest IRS data available.

**Table 3: RALs in the City of Fresno by Zip Code, TY 2004**

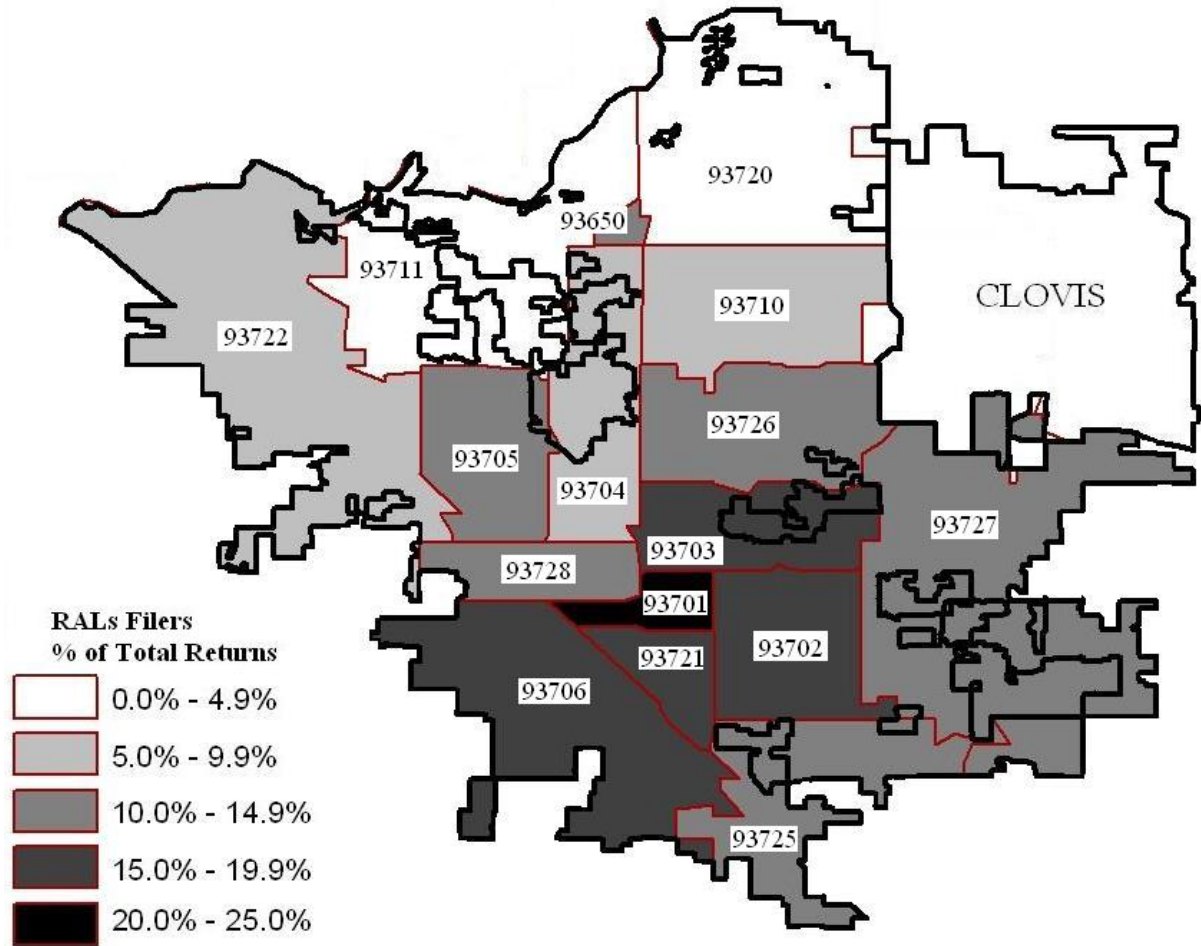
<b>Zip Code</b>	<b>Total Tax Returns</b>	<b>Returns Receiving RALs</b>	<b>Returns Receiving EITC</b>	<b>RALs Filers as % Total Returns</b>	<b>RALs Filers as % of EITC Filers</b>
<b>93650</b>	1,523	203	529	13.33%	38.37%
<b>93701</b>	2,829	637	1,669	22.52%	38.17%
<b>93702</b>	12,710	2,420	6,552	19.04%	36.94%
<b>93703</b>	7,722	1,278	3,066	16.55%	41.68%
<b>93704</b>	7,546	493	1,380	6.53%	35.72%
<b>93705</b>	12,386	1,712	4,221	13.82%	40.56%
<b>93706</b>	6,879	1,099	3,059	15.98%	35.93%
<b>93710</b>	11,132	789	1,979	7.09%	39.87%
<b>93711</b>	13,758	398	1,112	2.89%	35.79%
<b>93720</b>	21,639	509	1,702	2.35%	29.91%
<b>93721</b>	890	151	328	16.97%	46.04%
<b>93722</b>	22,033	1,825	5,164	8.28%	35.34%
<b>93725</b>	3,856	478	1,510	12.40%	31.66%
<b>93726</b>	14,489	1,718	4,332	11.86%	39.66%
<b>93727</b>	13,386	1,498	3,971	11.19%	37.72%
<b>93728</b>	5,395	656	1,711	12.16%	38.34%
<b>TOTAL</b>	<b>158,173</b>	<b>15,864</b>	<b>42,285</b>	<b>10.03%</b>	<b>37.52%</b>

