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CHALLENGING MINDS, CHANGING LIVES

Research

An assessment of payday lending practices in the Metro-Jackson Area, Mississippi, and potential policy responses[a]

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Abstract

Payday lending volume has increased significantly across the nation in the past twenty years. However, the widespread provisions of easy accessibility and high cost credit have been controversial. Proponents argue that the benefit of easily accessible funds to address emergencies far outweighs the cost of the product. Opponents argue that the product is structured to encourage multiple rollovers or multiple loans simultaneously, resulting in excessive borrowing costs. During the summer of 2014, we conducted a questionnaire-based survey to users of payday loans and a location analysis in the metro-Jackson area to investigate payday lending patterns, focusing on socio-economic characteristics of the users, and their motives to use and perceptions of payday loans. We found that payment for unexpected expenses was the main reason for borrowing. However, respondents do not want to use the service again, if possible. Further, respondents did not understood the terms of the lending services. We also examined policies enacted around payday lending to military personnel for possible extension of similar protections to non-military borrowers. We believe that the methodology used in our study could be easily implemented in other areas of the state to provide valuable information for policy makers.

Introduction

Payday lending volume has increased significantly across the nation in the past twenty years. Payday lending is a form of small dollar – a range of $200- $500 – loans to individuals that are employed, or have a form of regular income (e.g., social security payments, pension payments, disability benefit payments, etc.), an active checking account, an established residency and an acceptable form of identification. Proponents of these loans tout them as an easy, quick solution to address a borrower's short-term need for cash to pay for items such as car repairs, medical situations, and family emergencies. However, opponents claim that the pricing and structure of payday loans combined creates a product that is predatory in nature and detrimental to the financial health and stability of individuals and households (Stegman, 2007). The fee schedule for payday loans in Mississippi is one of the most expensive in the country and is higher than all other states in the Southeast that allow payday lending (MEPC, 2010).

Payday loans are structured with relatively short-term repayment requirements (e.g., two weeks or thirty days) and must be paid in full at maturity. Estimates indicate that a payday loan is often difficult to repay at the first maturity date and is 'churned' (i.e., renewed) an average of 7-10 times annually or that multiple payday loans are borrowed simultaneously (Burke et al., 2014; King and Parrish, 2011). Thus, a more relevant analysis of cost may not be the initial fee on a payday loan but the total cost to borrow after all renewals or multiple loans are accounted for. For example, assume a fee of $21.95 per $100 borrowed for 14 days and four renewals for a Mississippi borrower to access $300. The borrower would pay the lender $329.25 in fees in addition to repaying the original $300 in principal for a loan of less than 3 months in term – an annualized interest rate of 285% (Table 1).

Table 1. A typical case of payday lending in the State of Mississippi

Amount Borrowed	$300	
Fee per 28 days	$65.85	($21.95 per $100 borrowed)
Fees for 4 renewals	$263.40	
Total Fees paid	$329.25	
Time Funds Borrowed	20 weeks / 140 days	(initial 4-week term + 4 renewals)
Annualized Interest Rate	285%	

The Truth in Lending Act (TILA) is a federal law that requires payday lenders to disclose to consumers the finance charge as a dollar amount and the annual percentage rate (APR) on a loan. However, according to research, the lenders are circumventing this law by using obscure means such as "fine print" to disclose the consumer finance charges on applications. Many of the borrowers do not carefully review the application, which leaves them vulnerable to exorbitant interest rates and fees. The federal government has delegated the responsibility to the states to protect consumers from lenders, enforce existing laws and ensure that alternatives are accessible (Title75: Regulation of trade, Commerce and Investments, Chapter 67, Loans).

Conflicting arguments for payday lending

While acknowledging the relatively high cost of a payday loan, the use of the product may be reasonable for a segment of customers that have limited options and where the expected cost of the payday loan is less than the anticipated penalties for not accessing the payday loan (Lawrence and Elliehausen, 2008). Examples include paying to repair a car needed for continued employment or paying for medication or childcare until an alternative is accessed, such as public funds. Additionally, a payday loan customer may segment financial transactions as a means of risk management (Wilson et al., 2010).

In addition to the benefit at the individual or household level, there is some evidence of a positive benefit to society when payday loans are available in situations of high distress such as natural disaster situations. For example, after events such as hurricanes or earthquakes, residents need cash to transact business immediately. Even those residents with access to conventional banking services may be restricted in their use of those systems outside of the affected area until back-up systems are put into operation. The availability of payday loans provides a means of accessing emergency funds that allow individuals and households to handle short-term needs in a way that is beneficial even when accounting for the relatively higher cost of the funds (Morse, 2011). Further, payday loans accessed by a small business owner are often used to meet these short-term needs of the business (Zywicki, 2010).

