Wise Counsel:
Credit Counselors Cite Perils of Payday Lending

A Report From

Policy Matters Ohio

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Author

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Acknowledgements

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Policy Matters Ohio is a nonprofit, nonpartisan research institute dedicated to researching an economy that works for Ohio. Policy Matters seeks to broaden debate about economic policy by doing research on issues that matter to working people and their families. Areas of inquiry for Policy Matters include work, wages, education, housing, energy, tax and budget policy, and economic development.

Ohio Payday Lending Overview

A new law in Ohio reforms short-term loans, known widely as payday loans, by capping the annual percentage rate (APR) of interest at 28 percent. Before the passage of HB 545, payday loans carried an effective maximum APR of 391 percent. Previous studies from Policy Matters Ohio and the Housing Research and Advocacy Center documented the steep increase in the number of payday loan stores throughout Ohio. Stores have proliferated in both urban and rural areas, growing to more than 1,600 stores statewide. This equates to a more than 15-fold growth in total lending stores across Ohio since their origination in 1995.

Our research found that the vast majority of stores charged the maximum fees and interest of $15 for every $100 borrowed on the two-week loan. The updated 2008 report also found that, based on an average family budget, it would be extremely difficult for families making $45,000 or less to pay back both the principal and interest in a two-week time period. This inability to pay off the loans leads to a cycle of borrowing that often results in the borrower being in a constant state of debt and having constant expenses for interest alone.[1]

Corrective Legislation and Ballot Challenge

Legislators in the Ohio General Assembly and Governor Ted Strickland, concerned with high interest rates and repeat borrowing, approved a bipartisan bill (HB 545) calling for a number of reforms in payday lending. The interest rate cap was the primary focus of the bill, but other provisions included limits on the number of loans per year and a database to track repeat lending.

Since the passage of HB 545, a group known as Ohioans for Financial Freedom, funded primarily by the Community Financial Services Association, gathered signatures to put a referendum on the November 2008 ballot that, if passed, would overturn the legislature's recent reform on interest rates and loan limits.[2] This referendum, which is Issue 5 on the ballot, is worded so that a"yes" vote would keep the new law that reduced APR to 28 percent, and a "no" vote would overturn the new law, allowing Ohio payday loans to charge 391% APR. As of October 10, 2008, Secretary of State Jennifer Brunner had yet to announce whether Issue 5 qualified for the ballot with a sufficient number of valid signatures. If Issue 5 lacks the qualifying signatures, the votes from absentee, early voting, and traditional ballots will be irrelevant.[3]

Ohio Policy Matters Survey - *Overview*

Much of the debate about payday loans circles around whether they help the financial situation of families living paycheck-to-paycheck. In order to determine how payday loans fit into a family budget and financial situation, Policy Matters Ohio surveyed groups that provide financial counseling and related services for low- and moderate-income families in Ohio. Specifically, we

[1] See David B. Rothstein and Jeffrey D. Dillman, "The Continued Growth of Payday Lending in Ohio." (March, 2008).
[2] The Community Financial Services Association is the trade association representing payday advance companies. Their information is available at http://www.cfsa.net/. As of 10/10/2008, CFSA was the sole donor to Ohioans for Financial Freedom, giving $850,000.
[3] The ballots are printed in advance and already contain the wording for Issue 5.

surveyed Housing and Urban Development (HUD)[4] and National Foundation for Credit Counseling (NFCC)[5] accredited agencies. These groups offer a variety of services, such as debt consolidation, financial literacy classes, free tax preparation, mortgage counseling and workouts, and other counseling to individuals and families. We identified 105 agencies or branches of agencies in Ohio. Forty of the Ohio HUD and NFCC groups identified are not separate agencies but branches of the Consumer Credit Counseling Services (CCCS) of Central Ohio that occasionally share staff and resources. Unfortunately, at least 16 of the other agencies listed closed or were no longer in operation at the listed location. We sent surveys to all branches and organizations, asking their managers and counselors about payday loans, debt, and financial planning.[6] Altogether, the agencies that responded to the survey serve more than 11,000 clients a year. We received 17 counselor responses, representing 28 Ohio counties.[7] Many of the agencies serve more than one county. The chart below displays the responses by county in Ohio, along with the number of payday lending locations. The urban areas are more heavily represented, in part because there are more counseling agencies and counselors in those areas.

