The cash business

Arizonans pay big price at thriving payday-loan firms

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Payday-loan offices, which provide extremely expensive short-term loans to those who struggle to make it from paycheck to paycheck, have found a perfect place to do business: Arizona.

A meteoric rise in the number of these offices is generating concern among senior military officials, consumer advocates and elected officials. Critics in these groups accuse payday-loan firms of exploiting those who can least afford the high charges and taking millions of dollars out of the state economy.

Some elected officials want to restrict the expansion and strengthen consumer protection. A measure that would lower interest rates could surface in the Legislature next year and at least one county, Pima, and Tucson and South Tucson are exploring ways to restrict the industry's expansion.

With its low-wage economy, large number of cash-strapped working people and minimal regulation, Arizona offers the kind of environment in which these loan operations thrive.

In the past four years, the number of payday-loan offices in Arizona has nearly tripled to 610, and there are more of these offices across the state than McDonald's restaurants and Starbucks coffee shops combined. Arizona also has a higher number of payday-loan offices per capita than the national average.

An analysis conducted by *The Arizona Republic* found that most are in strip malls or renovated convenience stores where low- to middle-income people live and work.

A payday loan is a short-term cash advance that is given to a borrower who promises to repay the loan plus a fee after the next payday. They are easy to obtain: A borrower needs only a checking account and a steady job to qualify. Loans of up to $500 are available instantly, usually for two weeks but at a steep price: the fees, or interest, on a two-week loan can be the equivalent of an annual interest rate as high as 460 percent.

If a borrower cannot repay the loan in two weeks, it can be extended with additional charges. Some companies encourage borrowers to pay off the interest before extending the loan. However, if nothing is paid, a second fee can be charged against the total of the loan and the first fee.

Borrowers who don't repay can be turned over to collection agencies or taken to court.

By allowing people who otherwise would have difficulty borrowing money to obtain cash easily and quickly, the national companies that own most payday-loan offices say they are providing a needed service at a fair price.

They say their loans allow people to deal with emergencies like a doctor's bill or broken-down vehicle.

Eric Norrington, a vice president of ACE Cash Express, the company with the largest number of payday-loan offices in Arizona, 91, says the industry's success demonstrates the need for its product. "If you can give consumers what they need and when they need it in a form that works for them, you will have a successful business," he said.

But a leading critic of the industry in the Legislature, Rep. Marian McClure, R-Tucson, said the business is "not good for the state of Arizona or consumers."

"It is taking money directly out of merchants' hands. As far as doing anything beneficial like some other companies do, they do nothing. They just take," said McClure. "In my mind, the only difference between payday-loan centers and loan sharks is that payday lenders don't break your legs."

The Republic projects that Arizonans will pay these lenders a total of more than $165 million in interest this year.

This projection is based on *The Republic's* analysis of data provided by the Consumer Credit Research Foundation, a non-profit organization funded by payday lenders, and the state Banking Department. *The Republic* calculates that an average payday-loan office in the United States collects at least $270,000 in interest, or fees, annually.

The Republic also found:

• The overwhelming majority, 70 percent, of payday-loan offices in Maricopa County is congregated in low- to middle-income areas where the median household income is below $45,000, the county average. Payday-loan offices in the county currently collect about $99 million a year in interest, or fees.

• The biggest concentration of payday-loan offices in the state is located in three ZIP code areas in west Mesa, which also is home to numerous dollar stores and discount shopping centers.

• Arizona has some of the most favorable laws for payday lenders, which allow them to charge up to $17.65 per each $100 borrowed, extend the initial two-week loan up to three times, or a total of six additional weeks, and charge an additional fee each time. Only four other states allow three extensions.

• Other states have stricter limits and better monitoring tools. Florida and Oklahoma have databases to ensure borrowers do not exceed the states' limits on the size of loans. Kentucky and Nebraska cap fees at $15 per $100 borrowed. Twenty-two states do not allow extensions.

How it works

To qualify for a payday loan, a borrower must have a steady income and a checking account. The borrower writes a post-dated check, which includes the principal and fee, and exchanges it for cash. At the end of about two weeks, which usually comes after payday, the lender can cash the check or the borrower repays the debt with cash.

If the borrow is unable to repay the debt, that person can extend, or roll over, the loan, which would include a new fee, for another two weeks. If a person borrowed $300 in Arizona, paid the maximum fees and extended the loan three times, he or she could pay nearly $575 at the end of eight weeks.

"You don't have to have a lot of customers if you can get them to flip their loans over and over," said Jean Ann Fox, director of consumer protection for the Washington, D.C.-based Consumer Federation of America. "Once someone gets started on this, it's really hard to stop." A federal study released this year found that most customers take out six or more loans a year.

In Arizona, no customer can have outstanding more than one payday loan that exceeds $500, excluding fees. But a lender has to rely only on the word of the borrower, according to state law.

Lynne Houston, a 31-year-old college student from Chandler, typifies many of the people who rely on payday-loan centers.

She said she borrows money from offices of Advance America, Cash Advance Centers Inc., up to five times a year because it's an easy way to borrow money. Spartanburg, S.C.-based Advance America is the largest chain in the country, with 2,408 offices. It is the third-largest chain in Arizona, with 53 offices.