Source: IRS Statistical Information Services Office and authors' calculations

Poor families in zip codes 93701, 93702, 93703, 93706 and 93721 (basically South and West Fresno) show the largest number of RALs filers as percentage of the total tax returns (all significantly above the average of 10.03 percent). In contrast, families living in North Fresno (zip codes 93711 and 93720) show the smallest number of RALs filers as percentage of the total tax returns. To give a sense of the geographical distribution of RALs in the City of Fresno, Figure 1 on the following page shows the number of RALs filers as percentage of the total tax returns by zip code.

Figure 1 also indicates the percentage of those filing for RALs as a percentage of total returns, by zip code, in the City of Fresno. The map offers proof that, while payday lenders may not be popular with advocacy groups, the industry draws from a sizable consumer base in the city.

**Figure 1: Number of RALs as a Percentage of Total Returns in the City of Fresno, TY 2005**

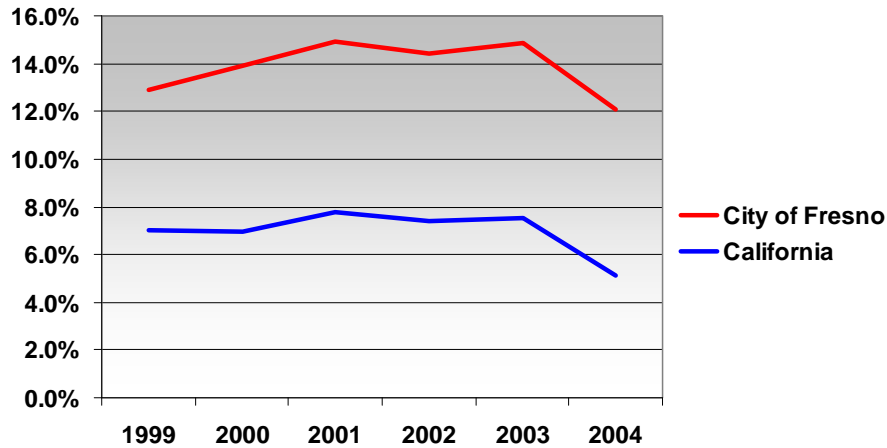


Source: IRS Statistical Information Services Office and authors' calculations

As reported in other studies based on IRS data, the volume of RALs in 2004 at the national level remains flat around 12 million with respect to the previous year.<sup>16</sup> For the City of Fresno, RALs in 2004 actually registered a decline, following a similar trend for the state, falling from 19,848 in 2003 to 15,864 in 2004 (a decline of more than 20 percent), while the number of RALs in California fell from 1,087,680 in 2003 to 742,202 in 2004 (a decline of more than 31 percent). Obviously, as the number of total tax returns increased and the number of RALs decreased, the number of RALs filers as a percent of the total tax returns declined for 2004.

Although there is no definitive explanation for this decline, it is possible it is attributable to an increase in the price for RALs in 2004. For example, the average fee for a RAL of \$2,000 to \$5,000 increased from about \$90 to \$100,<sup>17</sup> meaning RAL consumers simply responded to a price increase by demanding a smaller amount. Figure 2 shows the number of RALs as a percent of total tax returns for the period 1999-2004, which, in addition to the 2004 decline, clearly illustrates the difference between the average for California and the City of Fresno.

**Figure 2: RALs Filers as Percent of Total Tax Returns: 1999-2004**



Source: IRS Statistical Information Services Office and authors' calculations

### C. Direct Cost of RALs in the City of Fresno

Part of the objective of this paper is to estimate the economic cost that RALs produced in the City of Fresno. It is essential to calculate the expenses that taxpayers incur as they pay for the RAL fees and the tax preparation fees. This is achieved in two steps: First, the number of EITC and regular tax returns is calculated, as well as the average return. This is needed because, although the average tax preparation fee is around \$146<sup>18</sup> (regardless of the refund amount), the price of a RAL depends on the return. Second, the total cost of RALS are estimated based on the average returns, RAL fees and the tax preparation fees.

IRS data for 2004 show that nearly 56 percent of RAL consumers were EITC recipients.<sup>19</sup> Therefore, it is possible to split up the total number of returns receiving RALs between EITC and regular tax returns. It is important to note that in 2004, EITC recipients were considerably overrepresented among RAL consumers, comprising 31.6 percent of the total tax returns. The number of EITC and regular tax returns, as well as the average returns, are estimated and presented in Table 4 on the following page.