Table 1: Counties with counseling agencies that responded to the survey
Number of payday lending locations, 2007

County	Number of Locations	County	Number of Locations
Adams	3	Lake	40
Athens	7	Mahoning	50
Brown	3	Meigs	3
Butler	40	Montgomery	89
Clermont	16	Morgan	1
Clinton	8	Muskingum	16
Columbiana	20	Perry	5
Cuyahoga	163	Pike	5
Franklin	189	Ross	12
Gallia	8	Scioto	12
Hamilton	125	Summit	68
Highland	7	Trumbull	39
Jackson	6	Vinton	0
Jefferson	18	Washington	19

[4] HUD accredited counseling agencies are available at: http://www.hud.gov/offices/hsg/sfh/hcc/hcs.cfm?webListAction=search&searchstate=OH.
[5] National Foundation for Credit Counseling accredited agencies are available at: http://www.debtadvice.org/takethefirststep/state_locate.cfm?PleaseWait=OK.
[6] A copy of the letter and survey are included in this report in Appendix 1.
[7] Some agencies had more than one counselor that responded to the survey.

Results

While the number of respondents was modest, the findings were remarkably consistent. The results of the survey indicate that counselors are extremely concerned about the use of payday loans for low- and moderate-income families. Counselors almost universally indicated that they would not recommend use of a payday loans to their clients. No counselor or manager indicated they would recommend a payday loan under most circumstances. One respondent said he would only recommend the loan under "extreme conditions" and "if the person completely understood the terms of service." One counselor representing several southern counties in Ohio explained why a payday loan is not recommended, "You can't get out of debt by taking out another loan." The same counselor stated his concern for payday lenders and why he called them predatory. The respondent stated, "Preying on people who are in an economically vulnerable position is predatory. Budget counseling should be mandatory for everyone receiving these loans."

Survey respondents provided the following specific reasons for not recommending payday loans.

- Interest rate is too high
- Time to pay back is too short
- Product is designed to keep people in debt
- More debt is bad for struggling families
- Better products exist for this type of need
- Multiple loans outstanding make it difficult to pay them all back
- Costs more in the long run
- The product is deceptive because it only delays payments
- Collection practices are ruthless

Respondent Recommendations

Instead of payday loans, counselors offered the following suggestions for families facing financial hardships.

<u>Short-term recommendations</u>

- "Stretch Pay" loan from credit union
- Negotiating new terms of credit on credit cards, mortgages, and other debts.
- Determine if family is eligible for financial assistance programs such as mortgage, utility, food, and shelter assistance
- Borrow from family or friends
- Consider low interest rate credit card usage if total payment can be paid off

<u>Long-term recommendations</u>

- Crisis and basic budgeting counseling
- Financial literacy programs
- Reduce living expenses by developing "want"/"need" categories
- Develop emergency savings account
- Keep new income sources and job possibilities in mind

- File bankruptcy, if appropriate
- Work out new mortgage and other loan costs

When asked more specifically about clients that have payday loans, respondents indicated that repeat borrowing and large amounts of debt were prevalent. One counselor from Cuyahoga County remarked, “They are costly, cyclic and the premise of the payday loan is the framework of poor money management. The more loans, the more they don’t work.”

Respondents indicated that more than one-quarter (2,800) of their total clients had payday loans in their debt portfolio. Of those people with payday loans, respondents indicated that more than 50 percent had multiple loans outstanding at once. The average number of outstanding loans at once was four, with some counselors reporting up to eight. A Franklin County respondent had trouble estimating the number of loans per client, stating, “A few months for each loan. After that they come to us for counseling because the hole they dug is already too deep for them to get out of on their own.”

The total payday loan debt average was around $1,000. Respondents indicated that the product was used for an average of nine months. A respondent from Hamilton County explained, “Payday loans are a deceptive product that traps consumers in a downward spiral of debt. It is an industry based on deception and greed because they know you can’t pay it back in two weeks.”

