Payday Loans Drain Community Resources

Payday loans drain needed resources from households and trap borrowers in a cycle of unaffordable debt that is difficult to escape. In 2010, Kentuckians paid more than $105 million in payday loan fees.[1] But this cycle of debt is not simply a drain on families; it is a drain on community and public resources available to support Kentuckians in need. The crash of the housing market and subsequent recession led to significant increases in unemployment and dependence on community based support services and public aid.

As churches, charities, and government agencies work to provide needed support to families, payday loans push many of these families further into debt, requiring additional assistance. In the fourth quarter of 2011, four Kentucky social service organizations[2] administered surveys asking clients about payday loan use. They collected a total of 319 completed surveys. This brief reports the findings of the survey.

85% of borrowers said they would <u>not</u> recommend taking out a payday loan to another person in their situation

The findings from this survey confirm that payday loans are simply unaffordable for those customers who provide the industry with the bulk of its business. Moreover, the financial stress caused by the use of payday loans contributes to the need for families to rely on public and nonprofit support services.

Payday loans are a burden on social service agencies

Among responding clients, 40.4% said they had used a payday loan at some point in time. Of those, nearly half (46.3%) said they were trying to pay back a payday loan at the time they completed the survey.

Of those who had used payday loans, 48.7% said that stress caused by outstanding payday loans was part of the reason they needed assistance on the day they visited the service agency administering the survey. To put these figures in perspective, one participating social service provider served more than 75,000 people last year. Based on the figures from our sample, an estimated 30,300 of those clients have used payday loans and nearly 15,000 needed help from the agency in part because of financial hardship caused by payday loans.

67% of respondents who had used payday loans said that in retrospect, taking out their first payday loan hurt them rather than helped them

Payday loans do not provide a fix for the occasional financial crisis; they simply add to and often worsen the financial struggles of hardworking families struggling to make ends meet. Of those surveyed who currently have outstanding payday loans, 94.7% receive some form of government assistance. Among those who had ever used payday loans, 91.5% receive some form of government assistance.

Payday Loans are not affordable.

Those who oppose a payday loan rate cap argue that the loans are useful as an occasional source of short-term credit, but the vast majority of payday loans go to repeat borrowers: the average Kentucky payday borrower took out more than 10 loans in 2010.

Some contend that these loans are a good option for those without access to other forms of credit. But short term high-interest loans are not affordable, particularly for those who lack access to other credit as the result of

Research support provided by the Applied Research and Education Center as an outreach service of Indiana University Southeast. Please direct questions to Dr. Melissa Fry at frym@ius.edu.

their fragile financial situation. A full 76.0% of those social service clients who reported that they had used payday loans said they had trouble paying back a payday loan and 47.2% reported having to borrow from one payday lender to pay back a different payday lender.

The state of Kentucky allows borrowers to have up to two loans out at a given time and 44.9% of the borrowers surveyed had done so. The majority of borrowers (55.4%) reported that it took more than one month to be able to repay their payday loan without having to taking out a new loan. For a significant portion of borrowers (29.7%), they were stuck in this cycle for four months or longer. In Kentucky, 2010 Department of Financial Institutions data showed that a typical Kentucky payday borrower was indebted to a payday lender for 160 days of the year.

Because payday loans are marketed to and most often used by low to moderate income people who are living paycheck to paycheck, the two week term does not allow enough time for the borrower to repay the loan and maintain their financial obligations. A clear majority of borrowers (67.2%) said that it was difficult to cover their other bills when they had a payday loan. The industry's business model rests on the continued need for borrowers to repay the two-week loan only to turn around and take out a new loan with new fees. In addition, the industry encourages borrowers to increase their loan amounts to ease their financial stress. Among surveyed borrowers, 59.2% reported that they were encouraged by a payday lender to borrow more than they originally intended.

The payday loan product is not affordable. The business model of lenders rests on the understanding that borrowers will likely be unable to repay the loan in the two week term and pay all their bills before their next payday. Nationally, 76% of payday loan volume is generated by repeat loans.[3] In Kentucky, 2010 Department of Financial Institutions Data confirmed that 90% of Kentucky payday loan volume went to those who had taken out 5 or more loans in a year.

Ask the users: most would not recommend a payday loan to a friend in need of cash

Defenders of payday loans at 400% interest suggest that the loans meet a need and that capping such loans will hurt those in need of fast cash. But if payday loans were effectively serving a need, then users would recommend them to others. Instead, users report that it was not a good idea to use payday loans and they would not recommend it to others in the same situation.

67.2% of borrowers said that it was difficult to cover their other bills when they had a payday loan

Among Kentucky borrowers surveyed, 67.3% of respondents who had used payday loans said that in retrospect, taking out their first payday loan hurt them rather than helped them and 85.2% said they would not recommend taking out a payday loan to another person in their situation.

Policy Implications

While they are marketed as a short term emergency stopgap, the majority of payday loans go to borrowers who simply cannot afford the high interest product. Our communities and the social service agencies and safety net programs designed to provide emergency support bear a portion of the cost of this unaffordable product.

A 36% rate cap on payday loans levels the playing field by bringing payday lenders back into line with other financial service providers. By removing an exception made for a predatory product built on the vulnerability of low-income people, the cap protects individual, family, community and public resources.

1 Department of Financial Institutions payday loan database.
2 Catholic Charities, Northern Kentucky Community Action Center, the Brighton Center and CAN.
3 Parrish, Leslie and Uriah King. 2009. "Phantom Demand." Center for Responsible Lending. www.responsiblelending.org.

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