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Consumers caught in spiral of payday loans

Deal looks like good way out of a jam, but costs often are sky high

By Betty Lin-Fisher,Beacon Journal business writer

Our state has just been given another honor -- but this is one we don't want.

In a recent report from the Center for Responsible Lending, Ohio is among the top 10 states where consumers are paying the most in fees from payday loans. Nationally, the nonprofit group estimates that consumers pay $4.2 billion in fees to the payday industry every year. In Ohio in 2005, consumers paid nearly $233 million in fees.

Payday loans are cash advances on a person's next paycheck.

In exchange for writing a post-dated personal check payable to the lender for the amount to be borrowed plus a fee, the consumer gets to walk out of the store with that money from the next paycheck, minus the fee. But the problem with these type of loans are they are very expensive credit. That's because they are not installment loans and are due in full in two weeks time. Often, the consumer isn't able to pay back the fees within the two weeks, so they go to another payday lender to borrow on the money they owe the first. That then starts a spiral that many people can't escape.

In Ohio, payday loans can be up to $800. On loans of $500 or less, there's a $5 loan origination fee for every $50 borrowed, plus 5 percent interest per month or partial month. For example, a $500 loan for two weeks will cost $575.

Loans of more than $500 can charge 5 percent interest, plus a $5 loan origination fee for every $50 of the first $500 and a $3.75 loan origination fee for every $50 above $500. That translates into $912.50 for an $800 loan.

Consumers can end up paying annual interest rates of 400 percent and higher on these small loans, said the Center for Responsible Lending, based in Columbia, S.C. The group estimates that 90 percent of payday lender revenue comes from people who can't pay off the loans when they're due. The typical consumer borrows $323 but pays $793, the report said.

The payday lending industry has exploded in the last few years. The lenders must be licensed by the Ohio Department of Commerce. As of this month, there are 1,509 payday lenders, called Check Casher Lenders by the state, in Ohio. That's up from 983 in 2003 and 511 in 1999.

Often, you see competing payday lenders in clusters along roads in economically challenged areas or places where there aren't as many traditional banking institutions. Some even have drive-throughs.

``I think they've found very fertile ground in Ohio,'' said Tom Allio, executive director of the Catholic Commission in Summit County.

Payday lenders can be a Catch-22, because people who use them need the money and often feel they have no alternatives, said Cynthia Sich, director of the Summit County Office of Consumer Affairs.

But ``if you're already going paycheck-to-paycheck and you had to borrow against your paycheck, you didn't plan to pay it back. If I borrow the money, will I be able to pay it back next week? If my next week's (paycheck) is already spent, how am I going to pay that loan back? That's how the cycle starts,'' Sich said.

Darryl Dever, a lobbyist for the Ohio Association of Financial Service Centers, said his clients fulfill a short-term cash need.

``We're trying to get someone through a situation. We're a viable solution,'' he said.

Compared with returned check fees from banks, payday lenders are not an expensive alternative, he said.

Dever said he also believes Internet-based payday lenders, who do not have to comply with Ohio state laws that cap fees and prevent rolling over loans from the same lender, play a role in high fees.

Dever takes issue with consumer advocates who use high annual-percentage rates or APRs to describe payday loans, because the loans are not paid over one year.

``I think people are using that to be dramatic,'' he said.

But Julie Robie, a staff attorney for the Legal Aid Society of Cleveland, said APRs are a standard indicator for loans of any length and fair way to compare apples to apples.

The typical payday lending borrower at Legal Aid has been stuck in the ``debt trap'' of payday lending for anywhere from two months to two years and has three to nine loans that are all coming due at the same time. Usually the total debt owed on all of the loans is higher than the borrower's monthly income, she said.

``It's marketed to people as a one-time emergency product, but in our experience the reality is it doesn't end up being a one-time situation,'' she said.

So what's the answer? Education about how payday lenders work for consumers who feel compelled to use them. And real alternatives from traditional banking institutions and credit unions.

Robie said she also believes the business model and the structure of existing payday loans needs to be evaluated.

The payday lending business is not going to go away, said Dever, even if state regulators put payday lending out of business, because it will still exist on the Internet in an unregulated manner.

A group of economists for the Consumer Credit Research Foundation also recently wrote in a study that ``efforts to ration or eliminate payday loans could hurt those who need them most, and may have the harmful effect of driving this service into the informal or underground economies where few of the essential conditions necessary for rational economic choice are likely to exist.''

There is some movement in banking and credit union circles to come up with alternatives for consumers.

About 20 credit unions in the state, including the Kent Credit Union with branches in Portage County, offer a product called Stretch Pay (see more information in the accompanying article).

And Mike Griffin, senior vice president of community development banking at KeyBank said his bank is researching alternatives, but ``we are internally struggling with how to develop a short-term loan that is profitable... but still meets the needs of people without charging the costs that payday lenders are charging.''

The discussion needs to continue -- as well as the education.

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