

Hard Cash: Predatory Lending in Alabama

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On busy highways and run-down streets across the state, you can't miss them – big, bright signs promising easy money. From **payday loans** to **refund anticipation loans** to **title pawns**, Alabamians face a dizzying array of credit services designed to trap consumers in financial quicksand.

Most states have laws against usury, or excessive interest. Alabama's Small Loan Act caps the interest on small, short-term loans at 3 percent a month, or an **annual percentage rate (APR)** of 36 percent. But laws covering payday lenders and pawn shops permit certain kinds of loans at APRs of more than 10 times that limit.

Lawmakers carved out special exceptions for certain types of loans, including payday loans and title pawn transactions, citing the industries' service to consumers who are bad risks for conventional credit. The catch, however, is the huge profit that high interest rates pull from the pockets of vulnerable borrowers. **Predatory lending** promotes poverty by exploiting those caught in the gap between low wages and the real cost of getting by.

Payday loans

Payday loans allow borrowers to use a check dated in the future (usually two weeks) as collateral for a cash loan. To qualify, all a person needs is proof of income (a pay stub or verification of government benefits) and a bank account. Research shows the payday lending business model is designed to keep borrowers in debt. According to a 2003 study by the Center for Responsible Lending (CRL), borrowers who receive five or more loans a year account for 91 percent of payday lenders' business.

Alabama passed a payday lending law in 2003 that introduced only minimal regulation. It failed to limit fees, which can reach 456 percent APR. The law does prohibit lenders from loaning more than \$500 at a time to one borrower, but a last-minute change made that provision ineffective. Rather than establishing a central database that would track loans, the law requires only that the lender "use a database, where available." As a result, Alabama lenders can choose from three databases that operate in the state. And a consumer can

borrow the maximum amount from three different lenders who use different databases. This loophole fails to protect lenders from risk and borrowers from becoming overextended. At 456 percent APR, even a short-term pay-off for a payday loan can take a sizable chunk from a borrower's paycheck.

Licensing of payday lenders in Alabama didn't begin until 2004, so growth in the industry is hard to measure. But roadside evidence points to a huge increase in recent years. As of mid-2010, there were 1,105 licensed payday loan shops in the state. By comparison, there were approximately 250 McDonald's restaurants.

According to the Consumer Federation of America (CFA), using payday loans doubles the risk that a borrower will end up in bankruptcy within two years, doubles the risk of being seriously delinquent on credit cards, and makes it less likely that

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Keywords

annual percentage rate (APR) – the adjusted value of a short-term interest rate if applied over a whole year.
churning – the practice of taking another loan immediately following repayment of an outstanding loan.
collateral – property pledged to secure or guarantee repayment of a loan.
flipping – the practice of "renewing" a short-term loan with additional credit and repayment of fees.
payday loan – short-term credit offered at high interest in exchange for proof of income and a post-dated check or debit authorization.
predatory lending – credit services exploiting low-income people by offering short-term, high-interest loans with high fees and penalties for late payment.
refund anticipation loan (RAL) – a short-term, high-interest loan secured by an expected income tax refund.
rent-to-own – a transaction in which the consumer rents a product at a weekly or monthly rate for a stated period, after which the renter becomes the owner – for a cumulative cost much higher than retail.
title pawn – a short-term, high-interest loan secured by a vehicle's title.
usury – an excessive rate of interest on borrowed money, especially interest in excess of legal limits.

consumers can pay other bills and get health care. Payday loan use also increases the likelihood that a consumer's bank account will be closed involuntarily, which may subject the borrower to criminal prosecution under state worthless check laws.

Serial borrowers are the bread-and-butter of payday lending, as CRL research shows. Among the more than 80 percent of payday borrowers who conduct multiple transactions, half take out new loans at the first possible opportunity, a process called **churning**. Addiction to debt is big business: Sixty percent of all payday loans go to borrowers with 12 or more payday lending transactions a year.

No state has legalized payday lending since 2005. In fact, 16 states and the District of Columbia have essentially banned payday loans. In 2006, Congress outlawed predatory lending to military personnel and their dependents, capping interest rates at 36 percent APR and prohibiting loans based on holding checks or debit authorization for future payment.

Title pawns

Title pawn stores proliferated across Alabama after a 1993 Alabama Supreme Court decision allowed the pawning of an automobile's certificate of title. Under the Alabama Pawn Shop Act, lenders can charge an APR of 300 percent on a short-term loan for which a vehicle's title is held as collateral. There are more than 1,000 licensed pawn shops in Alabama, most of which deal in title pawns.

Typically, such loans amount to well under \$1,000 – a fraction of the vehicle's fair market value. One missed payment allows the lender to repossess the vehicle, with additional fees for storage. The borrower must redeem the vehicle within 30 days by paying all amounts due. Failure to do so allows the pawnbroker to sell the car and keep all proceeds – even if the vehicle's value exceeds the amount loaned. The common sight of used car lots next door to pawn shops is no coincidence.

Refund anticipation loans

Refund anticipation loans (RALs) are short-term loans offered by tax preparation services and secured by the taxpayer's expected refund. According to CFA, more than half of RAL users nationwide are low-income recipients of the Earned Income Tax Credit (EITC), even though EITC recipients constitute just 17 percent of all taxpayers. According to the Internal Revenue Service, 79 percent of RAL recipients in 2003 had incomes of \$35,000 or less.

RALs provide taxpayers with the cash value of their refund – minus expenses – approximately 10 days earlier than the refund they could expect with standard electronic filing. Over this 10-day period, the annual percentage rates for RALs range from about 70 percent for a loan of \$5,000 to more than 700 percent for a loan of \$200.

RAL users pay to borrow their own money.

Nationally, RALs have stripped millions of dollars from low-income communities. According to the National Consumer Law Center, consumers paid an estimated \$1 billion in RAL fees in 2003, plus \$389 million in "administrative" or "application" fees to get quick cash for their refunds. In 2004, nearly 12.4 million taxpayers spent an unnecessary \$1.6 billion on RALs. New IRS rules have somewhat curtailed the ability of tax preparers to offer RALs, but the high-interest loans remain legal.

Low-income taxpayers can receive free tax preparation assistance at a number of sites across Alabama, such as those run by the Volunteer Income Tax Assistance (VITA) program. For a site listing, visit 211alabama.org. Many libraries also offer access to free tax preparation and electronic filing of federal tax returns on websites such as icanefile.org. Impact Alabama (impactalabama.org), a service initiative involving college students around the state, is a leading provider of tax preparation services and an advocate against financial products that exploit low-income people.

Real protections overdue

Alabama's last major protection against unfair lending was the Small Loan Act of 1959. In the half-century since, lawmakers have allowed certain categories of small-loan vendors to practice usury by another name.

The simplest solution is closing the loopholes in existing law. Alabama should cap interest on all consumer loans at 36 percent APR, just as Congress did to protect military families and as numerous states have done for their residents. We should require lenders to offer repayment options and to use a centralized database that makes it possible to enforce the existing \$500 cap on loans to a single borrower. We also need stronger enforcement provisions that let regulators stop lenders from violating the law. It's time for Alabama to ensure that low-income workers can borrow money on fair terms without fear of endless debt.

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