However, the fees charged on payday loans generally fall within a range of $15-$30 per $100 borrowed with repayment terms ranging from 14-30 days. When this pricing is converted to an annualized interest rate, payday loans have been estimated to cost as much as 400-1000% (Stegman, 2007). Credit cards are often used as a comparative measure for payday loans since credit cards can be used to meet short-term borrowing needs such as medical bills, auto repairs – many of the same loan purposes cited by providers of payday loans. Most credit cards are priced with variable interest rates to account for market changes compared to the flat fees charged by payday lenders, but a recent internet search of credit card rates resulted in rates between 10.99-24.9% (CreditCards.com, 2014) which are very low relative to the APR on payday loans when fees are included in the calculation.

Even when proponents acknowledge the cost of the payday loan product, they argue that benefits of the funds are expected to exceed the cost and the financial hardship within a household will be reduced over time. However, Melzer's research indicates that the financial condition of households using payday loans do not improve and that there is increased evidence of late mortgage and utility payments, increased delays in accessing medical care and increased occurrence of relocation related to financial distress (Melzer, 2011).

The expectations around the relationship between payday lending and crime are unclear. If payday lending fulfills a need in a non-harmful manner, the expectation is that the availability of payday lending could reduce crime if crime for profit is viewed as an alternative means of accessing resources. Alternatively, if payday lending is generally a harmful solution to a real need, then crime could be expected to increase. Research on the correlation between payday lending and crime is limited to date. When looked at on a societal or community level, there is no evidence that access to payday loans affects the incidence of crime (Skiba, 2007; Tobacman, 2007). However, there is some initial work that indicates there may be a correlation between household financial stress, payday loans, and partner violence (Pyles, 2005).

Payday Lending in Mississippi

The use of payday loans is widespread and growing in the State of Mississippi. In 2012, there were 166,493 payday loan transactions in the State of Mississippi (MSDBCF, 2012). This is an increase of almost 14% from the 146,206 transactions in 2007(MSDBCF, 2007). However, if Johnson's estimates of online lending are correct (Johnson, 2013), the actual growth in total payday lending in Mississippi between 2007 and 2012 could be almost 60% increase. Assuming the low end of the national average for renewals of 7 times per year, almost 39,000 Mississippians were involved in payday loan transactions in 2012 compared to slightly more than 24,000 in 2007.

The growth of payday lending in Mississippi initially corresponded with a significant increase in the number of payday lending locations along with the decreasing number of bank branches. According to the MSDBCF data, the number of payday loan locations increased by almost 40% between 2001 - 2005 and exceeded the number of bank branches in 2005. However, with the increased use of online payday lending, the number of payday lending locations in Mississippi decreased from its peak in 2005 and has remained relatively stable since 2008. Conversely, bank branches in Mississippi have exhibited growth since 2005 (Figure 1).