**Table 4: Average EITC Refund and Average Tax Return by Zip Code, TY 2004**

Zip Code	Total Returns Receiving RALs	EITC Returns Receiving RALs	Tax Returns Receiving RALs	Average EITC Return 2004	Average Tax Return 2004
93650	203	114	89	\$1,996	\$2,215
93701	637	357	280	\$2,250	\$2,213
93702	2,420	1,355	1,065	\$2,219	\$2,148
93703	1,278	716	562	\$2,125	\$1,880
93704	493	276	217	\$1,753	\$1,686
93705	1,712	959	753	\$2,046	\$1,741
93706	1,099	615	484	\$2,173	\$1,893
93710	789	442	347	\$1,846	\$1,362
93711	398	223	175	\$1,592	\$2,676
93720	509	285	224	\$1,581	\$1,965
93721	151	85	66	\$2,068	\$2,177
93722	1,825	1,022	803	\$1,887	\$1,797
93725	478	268	210	\$2,077	\$1,642
93726	1,718	962	756	\$1,931	\$1,915
93727	1,498	839	659	\$2,035	\$1,955
93728	656	367	289	\$1,877	\$1,580
<b>TOTAL</b>	<b>15,864</b>	<b>8,884</b>	<b>6,980</b>	<b>\$1,966</b>	<b>\$1,928</b>

Source: IRS Statistical Information Services Office and authors' calculations

NOTE: Total RALs fees include the 182.50 percent APR and the \$146 in tax preparation fees.

Data shows at least two salient facts:

- First, the number and average return of EITC filers receiving RALs returns are slightly larger than those filing for regular returns.
- Second, the average return for both EITC filers and regular tax return filers is larger for poor families in zip codes 93701, 93702, 93703, 93706 and 93721 (South and West Fresno) than families living in North Fresno (zip codes 93711 and 93720).

To estimate RAL fees, one can conservatively assume an annualized percent rate (APR) of 182.50 percent.<sup>20</sup> This APR is equivalent to a consumer paying about \$100 get a RAL for the average refund of about \$2,000.<sup>21</sup> The average tax-preparation fee of \$146 is added to this amount. The total RAL fees are also estimated and presented in Table 4.

Estimates indicate consumers in the City of Fresno paid a total of \$3.84 million in RAL fees in 2004 to obtain quick cash for their refunds, which means taxpayers using RALs borrowed their own money at extremely high interest rates. This total amount can be split up between the total RALs fees on EITC returns of \$2.19 million (56.5 percent) and the total RALs fees on regular tax returns of \$1.68 million (43.5 percent).

In 2004, the total amount received by Fresno City residents in EITC refunds amounted to approximately \$84.90 million, which means that RALs drained more than 2.5 percent of the EITC tax dollars.

#### D. Economic Cost of RALs in the City of Fresno

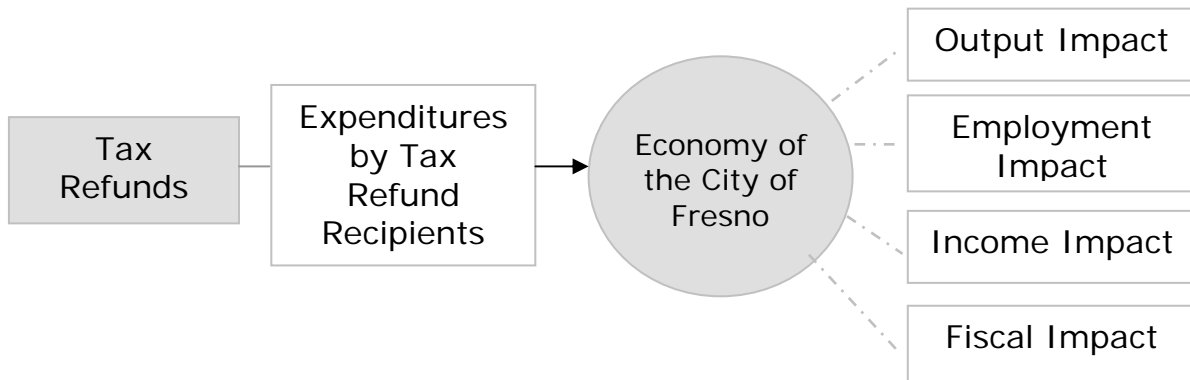
The large sums paid in RAL fees by City of Fresno residents represent a substantial reduction in the amount of expendable cash, from which the city's economy could benefit if the returns were spent among local business. Payday lenders capture the \$3.84 million in RAL fees. (The assumption is that not all these resources are injected into the local economy as consumer spending and, therefore, do not produce economic ripple effects, which clearly implies an economic cost.)

The impact attributable to the tax refunds to city residents is obviously linked to the impact attributable to the ways they spend this income in the city. Therefore, to calculate the cost of RALs in the City of Fresno, it is necessary to estimate the economic impact that the dollars spent in RALs fees would have if the dollars were spent within the city:

- 1) Additional output (business sales).
- 2) Number of jobs that these benefits payments support directly and indirectly.
- 3) Additional labor income.
- 4) Additional local and state tax revenue.

Following the North American Industry Classification System (NAICS) at the 2-digit level, the distribution by industry of this impact is also assessed.<sup>22</sup> Figure 3 illustrates the conceptual framework of the economic impact analysis.

