Part 1: Costly loans turn payday into debt day

Ron Nixon, Terry Collins and Dee Depass, Star Tribune

Last update: August 14, 2004 – 11:00 PM

Printer friendly

E-mail this story

Save to del.icio.us

Related Content

- Photo Gallery

Related content

- How payday loans work; help for consumers
- Banks have financed payday lenders' expansion
- Churches, nonprofits provide alternatives
- Part 2: Tax refund loans come at a heavy cost
- Part 3: Costly mortgages provoke backlash from borrowers

Business

Unemployment rate edges up

Ford adds 1.2 million vehicles to recall

General Mills' No. 2 takes a global view

Minnesota ethanol firm hopes to raise $300 million in IPO

Med-tech shares slide on Medtronic news

First of three parts Miasha Thomas was just 19 when she bought her first house in St. Paul's Thomas-Dale neighborhood three years ago. Every month, she scraped together enough money from her mail-sorting job to pay her mortgage and modest living expenses.

Then, without warning, she was laid off. What she thought would be a temporary setback turned into a long-term scramble to make ends meet. She found seasonal work, but her bills soon overwhelmed her paychecks.

Assuming she couldn't qualify for a bank loan, Thomas turned to a different kind of lender -- Payday America. Thomas walked into the green storefront with the yellow sign and asked for a $250 loan against her next paycheck. The only requirement was that she have an ID, a job and a checking account. She was charged $22.50 in fees and interest -- equivalent to a 469 percent annual rate.

A few weeks later, she was back to borrow $350. Then another $350, and another. She even persuaded her reluctant parents to take out their own payday loans for her.

"I would take them out, pay it off on Friday and return on Tuesday to take it out again," Thomas said. "I found myself paying at least $60 per month just to pay fees [in various loans]. It didn't seem so bad at first, but that's grocery or gas money."

By this past March, after incurring more than $2,100 in payday loan fees in nearly three years, Thomas felt she had little choice but to sell her house in order to end the cycle of debt.

For thousands of Minnesota's low-income residents, businesses such as Payday America have become both a financial lifeline and noose.

During the past decade, a number of financial businesses -- from mortgage lenders to rent-to-own stores to tax preparers -- have found ways to profit by catering to people who live paycheck to paycheck or have been shut out of mainstream financial institutions. The growth of these industries has been fueled by banking deregulation, the increased number of people with bad or impaired credit, a rise in personal debt, and the surge in the immigrant population.

None of those businesses is growing faster in Minnesota than payday lending.

A payday loan is borrowed against a paycheck. The lender gets a postdated check from the borrower for the loan and interest and deposits the check on payday.

Statewide, payday lenders made more than $32 million in high-interest loans last year, up from just over $182,000 in 1997. During that same period, the number of payday lending stores in the state has risen from two to 65.

Nearly all check-cashing businesses and many pawnshops in the state have obtained payday-lending licenses, according to the Minnesota Department of Commerce.

Brad Rixmann, founder and president of Payday America, the state's largest payday lender, says there's a simple explanation for the growth in demand.

"A lot of people can't go to Mom or Dad or friends asking for money," Rixmann said.

But payday lenders have larger issues working in their favor, including outstanding profitability.

"The return on investment ... is well in excess of 50 percent for the ones I've seen," said Richard Eckert, an analyst at Los Angeles-based Roth Capital Partners who tracks companies such as Ace Cash Express and Cash America that make payday loans.

The business also is less chancy than pawn lending or even the credit card business, since payday lenders can go to court and have people's wages garnished if they default, a step not available to many creditors.

And payday lenders are filling a void left by banks in many low-income areas.

A Star Tribune analysis showed that many of these businesses have expanded in a number of the same locations that once had one of the 57 bank branches that have disappeared from the Twin Cities since 1996. Among the closed branches were offices that served the urban core along Nicollet Avenue and E. Lake Street in Minneapolis, Arcade Street in east St. Paul and Robert Street in West St. Paul.