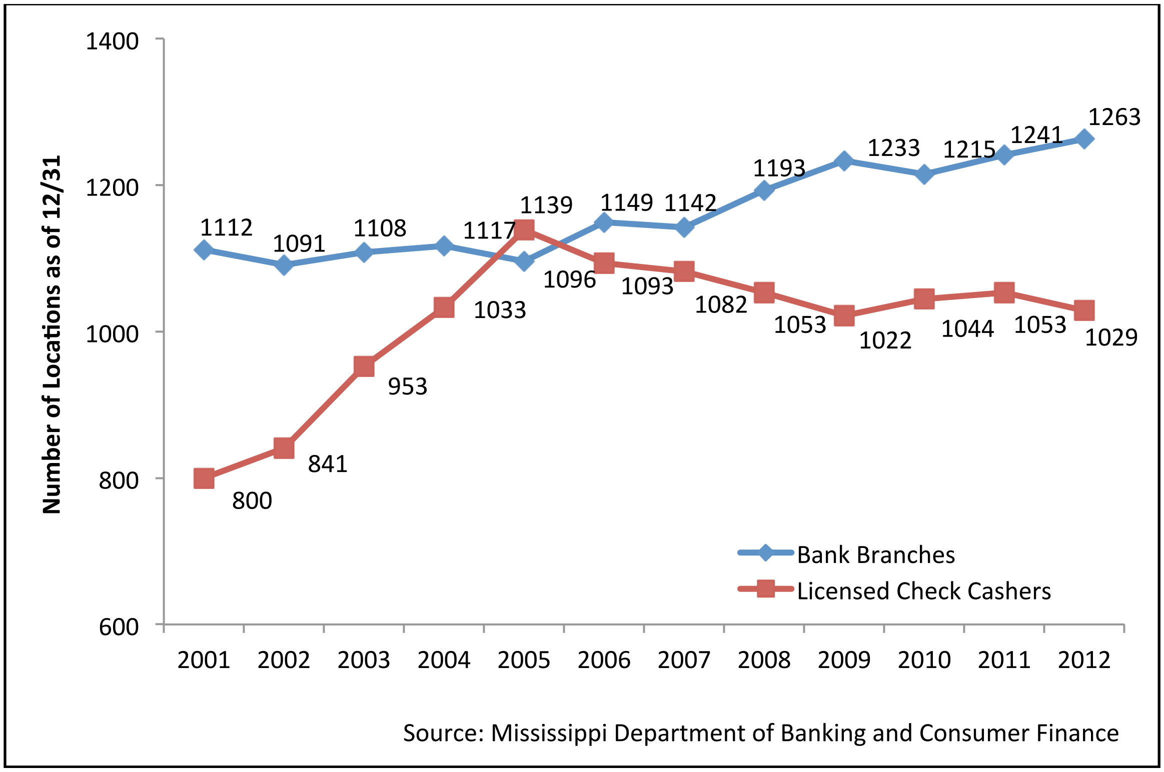

Figure 1. Licensed Check Cashers and Bank Branches in Mississippi, 2001-2012

With the rapidly increasing role of payday lending in Mississippi, we conducted a questionnaire-based survey to provide information on characteristics of the payday loan customers, their motives and satisfaction of using payday loan services for the Jackson MSA (Metropolitan statistical area), and provide policy implications from the current regulation of payday loan in the military service sector.

Research Design

Research Questions and Hypotheses

This study was organized around three primary research questions:

1) Do payday lenders in the metro-Jackson area target residents of low-income communities or communities of color?

2) Are payday lending practices in the metro-Jackson area predatory as evidenced by multiple loans outstanding per borrower?
3) Are the use and perception of payday loans affected by borrower characteristics?

Above research questions and the literature generated the following hypotheses:

H1. Payday lending practices are predatory as evidenced by multiple payday loans per borrower.

H2. There are different level of understanding on loan terms and conditions among customers, depending on their education levels.

H3. Payday loans hurt borrowers more than they help.

H4. More educated people use the payday landing less frequently than less educated people.

Methodology

Using data from the Mississippi Department of Banking and the 2010 U.S. Census, we looked at the location of payday lending stores in the City of Jackson and nearby cities.

After examining second hand data for the location analysis, we then employed a survey methodology in order to create a unique data set of Jackson MSA payday loan borrowers. The purpose of the survey study was to gain increased understanding of the practice of payday lending and the potential impact on the borrower from the borrower's perspective in the Jackson MSA. Such a study would provide a unique perspective in the policy debate within Mississippi and could be replicated elsewhere within the State at minimal cost. The findings would assist policy makers with a fuller understanding of who uses payday loans, why payday loans are used, and consumers' perceptions of how payday loans affect their personal finances and, possibly, the impacts on households and communities.

We conducted a field survey study during the summer of 2014 in the Jackson MSA. We obtained 42 survey responses from payday landing customers (The survey form used is attached to the end of the paper as appendix.). The survey was administered to individuals who responded affirmatively to an initial inquiry on whether or not he/she had ever borrowed money from a payday lender.

Findings

Patterns of payday loan store distribution

There does not appear to be much of a pattern between payday stores per capita, non-white population, and median household income, after analyzing the data from the Mississippi Department of Banking and the US Census. However, if the sample is sorted by total number of payday loan stores per zip code, the order of the payday loan stores per capita by zip code is almost matched in terms of ordinal ranking. That is, as the population of a zip code increases, the density of payday loan stores increases. This suggests that there may be a 'clustering' effect among payday loan stores in similar fashion to that of bank branches, car dealerships, etc. Further study of this possible finding would require a larger data set to be able to generalize the findings. However, a clustering strategy would be consistent with the anecodtal evidence of payday loan borrowers taking out multiple payday loans at the same time. A clustering strategy by payday lenders would help to facilitate such behavior by consumers.