**Figure 3: Conceptual Framework**



The analysis mainly relies on the use of input-output models and associated databases, which are techniques for quantifying interactions between firms, industries and social institutions within a local economy. In particular, the examination makes extensive use of IMPLAN, which is a computer software package, produced by the Minnesota IMPLAN Group, Inc. or MIG, Inc. and used widely around the country.<sup>23</sup>

An essential assumption in the economic cost estimation is that 50 percent of the \$3.84 million in RAL fees captured by payday lenders is not injected back into the local economy. The reasoning is that not all the money captured in RAL fees is kept by payday lenders, since these companies also have operating expenditures and payroll employees.

The assumption, however, is \$1.92 million is kept as revenue and is taken out of the local economic stream, and \$1.92 million is injected into the local economy through operating expenditures of payday lenders. Table 5 shows the estimated annual economic cost that RALs produce in the City of Fresno. Estimates show that spending resulting from taxpayers receiving EITC and regular tax refunds could create a total of \$2.6 additional millions in business sales in the city (output), support 19 more jobs<sup>24</sup> and create an additional \$0.66 million in labor income paid by city companies, if these taxpayers were not paying RAL fees.

**Table 5: Annual Economic Costs of RALs in the City of Fresno**

<b>RALs Fees</b>	\$3,873,059
<b>% of RALs Kept by Payday Lenders</b>	50%
<b>Spent Locally</b>	50%
<b>Local Spending Lost</b>	\$1,936,530
<b>Economic Cost:</b>	
<b>Output</b>	\$2,658,989
<b>Employment</b>	19
<b>Labor Income</b>	\$669,015

Source: IMPLAN and authors' calculations

Table 6 on the following page shows the estimated output and employment cost of RALs in the City of Fresno following NAICS at the 2-digit level. Retail Trade and Health & Social Services industries register the bulk of the economic impact generated by RAL fees spent within Fresno City's economy.

The impact on these three industries would amount to more than 31 percent of the total business sales, and almost 50 percent of the supported jobs.

Finally, the total estimated tax revenue that would be generated for the State of California and its local governments is greater than \$167,000. IMPLAN does not produce separate reports for the state and local government. Due to the complexity of the fiscal structure in California, as well as its changing nature, however, estimating how much of this total tax revenue is retained by or returned to cities or counties is very difficult. Based on state and county local government information from the U.S. Census Bureau, however, it is possible to approximate the percentage of total tax revenue that Fresno County captures from the state's total (2.3 percent). The state and local tax revenue calculated by IMPLAN can be broken out into approximately \$3,856 for the city and \$163,824 for the state.

**Table 6: Annual Economic Costs of RALs in the City of Fresno by Industry**

<b>INDUSTRY</b>	<b>Output</b>	<b>Employment</b>
Ag, Forestry, Fish & Hunting	\$7,309	0
Mining	\$0	0
Utilities	\$35,755	0
Construction	\$17,418	0
Manufacturing	\$139,588	0
Wholesale Trade	\$176,715	1
Transportation & Warehousing	\$63,913	1
Retail trade	\$356,677	4
Information	\$82,010	0
Finance & insurance	\$238,169	1
Real estate & rental	\$213,544	1
Professional-scientific & tech services	\$117,695	1
Management of companies	\$29,574	0
Administrative & waste services	\$62,168	1
Educational services	\$32,058	0
Health & social services	\$476,563	5
Arts- entertainment & recreation	\$20,562	0
Accommodation & food services	\$141,387	2
Other services	\$115,383	2
Government	\$332,501	0
<b>TOTAL</b>	<b>\$2,658,989</b>	<b>19</b>

Source: IMPLAN and authors' calculations

## **SECTION IV.**

### **A. A Typical Cycle of Debt: The Cost of Short-term Loans**

Another popular payday lending industry product is short-term loans for immediate cash secured by the borrower's next paycheck. To get a loan of this kind, the borrower authorizes a payday lender to cash a postdated check (usually dated on the borrower's next payday) and receives cash, minus fees charged by the payday lender.

Although now advertised as short-term emergency loans, most loans are "flipped" or "rolled over" multiple times, with borrowers paying interest rates and fees without touching the principal. Such lenders encourage multiple loan renewals (although rollovers are illegal in California, but are often necessary because borrowers are unable to repay the full amount of the debt within the allowable time frame, usually two weeks). Instead, payday lenders close the first loan and open the second, while the borrower continues paying interest.

Due to the short duration of these loans, the fees charged by payday lenders generally entail sizeable annualized interest rates, averaging between 100 percent and 700 percent. Short-term loans, therefore, can substantially reduce the cash that borrowers would have available to spend if they did not have to pay such fees. Borrowers often turn to other payday lenders in an effort to pay off the original loan. This means that many borrowers soon discover they have entered a tangled cycle of debt that presents great difficulties from which to escape.

Short-term loans and rollovers have a negative impact on individuals and their families, but the aggregate economic cost can also be significant. For the City of Fresno, this means that since residents must pay considerable lending fees to payday lenders, rather than consuming these refunded dollars among local business, the amount of fresh funds that could be annually injected into the local economy are diminished. Consequently, the economic benefits for the city in terms of employment and income are also substantially decreased.