Respondents also indicated that payday loans negatively contribute to the financial health of their clients. Two-thirds of respondents stated that payday loans contribute “somewhat” to the overall debt of a client, and one-quarter of respondents indicated that payday loans contributed a “large degree” to their debt. A counselor from Cuyahoga County argued that payday loan debt contributed substantially to overall poor financial health indicating, “The outstanding amount is usually in the way of paying the mortgage/rent. I've even noticed lenders telling homeowners not to pay them until they pay down the payday loans in an attempt to give them a sustainable workout.”

Every respondent indicated that payday loans added to the financial problems facing their clients. One Summit County respondent wrote, “Over time, nothing gets paid but the payday loan.” Most counselors agreed that payday loans detract the client from paying other bills and necessities. Respondents from Cuyahoga and Franklin County all indicated that payday loans impede clients from paying mortgage or rent costs. Respondents were grim on “workouts” with lenders or collection agencies, as half of the respondents indicated that reducing or consolidating debt with lenders was “very difficult.” The other respondents indicated that the process was “somewhat difficult” and only one said the process was “somewhat easy.”

Conclusion and Recommendations

Based on this survey and our previous research, we continue to recommend the preservation of HB 545. If it qualifies for the ballot, this would require a "yes" vote on Issue 5. This bipartisan, comprehensive bill provides adequate protections to working families by regulating the interest rate of payday loans. Additional policy recommendations should include the following:

- Financial education and literacy programs through community agencies and banks.
- The development of an alternative loan product, similar to Pennsylvania's Better Choice Loan, where the APR is low (18%), the payback period is reasonable (90 days), and there is a built-in savings program.[8]
- Promote and expand current Ohio credit union "Stretch Pay" products, which offer alternatives to payday loans at lower rates and work with families to plan for emergency situations.
- Fund and promote credit counseling agencies to help families with credit and debt difficulties.

[8] http://www.patreasury.org/BetterChoice.htm.

Appendix 1

Dear Ohio Credit Counseling Agency,

Policy Matters Ohio is a nonprofit, nonpartisan research group in Ohio. We are conducting a research project that investigates the relationship between debt and payday lending.

We are surveying HUD and NFCC approved debt consolidation and counseling agencies to better understand this situation. We ask that you please complete the enclosed survey and return it to us at your earliest convenience. In order to best assess the needs of clients, we ask that you also ask your counselors to fill out this survey. The more responses we receive, the more comprehensive this study will be.

Fax: 216-361-9810, Attn: David
Email: drothstein@policymattersohio.org

If you have any questions, please contact David Rothstein at 216-361-9801 or drothstein@policymattersohio.org.

All answers will be kept anonymous in the study. Please return the surveys by September 19.

Sincerely,

Amy Hanauer
Executive Director

David Rothstein
Researcher

Ohio Credit Counselor Survey

In which city and county do you provide services?

______________ ______________________
City County

Approximately how many people do you serve each year for debt and credit issues? __________

What options or strategies would you suggest to a client who is facing a financial short-fall?
____

____

____

Would you recommend to a client to use a payday loan or lender?
Why or why not? ____

____

What percentage of your clients have outstanding payday loans in their debt portfolio?

____

What percentage have more than one payday loan outstanding?

____

On average, for those with payday loans, how many outstanding loans do they have at once?
____

On average, for those with payday loans, how long have they been using this product?

____

Of your clients who have payday loans debts, what is their average total debt in dollars?

____

To what degree do payday loans contribute to the debt your clients have?

Huge problem A large amount Somewhat Small amount Not at all

Has payday loan debt caused any of your client's problems meeting other financial obligations, such as mortgage payments, other loans, or general bills?

____

How would you describe working with payday lenders to reduce or consolidate debt for a client?

Very easy Easy Somewhat easy Somewhat difficult Difficult Very Difficult

Do you have any additional comments or thoughts on payday loans as they pertain to your clients? ____

____

Please return the surveys by September 19.

This is survey is written and administered by Policy Matters Ohio, a nonprofit, nonpartisan research organization in Ohio. More information is available at www.policymattersohio.org. All results will be kept anonymous.

If you have any questions, please contact David Rothstein at 216-361-9801 or drothstein@policymattersohio.org.

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