Survey results of payday loan borrowers in the Jackson MSA

Payday lenders seek out young and financially inexperienced borrowers who have bank accounts and steady jobs, but also little in savings, flawed credit or have hit their credit limit. Payday lenders make loans based on access to assets (through checks, bank accounts, car titles, tax refunds, etc.) and guaranteed continued income, but not on the ability of the borrower to repay the loan without experiencing further financial problems. Payday lenders market to the military through a ubiquitous presence around military installations and/or through the use of terms to affiliate themselves with the military.

The survey results are limited, in part, by the non-probability sample used in the study. The study was not able to account for individuals who use different payday lending institutions in other parts of the state or who access payday loans online; the study design only looks at a snap shot of data collected from 42 participants during a relatively short period of time in a single market which will not account for variance of the payday lending institutions or locations. The study was only administered to individuals who responded affirmatively to an inquiry of past or present payday loan use. Thus, the survey respondents cannot be compared to a group of non-borrowers nor can the survey distinguish between temporal differences in payday use.

Characteristics of the survey respondents

Over half of the survey respondents lived in the Canton zip code (39046), which is lower than expected given that approximately two-thirds of the surveys were obtained in Canton. Some of the surveys were obtained at respondents' places of employment so the greater dispersion of respondent addresses is likely a result of commuting patterns within the Canton area.

All survey respondents were older than 20 years old. The distribution of respondents increased across the 10-year age ranges used in the survey until age 50. The largest number of responses was in the 40-49 age range. Respondents were primarily African-American women. Men accounted for less than 25% of the respondents. White and American Indian respondents accounted for less than 20% of the surveys received. About one-third of the respondents had attended college. College graduates and those with some post graduate experience accounted for almost half of the respondents. The remainder attended or graduated from high school.

An analysis of payday lending pattern in the Jackson MSA

The respondents were not uniformly stressed financially. Sixty percent (60%) of the respondents reported having financial stress less than half the time or never. Fifteen percent (15%) reported experiencing financial stress about half the time. The remaining seventy-five percent (75%) reported financial stress most months or every month.

The most frequent reason for using the payday loan was to pay for unexpected expenses, such as car repair, or emergency medical expenses (38.1%), followed by regular expenses payment for utilities, car payment, credit card bills, etc. (31.0%), and payment for discretionary purchases such as a vacation, entertainment or gifts (14.3%). Also rent or mortgage payment took 9.5%, and grocery shopping took the remaining 2.4%.

Slightly over half of the respondents considered the terms and conditions of the payday loan clear or somewhat clear. Further, respondents with more education reported a higher understanding of loan terms and conditions than less educated respondents (Table 2). The highly educated customers showed high levels of understanding on loam terms and conditions, while less educated people seem confused in understanding the loan conditions (Spearman's rho = -0.327; p=0.037).

Table 2. An association analysis of education level and understanding on loan terms and conditions

Education\understanding	Very clear	Somewhat clear	Somewhat confusing	Very confusing
Lower than higher school	0	0	0	2
High school or GED	0	1	1	4
Some college	4	6	2	2
College graduate	5	6	3	2
Post graduate	0	1	2	0
Total	9	14	8	10

Slightly more than forty percent of the respondents had never taken out more than one loan simultaneously. About half had taken out 2-3 payday loans simultaneously. The remainder had taken out 4-5 loans simultaneously. None of the respondents had taken out six or more loans at the same time. We found an association between the customers' education level and number of loans (Table 3). People with college degree or higher tend to use the loan service less frequently (Spearman's rho = -0.393; p=0.011).

Respondents with more education may be more likely to have more income than those with less education due to factors such as increased wage levels or increased job options. Another possibility may be that the respondents with more education had a better understanding of the financial risks and costs of using the payday loan and were able to limit their use of the product.

Table 3. An association analysis of education level and number of payday loans at one time

Education\number of loan	1	2-3	4-5	Total
Lower than higher school	0	2	0	2
High school or GED	0	6	0	6
Some college	6	6	2	14
College graduate	11	5	0	16
Post graduate	1	2	0	3
Total	18	21	2	41

Overall, the respondents showed negative evaluations of payday lending practices. Less than ten percent of the respondents had an overall favorable opinion of the benefit of payday lending, and most of the respondents said that the loan hurts them. Further, more than sixty percent stated they were not likely to take out another payday loan.