To estimate the economic cost of the cycle of debt, the behavior and conditions of a typical borrower are considered. For this exercise, the following assumptions hold. First, the amount of the payday loan is \$300, which is the maximum allowed in California. Second, the cost of the payday loan is \$15 per \$100 loaned for a period of 14 days. So, for a \$300 loan, the loan fee amounts to \$45, which is equivalent to an annualized percentage rate (APR) of 391.07 percent.<sup>25</sup> Third, since there are no reliable data on the number of times a typical borrower uses a payday lender every year, the economic cost will be calculated for a loan that is extended (or "rolled over") up to 11 times.<sup>26</sup>

Based on the previous assumptions, Table 1 shows how quickly a typical borrower can get caught in a debt trap. On a typical \$300 payday loan, the borrower pays \$45 in fees and receives \$255 as cash advance the same day the contract is signed at an APR of 391.07 percent. After 14 days (two weeks), if the borrower cannot pay the full \$300 and wants to avoid defaulting on the loan, the extension ("rollover") and a "back-to-back" loan options are basically the same in terms of costs.

Both require an additional \$45 to extend the term of the loan for another two weeks without reducing the amount owed. Moreover, since the loan fee doubled (from \$45 to \$90) as well as the term of the loan (from two to four weeks), the APR remains at 391.07 percent. At week four, if the borrower still cannot pay the full amount of the loan in full, the payday lender will offer the same alternatives. This process can repeat for several weeks or even for months, which strongly suggests the borrower using a short-term loan of this kind borrows residents' own money at extremely high

interest rates. In fact, by week 12 (after the loan has been extended six times), the borrower would have paid \$315 in fees but would still owe the original capital loaned of \$300. On a yearly basis, this borrower would pay \$1,170 in loan fees as the cost of borrowing \$255 in cash.

**Table 7: The Cycle of Debt of a Typical Borrower**

<b>Week</b>	<b>Rollover</b>	<b>Amount Owed Amount</b>	<b>Fees Paid</b>	<b>Accumulated Fees Paid</b>	<b>Cash Received</b>	<b>APR</b>
0	0	\$300	\$45	\$45	\$255	391.07%
2	1	\$300	\$45	\$90	\$0	391.07%
4	2	\$300	\$45	\$135	\$0	391.07%
6	3	\$300	\$45	\$180	\$0	391.07%
8	4	\$300	\$45	\$225	\$0	391.07%
10	5	\$300	\$45	\$270	\$0	391.07%
12	6	\$300	\$45	\$315	\$0	391.07%
14	7	\$300	\$45	\$360	\$0	391.07%
16	8	\$300	\$45	\$405	\$0	391.07%
18	9	\$300	\$45	\$450	\$0	391.07%
20	10	\$300	\$45	\$495	\$0	391.07%
22	11	\$300	\$45	\$540	\$0	391.07%
24	12	\$300	\$45	\$585	\$0	391.07%

**Source:** Authors' calculations based on averages reported in several sources (see endnotes).

**Note:** Since the \$45 fee does not change, the APR remains the same throughout the loan term.

**B. The Aggregate Economic Cost for the City of Fresno**

Since the exact number of payday lender users is unknown, calculations are made for different scenarios assuming that different percentages of the population use payday lenders. Based on the previous calculations, it is possible to estimate the aggregated payday-loan fees charged to repeat borrowers in the City of Fresno. In 2006, the total population in the city totaled 447,468 residents;<sup>27</sup> obviously, not everybody makes use of payday lenders. It is necessary, then, to first estimate the number of borrowers per year and the number of times such borrowers pay for extensions of the loan term (number of “rollovers”).

The only available local data on the number of borrowers comes from a survey conducted in West Fresno in 2003, which found 25 percent of the area residents use payday lenders. It is clearly unrealistic to assume 25 percent of the total population in the City of Fresno use payday loans, since residents of different areas of the city have different income levels or use traditional financial institutions.

While it is reasonable to expect large numbers of payday borrowers in low- and middle- income level areas of the city, obviously, more affluent regions are likely to register lower numbers of borrowers. As previously discussed, since there are no reliable figures regarding the number of times a typical borrower uses a payday lender every year, the calculations are made for customers that rollover debts three, six, nine and 11 times in California, which is the average number reported by the Los Angeles Times.<sup>28</sup>

Table 4 shows the aggregate payday loan fees by repeat borrowers in the City of Fresno under different scenarios. Estimates show that, depending on the percentage of the population using payday loans, and on the number of rollovers, the total amount in fees ranges from \$8.59 million to \$77.34 million, a range probably too wide to reach any conclusions; thus, a more significant but conservative estimate is considered. Assuming 20 percent of the population uses payday loans and that they roll over their loans 11 times, the annual aggregate cost of payday-loan fees in the City of Fresno amounts to \$51.56 million. This figure is used to calculate the economic cost for the City of Fresno.