Josh Fuhrman of the Roseville-based Auriton Solutions credit counseling agency can attest to how fast payday lending is taking hold in Minnesota. He said about 10 percent of his clients now list payday loans as the cause of their debt, or at least a contributing factor, up from zero a few years ago.

"You didn't see that three or four years ago," Fuhrman said. "It's really taken on a huge dimension."

Customer traffic in and out of the UnLoan Store along University Avenue in St. Paul or Express Payday Loans on E. Lake Street in Minneapolis can get as hectic as any bank branch, especially early in the morning and late in the afternoon, as people stop by before or after work.

The borrowers use payday loans essentially the same way that bank customers rely on lines of credit, overdraft protection or advances on their credit cards to bridge the gap between this week's bills and next week's paycheck. The payday customers simply face a more onerous cost.

Reye DeLowell found out this year how quickly the visits to a payday lender can become routine.

The 61-year-old Bloomington man worked two jobs as a hotel custodian but still barely made ends meet. Strapped for cash, DeLowell turned to Payday America in Bloomington for a short-term fix. Instead, DeLowell became a frequent customer after poor health forced him to quit one of his jobs. He'd borrow $250, pay it back in two weeks, then take out a similar loan again.

During a three-month period that ended this spring, DeLowell incurred more than $200 in fees to repeatedly borrow what amounted to the same $250. At one point, he had to choose between paying his loans or his rent.

"I don't have anything against the payday loan folks," said DeLowell, who still is struggling to get current on his rent after paying off Payday America. "But I'd like to be in a situation where I wouldn't see them every other week."

Repeated borrowing

Payday lenders need people such as DeLowell, according to a study by the Center for Responsible Lending, a nonprofit research group in Durham, N.C.

While payday lenders commonly describe their products as answers for emergencies, the center concluded that lenders made 91 percent of their loans to repeat borrowers.

Separate research by the University of North Carolina at Chapel Hill's Center for Community Capitalism revealed that each 1 percent increase in the number of customers who borrow at least monthly raises the gross revenue of a typical payday lender by $1,060. Michael Stegman, a professor at the Center for Community Capitalism who conducted the study, said payday lenders count on people becoming chronic borrowers.

"These companies thrive by converting a significant number of one-time customers to repeat borrowers," Stegman said.

Many of the dozens of payday loan customers interviewed by the Star Tribune said they were regular borrowers. Some talked of taking out a new loan right after paying off another.

Jean House, 49, of St. Paul has spent the past two years regularly borrowing $250 at Payday America to cover her husband's diabetes medication. Each payday, House hands over $272.28 to pay her loan and fees. She then fills out paperwork for another loan and the clerk hands back the same $250.

She has paid at least $1,200 in fees so far.

"I don't think I can stop because I always need the money," House said.

Jonathan Palmer, executive director of the Jordan Area Community Council in north Minneapolis, worries about the proliferation of payday lenders, since they don't offer customers the option of saving their money like banks do.

He said the result is neighborhoods that become increasingly poor, where no one wants to live or invest.

"All these stores are geared to take money out of the communities, not keep it there," he said. "These shops are no more a service than the prostitute on the corner is for a guy who says he's lonely."

Meeting a need

Gary Dachis says payday lenders are unfairly criticized.

Dachis is founder and president of the UnBank, the largest check-cashing store in Minnesota. Following the trend, UnBank recently expanded into payday lending through its first UnLoan Store in St. Paul. Eleven more UnLoan locations are planned throughout the metro area.

"Banks won't take this kind of risk. The banks are not servicing anyone who needs less than $300," Dachis said. "Where else can a customer walk in and get $200 on a signature?"

The risk might not be as high as the industry claims, though.

Unlike pawn lending, in which small loans of $100 or less are made in return for items of uncertain resale value, such as TVs or jewelry, payday lending puts most of the risk on the borrower. A Star Tribune analysis of records from the state Commerce Department showed the overall default rates for payday lending at 2 percent in 2003, far lower than typical default rates for many credit cards.