Payday lending protections for military – model for general public

Within the military sector, the typical payday loan customers share common factors such as being junior enlisted personnel in the lower pay grades (less than $30,000 per year) from enlisted level 1 to level 4 (E1-E4) and ranging in the age group of 21 to 31. The Army, in particular, reported that 80 percent of Army payday loan case studies were based on the lower pay grade from E1-E4. This population is extremely vulnerable to payday lenders due to their inability to properly manage their finances during unexpected emergencies and save money (Brown & Cushman, 2006). In an effort to avoid disciplinary actions for indebtedness, many military members feel forced to hide their debt and will avoid utilizing a number of financial services and programs provided to military members facing an emergency financial crisis such as Army Emergency Relief, Air Force Aid Society and the Navy-Marine Corps Relief Society which offer zero-interest loans. There are some military personnel with high level security clearances who, if found to have serious financial problems, could face not only disciplinary action but could also lose their security clearances and be unable to perform their duties which could ultimately result in separation from the military (Sanchez, 2011).

As a provision of the National Defense Authorization Act for Fiscal Year 2006, the Department of Defense produced a report, "Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents," on the impact of predatory lending on their troops. The Department of Defense determined that 17 percent of military personnel used payday loans. The report concluded, "Predatory lending undermines military readiness, harms the morale of troops and their families, and adds to the cost of fielding an all-volunteer fighting force." In response to the report, the Department of Defense recommended a 36 percent cap on the Annual Percentage Rate (APR) for consumer loans to military personnel including all fees (U.S Department of Defense, Armed Forces Press Services, 2007).

This study and the recommendation from the Department of Defense led to the passage of the Military Lending Act of 2007, which set the interest rate cap at 36 percent including all fees and charges, credit insurance premiums and other ancillary charges on certain payday, auto title and other loans made to military families. The Military Lending Act of 2007 applies to active-duty military personnel and their dependents (U.S Department of Defense, Armed Forces Press Services).

The Department recognizes that there are a number of inexperienced borrowers who are being led astray by a payday lending marketing strategy that over aggressively entices borrowers to use their services vice more traditional methods of accessing money when in need. The payday lenders are taking advantage of a population of people who are vulnerable during unexpected emergencies. Currently the Department is aggressively educating military personnel on the financial consequences of frequenting payday lenders to bridge the gap from payday to payday. The efforts to aggressively educate, counsel and provide additional financial alternatives to borrowers have proved helpful in the effort to combat the problem.

Public policy makers should consider extending the model of payday loan regulation provided for the military to the non-military citizenry while also expanding the language of the types of loans covered. The solutions provided to the military community to combat the problem of predatory lending could be expanded and extended to also assist citizens at the state and local levels. Leaders at all levels, federal, state and local can work together using the approach of education, counseling, increased service agencies that assist the low-income families and fair lending practices to provide solutions to protect financially vulnerable citizens.

Discussion and Conclusion

This study set out to determine whether or not payday lending practices are predatory. In the state of Mississippi, particularly in Jackson and the surrounding areas there has been an increase in the use of payday loans to borrowers with quick access to cash in the form of small dollar, high cost lending that often results in borrowers finding themselves in a hopeless cycle of indebtedness. In and around the city of Jackson alone there are 55 payday lending establishments that are geographically centered in low-income communities.

The payday lending business model is dependent upon low-income borrowers who do not understand the details of the loan. Furthermore, the payday lending business model anticipates that the borrower will not be able to repay the loan in the time prescribed and will have to resort to rolling over an existing loan multiple times and/or taking out multiple loans while trying to pay off their loans.

Our survey was developed to test the behavior and opinions of payday loan borrowers in the Jackson MSA. The results showed that people tend to use the loan services primarily for the payment of unexpected expenses, however, some customers depend on the loan for grocery shopping-related payments. The respondents to this survey liked the quick easy process of getting money from the payday landing, however, they expect more time to payback their loans with reduced interest rates.

Our findings were consistent with the four research hypotheses proposed: 1) Payday lending practices are predatory as evidenced by multiple payday loans per borrower; 2) There are different level of understanding on loan terms and conditions among customers, depending on their education levels; 3) Payday loans hurt borrowers more than they help; and 4) More educated people use the payday landing less frequently than less educated people. The use of the survey to construct a unique data set for the Jackson MSA and establish a protocol that can be replicated elsewhere in Mississippi is a possible extension of this paper. The data also provided some initial support for the idea that payday lenders tend to locate in clusters; however, the data in this study is not sufficient to test this possible finding. The findings of the DOD research paper may provide guidance for payday loan regulations that would benefit the non-military citizenry of the U.S.

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