**Table 8: Aggregate Payday Loan Fees by Repeat Borrowers in the City of Fresno**

		Rollovers			
		3	6	9	11
% of the Population	10%	\$8,594,424	\$15,040,242	\$21,486,060	\$25,783,272
	15%	\$12,891,636	\$22,560,363	\$32,229,090	\$38,674,908
	20%	\$17,188,848	\$30,080,484	\$42,972,120	\$51,566,544
	25%	\$21,486,060	\$37,600,605	\$53,715,150	\$64,458,180
	30%	\$25,783,272	\$45,120,726	\$64,458,180	\$77,349,816

**Source:** Authors’ calculations based on averages reported in several sources (see endnotes).

**Note:** The figures are computed by multiplying the percentage of the population times the individual loans fees based on the number of rollovers.

**C. Economic Cost of Short-Term Loans in the City of Fresno**

Large sums of dollars lost to short-term loan fees by City of Fresno residents results in a substantial reduction in the amount of expendable cash, which could benefit the city’s economy.

The average payday lender grosses about \$250,000 per year. A study by the FDIC Center for Financial Research found “operating costs lie in the range of advance fees collected and that, after subtracting fixed operating costs and “unusually high rate of default losses, payday loans may not necessarily yield extraordinary profits.” Based on the annual reports of publicly traded payday-loan companies, loan losses can average 15 percent or more of loan revenue. Underwriters of payday loans must also deal with residents presenting fraudulent checks as security or making stop payments, the report said.<sup>29</sup>

The assumption is that, of \$51.56 million in short-term loan fees captured by payday lenders, \$25.78 million is set aside as revenue and taken out of the local economic stream. The remaining \$25.78 million is injected back into the local economy through operating expenditures of payday lenders. Table 5 shows the estimated annual economic cost \$25.78 million produced in the City of Fresno. Estimates show that spending resulting from borrowers could create a total of \$35.40 additional millions in business sales in the city (output), support 251 more full-time jobs and create \$8.90 additional million in labor income paid by city companies, if these borrowers were not paying costly short-term loan fees.

**Table 9: Annual Economic Costs of Short-Term Loans in the City of Fresno**

<b>Short Term Loan Fees</b>	\$51,566,544
<b>% of Fees Kept by Payday Lenders</b>	50%
<b>Spent Locally</b>	50%
<b>Local Spending Lost</b>	\$25,783,272
<b>Economic Cost:</b>	
<b>Output</b>	\$35,402,222
<b>Employment</b>	251
<b>Labor Income</b>	\$8,907,378

Source: IMPLAN and authors’ calculations

The total estimated tax revenue that would be generated for the State of California and its local governments is more than \$2.3 million. IMPLAN, a software program, does not produce separate reports for the state and local government. Due to the complexity of the fiscal structure in California, as well as its changing nature, it is very difficult to estimate how much of this total tax revenue is retained by or returned to cities or counties. Based on state and county local government information from the U.S. Census Bureau, however, it is possible to approximate the percentage of total tax revenue that Fresno County captures from the state’s total (2.3 percent). Therefore, the state and local tax revenue calculated by IMPLAN can be broken out into \$53,429 for the city (approximately) and \$2,226,571 for the state.

In terms of the aggregated payday loan fees charged to repeat borrowers in the City of Fresno, estimates in Table 10 show that, depending on the percentage of the population using payday loans as well as on the number of rollovers, the total amount in fees ranges from \$0.79 million to \$7.1 million. Again, this range estimate is probably too wide to reach any conclusions. Thus, a more significant but conservative estimate is considered. Assuming 20 percent of the population uses

payday loans and they rollover loans 11 times, the annual aggregate cost of payday loan fees in the City of Fresno amounts to \$4.74 million, which is significantly lower than the estimated \$51.56 million when the APR is 391.07 percent.

**Table 10: Aggregate Payday Loan Fees by Repeat Borrowers in the City of Fresno with 36 percent APR**

		Rollovers			
		3	6	9	11
% of the Population	10%	\$790,687	\$1,383,702	\$1,976,718	\$2,372,061
	15%	\$1,186,031	\$2,075,553	\$2,965,076	\$3,558,092
	20%	\$1,581,374	\$2,767,405	\$3,953,435	\$4,744,122
	25%	\$1,976,718	\$3,459,256	\$4,941,794	\$5,930,153
	30%	\$2,372,061	\$4,151,107	\$5,930,153	\$7,116,183

**Source:** Authors' calculations based on averages reported in several sources (see endnotes).

**Note:** The figures are computed by multiplying the percentage of the population times the individual loans fees based on the number of rollovers.