"I don't like to borrow from friends," Houston said. "And with a bank, they don't lend small amounts of money for temporary loans."

Houston, who is studying psychology and has two part-time jobs, said if the local economy were better, she wouldn't use payday-loan centers. "If people were paid enough money, there would not be payday loans," she said. "If the money was out there for people to pay their own way without a hand or help, these businesses wouldn't be popping up at every corner."

National growth

Payday-loan offices began popping up in the early 1990s. By the middle of the decade, the industry was taking off.

In the past 10 years, the number of states allowing payday-loan offices has grown from six to 39 and the District of Columbia, according to the Consumer Credit Research Foundation. The number of offices across the United States has increased more than tenfold, according to major payday-loan companies. In states where payday loans are prohibited, borrowers can get a loan through the Internet or by phone.

Five of the 13 largest payday lenders now have publicly traded stock, and two had initial public offerings last year, according to the Federal Deposit Insurance Corp.'s Center for Financial Research.

Some of the nation's largest banks, including JPMorgan Chase & Co. and Wells Fargo & Co., provide credit to payday lenders.

"Payday lenders are legal businesses. So we provide them banking services just as we do other businesses," said Mary Jane Rogers, a Chase spokeswoman.

Only a few banks and credit unions offer consumer products similar to payday loans-and they are much less expensive. But most have stayed out of the market because of their perception that it is a high-cost, high-risk business.

However, Sheila Bair, a professor at the University of Massachusetts at Amherst, concluded in a recent study that these perceptions were "exaggerated" and banks could profitably offer competing products at a much lower price. The study was funded by the Annie E. Casey Foundation, a charitable organization dedicated to helping disadvantaged children and families.

Meanwhile, business has been good for payday lenders across the country.

The Consumer Credit Research Foundation estimated that in 2002, the most recent figures available, the gross volume of payday loans was $45 billion, with roughly 180 million payday loans originating in the United States. Bill Brown, an economist and professor at Claremont McKenna College in California who has conducted research for the foundation, estimates that consumers paid $6 billion to $7 billion in annual fees.

The Consumer Federation of America estimates that 53 percent of Americans live paycheck to paycheck at least some of the time.

Expansion in Arizona

Arizona began licensing payday-loan offices in 2000, following intense lobbying by the industry.

Before that time, there were only four lenders, which were operating in Arizona through an affiliation with another financial institution or under an exemption.

"There was a legitimate need," said former state Sen. Ed Cirillo, who pushed through legislation in 2000 that permitted payday-loan offices. "The fact they have grown so much shows there is a need. If they were doing bad things, word would get around. . . . They wouldn't be growing. They would be shrinking."

In 2000, the state Banking Department approved 24 licenses. A company can operate several branches under one license. The following year, when the state began recording the number of branches, 40 licenses were granted for 212 branches. Currently, there are 82 licensees and 610 branches.

Many of the offices are well-lit, clean places that have a clear bulletproof window that separates customers from tellers.

Around half of the lenders make additional money by offering check-cashing services. The typical charge for check cashing is 3 percent of the face value of a payroll check and 5 percent of the face value of a personal check, according to a trade association attorney. But some outlets charge nearly 10 percent of the face value of a personal check.

Nine of the top 10 payday lenders in Arizona are headquartered out of state. Some local entrepreneurs also operate smaller operations with a handful of offices in the state, including one owned by George Brimhall, chief executive of Castles N' Coasters, a popular amusement park. A spokesman for Brimhall said the entrepreneur moved into payday lending to diversify his business portfolio, which also includes real estate and natural foods.

Lee Miller, an attorney for the Arizona Community Financial Services Association, the payday-loan industry's trade association, believes the number of players in the state will shrink.

"Like Blockbuster's domination of video rentals, the payday industry is consolidating and a few companies will dominate the business, so that they can, among other things, pay the high rent asked by the owners of the high-traffic-count retail centers," Miller said.

Target customers

Industry executives say they target low- to middle-income wage earners who both need loans and eventually will repay them. Major payday lenders say loan losses are 5 percent or less of their total loan volume. That's fairly low, according to David Robertson, publisher of the *Nilson Report,* a California-based newsletter for the debit- and credit-card industry. By comparison, major card issuers wrote off 6.2 percent of credit-card debt in 2004.

The typical customers of payday lenders are educated, young and married, and more than half of borrowers have family incomes of $25,000 to $49,999, these industry officials say.

The Republic's analysis found that most payday-loan offices in metro Phoenix are on busy streets near neighborhoods with low-cost housing. Nonetheless, people in the industry insist that they do not target the poor.

"Why would we want to lend money to people who can't afford to pay you back?" said Jabo Covert, a vice president for Check Into Cash, a Cleveland, Tenn.-based company that has 48 payday-loan offices in Arizona.

"We're targeting the people who drive through those neighborhoods," Miller said. "It's all about convenience."

One segment that payday lenders do home in on is lower-level military personnel.