Still, the law provides broad protection for the lenders, including the right to win garnishment of wages, something banks can't do when someone files for bankruptcy to avoid paying credit card balances or other unsecured loans.

Hennepin County District Court records from 1993 through January 2004 show more than 425 such judgments in favor of payday lenders. State wide, there were nearly 700.

The borrowers not only have to repay their loans with interest and bounced-check fees, they must pay court costs, too. A random sampling of court records concerning Payday America customers during that period showed them paying nearly four times the average amount of their loans.

Regretful borrower

Michael Anderson of Brooklyn Park ended up owing more than $1,060 because he couldn't repay a $260 loan from Richfield-based Money Centers last year. The extra costs stemmed from fees for bounced checks, court costs and the cost of delivery of his court summons by a Hennepin County sheriff's deputy.

Anderson wishes he had never taken the payday loan in the first place.

He said that if he could go back and do things differently, "I'd try to borrow money from friends or family."

Rixmann, whose Burnsville-based Payday America made more than $19 million in payday loans last year -- nearly 60 percent of the state total -- said the industry doesn't like to see people get in over their heads.

"Do I have concerns about those who get themselves into financial situations they can't get out of? Yes," he said. "I'd also be very concerned if they didn't have anyplace to go to get help. We don't encourage long-term lending. We do not do anything to encourage people outside of a good clean business and hopefully good customer service."

Jim Bernstein, who was commissioner of the Commerce Department during the Ventura administration, takes a far harsher view, saying payday lenders are little better than loan sharks.

"The industry says, 'Hey, we're just making loans to people and offering a service,' " Bernstein said. "But when they get behind [or can't pay], it's like going to a loan shark, except they aren't threatening to put a bullet in your knee.

"The Legislature needs to take a hard look at it."

Some states react

Legislatures in several states have taken action.

North Carolina allowed its law authorizing payday loans to expire, effectively rendering them illegal, although many lenders there continue to make loans by acting as processors for out-of-state banks. Fourteen other states also have made payday lending illegal. In Georgia, lawmakers recently passed a bill that would severely restrict payday lending, and Oklahoma passed a law to strengthen consumer protections for payday loans.

Minnesota's laws are somewhat more restrictive than neighboring states', and there is little momentum to change the laws here.

Minnesota law places a limit on what payday lenders can charge customers and requires stores to post their rates in plain view. Most significantly, the law forbids "rollovers" -- in which a customer borrows money and then rolls the debt into another loan rather than paying it off.

However, some borrowers get around that prohibition by paying off a loan and quickly taking out another or by taking out loans from multiple lenders. Critics of payday lending say that renders the rollover provision meaningless.

"If you can take out back-to-back loans without restriction, its basically the same thing as a rollover," said Jean Ann Fox of the Consumer Federation of America.

Still, many Minnesota lawmakers believe the laws governing payday lending in the state are sound.

State representative Jim Rhodes, R-St. Louis Park, had introduced legislation to strengthen Minnesota payday lending laws, but let the proposed legislation die after deciding the current laws were strong enough.

"We're a lot better than states like Wisconsin, where the industry is not regulated," Rhodes said.

Payday lenders think Minnesota's law is too restrictive. The industry took its first step toward formally lobbying the Legislature earlier this year when the Community Financial Services Association of America, a trade group for payday lenders, hired two lobbyists in Minnesota.

Several lenders, including Payday America, already have lobbyists. Payday America and Pawn America, which is owned by the same company, employ four lobbyists. Community Money Centers, another payday lender, has two lobbyists.

Douglas Franzen, lobbyist for the Community Financial Services Association of America, said the industry wants to make some changes in the law.

"We think you can make a fair rate of return on your investment and still treat customers right," Franzen said.

Hard lesson

Miasha Thomas, the laid-off postal worker who had been hooked on loans for two years, now strongly discourages others from using the alternative banking options.

She regrets learning fiscal responsibility the hard way.

"At the time, I felt it was my only option. Nowadays, I will see if there is something else," Thomas said. "You end up losing more in the end."