**Alternatives to Mainstream Banking and Payday Lenders**

In reality, few options exist for those seeking unsecured loans. Cypress Research's Pat Cirillo said what they hear most often from consumers in the decision process involves these basic choices in terms of unsecured loans:

1. Be late on routine bills on purpose, and take the late-fee hit. Consumers will often take this choice once, but fear doing it more than once within a short time frame. Their concern is the hit on their credit rating, which probably is already bad.
2. Bounce a check(s) on purpose. Overdraft protection essentially is a payday loan in the minds of consumers. This is the preferred option if the number of checks that will bounce is fairly small. This way, the consumer can essentially get a \$500 loan for \$27 in overdraft fees and the interest until the bank is repaid. The problem with this option is that the consumer must pay the bank back or risk being blacklisted and, in most states, will not be able to get another checking account.
3. Payday loans are the most inexpensive choice if a borrower has many checks that will bounce or can't risk being late on a routine bill. Another benefit of this choice is there is no hit on credit ratings. The "don't ask, don't tell" policy is very attractive to these consumers. Some credit unions offer them, too -- but the surviving ones do not offer loans cheaply.
4. An Internet payday loan is the same as the above for those who are comfortable with passing private information over the Internet.
5. Borrowers do not psychologically favor cash advances on credit cards. Additionally, most have no availability on their cards, so it isn't really an option.
6. Ask family or friends (they'll try this, but it will only work once).
7. Ask employers (most hate this idea -- a violation of their privacy unless the employer has a program in place. Cleveland Clinic is a good example.).
8. Pawn something

Cirillo said that when she testifies to state authorities, advocates acknowledge few or no financial options exist. "I think this situation is long-lived. It is just more visible now because payday loans are now visible: They are sitting right there in our communities. No one seems to be able to get around the fact that offering these loans is expensive, really expensive. When they are offered at a low cost, it is because the non-profit is being subsidized either by tax payers or the philanthropic community."

Alternatives to traditional financial institutions and payday lenders are proposed in the following:

**1. California Reinvestment Coalition: The Essential Bank Account**

The *Essential Bank Account* would have following features:

- Direct Deposit
- No checks
- ATM/Debit Card with unlimited use
- Unlimited teller access and telephone customer service (live and pre-recorded)
- Five free money orders per month
- No minimum deposit to open and no minimum balance to maintain
- Account statement (hard copy, not online)
- Loosened ChexSystems screening: Non-fraudulent activity older than 1 year is disregarded if overdraft has been paid
- Publicized acceptance of Matrícula Consular as well as other foreign government-issued identification cards (i.e., Consular Identification cards) for primary identification
- Publicized acceptance of alternative identification (i.e., utility bills) for secondary identification
- No enrollment in a “bounce protection” plan

**2. California Reinvestment Coalition: The Quick Consumer Loan**

California Reinvestment Coalition (CRC) is advocating with banks and savings & loans for a low cost consumer loan known as the *Quick Consumer Loan*. This lending product is designed as an alternative to payday lending. The *Quick Consumer Loan* has a longer term, lower interest rate and does not allow extension of the loan.

The *Basic Consumer Loan* would have following features:

- Customer with direct deposit and regular paycheck
- Loan at \$1 per \$40 borrowed (30 percent APR)
- Term of loan = two months
- Loan cannot be taken out for a third consecutive month

**3. Bank on San Francisco**

Bank on San Francisco is a joint effort of Treasurer José Cisneros, the Federal Reserve Bank of San Francisco and the non-profit group EARN. San Francisco is the first city in the nation to develop a program of this kind to help everyone to enter the financial mainstream and start saving for the future.

An estimated 50,000 households in San Francisco are unbanked, representing nearly 15 percent of all households in the city. Among African Americans and Latinos, approximately half of the adult population does not have a checking or savings account.

Focus groups with unbanked consumers in San Francisco reveal that they would prefer to have a bank account than to use check cashers, but that they do not know of banks that offer low cost accounts or are worried that they will not be allowed to open an account because of their credit history or because they lack the proper ID.

The goal is to bring 10,000 of the estimated 50,000 unbanked households in San Francisco into the financial mainstream by helping them to open a low-cost, starter bank account. To accomplish this goal, we turned to the financial institutions in the city to demonstrate leadership and to help remove the barriers that low-income families face in opening a bank account.

Bank on San Francisco worked with financial institutions to:

- Develop a checkless, low-cost product that meets the needs of unbanked consumers. The structure of many accounts—with high minimum balances and fees—is a key factor keeping the unbanked out of the financial mainstream.
- Adapt internal systems to allow customers on ChexSystems to open “second chance” checking accounts.
- Accept alternative forms of identification, such as consular identification cards. For many immigrants, the barrier to opening an account is having the proper documentation.
- Expand marketing in targeted, low-income neighborhoods. Increase the visibility of appropriate products in San Francisco and develop new strategies to reach unbanked customers in low-income neighborhoods.
- Partner with nonprofits in San Francisco to identify customers ready to enter the financial mainstream.

For more information please call the Bank on San Francisco hotline at 415-554-4409 or e-mail at [bankonsf@sfgov.org](mailto:bankonsf@sfgov.org).