A recent study of 15,000 payday-loan offices in 20 states where there were 109 military bases concluded, "There is irrefutable geographic evidence demonstrating payday lenders are actively and aggressively targeting U.S. military personnel." Steven Graves of California State University-Northridge and Christopher Peterson of the University of Florida conducted the study.

Their steady but modest paychecks and the pressure exerted on them by their commanding officers to repay their debts make military personnel ideal clients.

"They make it easy. They don't check your credit, and they will just give it (cash) to you," said Afiya Jenkins, an airman at Luke Air Force Base in Glendale who has borrowed money from a payday lender.

A study by the Government Accountability Office published in April found there were 49 payday-loan businesses in neighborhoods adjacent to Luke.

"We view it as very bad," said Col. Robin Rand, commanding officer of the base. "The interest rates on these loans are obscene, to put it mildly. . . . One payday-loan store is one too many."

In June, the Defense Department launched a campaign to educate military personnel about the dangers of borrowing from payday lenders because the loans can trap borrowers into high payments.

Hispanics are another group that some companies in the industry are targeting.

Texas-based Ace Cash Express said in its 2004 annual report that Hispanics provide "significant growth potential for us" because they are the largest minority group in the United States.

The Republic found that a much higher proportion of the Valley's Hispanic population (nearly half) than its Anglo population (about one-fourth) live within a half-mile of payday-loan offices.

A ripe market

Arizona has plenty of people struggling to make ends meet The median household income in Arizona is estimated at $41,995, 6 percent below the national average, according to the Census Bureau. Meanwhile, personal bankruptcy filings in Arizona have risen 53 percent from about 20,000 in 2000 to about 31,000 in 2004, according to U.S. Bankruptcy Court figures.

Another sign of financial strain in the Arizona economy: Nearly half of the adults currently enrolled in the state-sponsored health-insurance program for the poor are employed; many of them work in jobs that either offer no medical benefits or benefits that are too expensive for employees to afford. The state insures more than 1 million Arizonans, one in five people in the state.

Arizona has a rate of 10.7 payday-loan stores per 100,000 residents, higher than the average of 10.2 per 100,000 for the states that allow lending.

The biggest concentration of offices in the state, 47, is in three ZIP codes in west Mesa, where the average median income is about $41,000.

Joe Morgan, 49, lives on Pepper Place in the 85201 ZIP code area of west Mesa, which has the highest concentration of payday-loan offices in the state, and he is not happy they have moved into his neighborhood. He believes they contribute to the area's image of being a haven for low-rent hotels and discount stores.

"West Mesa got left behind a long time ago," said Morgan, a merchant seamen who has lived in the community his whole life. "My biggest concern has been Main Street and the city's inability to clean it up."

Tighter regulations?

Mesa Vice Mayor Claudia Walters, whose district covers west Mesa, shares Morgan's sentiments.

"There is no one who dislikes them more than I do," she said. "I have seen people use them who are not financially savvy and don't know what they are getting into. People can end up paying more than 300 percent interest (annually)."

Walters would like to see the city restrict the expansion of payday-loan offices, but she doesn't believe others at City Hall would give her much support.

Pima County, Tucson and South Tucson are considering zoning and licensing changes.

At least one Arizona city already has imposed restrictions: Peoria passed an ordinance five years ago that limits the number of payday-loan offices in a given neighborhood by prohibiting them from being within 1,000 feet of each other.

Other changes may be coming at the state level.

Richard C. Houseworth, state banking superintendent, believes his department needs more resources to monitor payday lenders. In addition, both Houseworth and Rep. McClure would like to see consumer-protection laws strengthened.

The Banking Department, which regulates payday-loan offices by granting licenses and responding to complaints, has one examiner to monitor the 610 payday-loan offices. For the fiscal year that ended June 30, the state examined about one-fourth of the 82 payday licensees.

"The department is concerned about the increase in the number of payday-lender licensees and the strain that such growth places on the department's resources to adequately examine and regulate these businesses," Houseworth said.

Consumer activists think the concerns about the state's consumer protections are warranted. "I have never been impressed with the Banking Department's role in regulating payday lenders," said Eddie Sissons, a former consumer activist who now works for the Attorney General's Office.

But Banking Department officials say one problem is the vague wording of the law governing loan limits.

State law allows payday lenders to charge a fee of 15 percent of a postdated check. That has been interpreted by the industry, and supported by a 2001 opinion from then-Attorney General Janet Napolitano's office, that the maximum charge can be $17.65 per $100 borrowed.

The reasoning: If a borrower wants $100, a 15 percent deduction from a $117.65 check would leave the borrower with that amount.

The rates charged by most other states range from $15 to $20 per $100 lent.

McClure, of Tucson, a former bill collector, said she planned to introduce legislation to tighten regulation of the payday-loan business next year. She believes that a growing number of legislators would support a reduction in maximum fees and rollovers. Nonetheless, she anticipates an "uphill battle."

But she believes time is on her side: Legislation that created payday-loan offices in 2000 expires on July 1, 2010. So the Legislature will have to revisit the issue.

"We will have a rather comprehensive bill," she said.

"When payday lenders were allowed to come into the state, the Legislature put in a sunset provision. Unless the Legislature extends their right to operate as of 2010, they have to close their doors."