#### **4. State Employees Credit Union**

In 2001, the State Employees' Credit Union (SECU) introduced a short-term loan that has a 12 percent annual interest rate, a maximum limit of \$500, and requires borrowers to repay via direct deposit of their paychecks and put 5 percent of loan proceeds in savings accounts. Each month, more than 40,000 people use the product, which has a maximum 31-day term. Overall, members have accumulated \$10 million in savings accounts. At a 12 percent interest rate and 4 percent default rate, the SECU makes a healthy 2 percent on its cash advances. The default rate is far less. With 40,000 people using the program monthly, the SECU became the largest payday lender in the state. It modified the program in 2003 to require that 5 percent of loan proceeds go into savings. The idea is that after 18 months, borrowers will set aside enough to pay off the loan.

#### **5. GoodMoney**

In New York, a program called GoodMoney is a collaboration between Goodwill and Prospera Credit Union, and is an alternative to payday lenders. At GoodMoney, tellers encourage borrowers to consolidate their debt in lower-interest term loans, and to use other credit union services such as automatic savings. If borrowers cannot repay a loan after rolling it over twice, they can get the loan interest-free by attending a free credit-counseling session with a nonprofit service. For example, borrowers pay \$9.90 for every \$100 they borrow, which translates to an annual rate of 252 percent, roughly half the rate offered by commercial payday lenders.

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<sup>7</sup> Payday lenders to reform policies, March 17, 2007, priwatch.org.

<sup>8</sup> <http://www.checkintocash.com/media-article-by-Allan-Jones.htm>

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<sup>11</sup> Payday Lending Consumer Information, State of California, <http://www.paydayloaninfo.org/lstatus.cfm>

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<sup>13</sup> The APR is calculated as follows:  $(1.38) \times (365) / 14 = 35.97$  percent. Thus, \$1.38 per \$100 borrowed is equivalent to \$4.14 per \$300 borrowed.

<sup>14</sup> Serna, Rhea, Where Are The Bank Branches in My Community? An Analysis of Branch Distribution In Low-Income Neighborhoods, Center for Responsible Lending, Nov. 2005

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<sup>16</sup> As reported in “*Another Year of Losses: High-Priced Refund Anticipation Loans Continue to Take a Chunk Out of Americans' Tax Refunds*”, National Consumer Law Center Inc. and Consumer Federation of America, Refund Anticipation Loan Report.

<sup>17</sup> As reported in “*The High Cost of Quick Tax Money: Tax Preparation, 'Instant Refund' Loans, and Check Cashing Fees Target the Working Poor*”, National Consumer Law Center Inc. and Consumer Federation of America, Refund Anticipation Loan Report.

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<sup>18</sup> According to industry leader H & R Block Inc., “2004 Form 10-K: Annual Report Pursuant to Section 13 of 15(d) of the Securities Exchange Act of 1934”.

<sup>19</sup> IRS Stakeholder Partnerships, Education and Communication (SPEC) return information database.

<sup>20</sup> The U.S. General Accounting Office (GAO) has reported higher APR estimates for RALs of around 400 percent. U.S. General Accounting Office, “*Tax Administration: Most Taxpayers Believe They Benefit from Paid Tax Preparers, but Oversight for IRS is a Challenge*”, GAO-04-70, 2003.

<sup>21</sup> The APR is based upon a 10 day loan period and is an arbitrary number based on the estimated time provided by the IRS to receive a refund with e-filing and direct deposit of 8 to 15 days. “*IRS e-file 2006 Refund Cycle Chart*”, Publication 2043, 2005.

<sup>22</sup> The North American Industry Classification System (NAICS) replaced the U.S. Standard Industrial Classification (SIC) system and was developed jointly by the U.S., Canada, and Mexico to provide new comparability in statistics about business activity across North America.

<sup>23</sup> Minnesota IMPLAN Group, Inc. was founded in 1993 by Scott Lindall and Doug Olson as an outgrowth of their work at the University of Minnesota starting in 1984. This developmental work closely involved the U.S. Forest Service's Land Management Planning Unit in Fort Collins, and Dr. Wilbur Maki at the University of Minnesota. Currently, there are over 1,500 active users of IMPLAN databases and software in the United State as well as internationally.

<sup>24</sup> These are full-time and part-time jobs, not Full-Time Equivalent (FTE) jobs.

<sup>25</sup> As proposed and explained in “Update on the Payday Industry: Observations on Recent Industry Developments”, Stephens Inc., 2003. Authors place the average cost of payday loans between \$15 and \$17 per \$100 loaned for a period of 14 days. The APR is calculated as follows:  $(15) \times (365) / 14 = 391.07$  percent

<sup>26</sup> The U.S. General Accounting Office (GAO) has reported higher APR estimates for RALs of around 400 percent. U.S. General Accounting Office, “*Tax Administration: Most Taxpayers Believe They Benefit from Paid Tax Preparers, but Oversight for IRS is a Challenge*”, GAO-04-70, 2003.

<sup>27</sup> American Community Survey (2006), U.S. Census Bureau

<sup>28</sup> In its editorial of May 14, 2001, “California: Stop Legal Loan Sharks,” The Los Angeles Times reports for California an average loans per borrower of 11.

<sup>29</sup> Committee Democrats Call for Stronger FDIC Payday Lending Guidelines, U.S. House of Representatives, Committee on Financial Services, Democratic Office, March 19, 2003