GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE ATTORNEY GENERAL

PRESS RELEASE

FOR IMMEDIATE RELEASE
April 26, 2007

For information contact:
Bennett Rushkoff at (202) 727-5173

D.C. ATTORNEY GENERAL TARGETS HIGH COST OF BEING POOR

Washington, DC – D.C. Attorney General Linda Singer announced today a series of consumer protection initiatives by the Office of the Attorney General to address many of the problems highlighted in "The High Cost of Being Poor in the District of Columbia: Financial Products and Services," a report prepared with help from D.C.-based staff at the Center for Responsible Lending and the Urban Institute.

The report, released today, focuses on the disadvantages that poor consumers in D.C. face in obtaining financial products and services, including check cashing, short-term loans, and mortgage financing.

"The disparity between what lower-income consumers pay and what moderate-to-higher income consumers pay for similar goods and services is a form of economic injustice that leaders in government and the private sector must work together to address," General Singer said.

The initiatives announced by General Singer include town hall meetings, new consumer protection legislation, stepped-up investigation and prosecution of predatory mortgage lending and foreclosure rescue scams, and improved consumer education. These initiatives will be pursued in cooperation with the D.C. Council, the Department of Insurance, Securities and Banking, the Department of Consumer and Regulatory Affairs' Office of Consumer Protection, Legal Counsel for the Elderly, and the Urban Institute.

Consumers with complaints about deceptive or abusive practices, including those relating to financial products and services, can call the Office of the Attorney General's consumer complaint hotline at (202) 442-9828. For consumer education tips and information on how to make an effective consumer complaint, go to the Office of the Attorney General website at www.oag.dc.gov.

###

GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE ATTORNEY GENERAL

LINDA SINGER
ATTORNEY GENERAL

April 26, 2007

I am very pleased to release "The High Cost of Being Poor in the District of Columbia: Financial Products and Services." This report was prepared with the assistance of Washington, D.C.-based staff of the Center for Responsible Lending and the Urban Institute.

The report highlights the exorbitant prices that low-income consumers in the District of Columbia routinely pay for basic financial services – including check cashing, payday loans, money transmitting, tax refund anticipation loans, rent-to-own purchases, automobile financing, and subprime mortgage loans. This premium can easily add thousands of dollars to the already strained budget of a low income consumer.

The disparity between what lower-income consumers pay and what moderate-to-higher income consumers pay for similar goods and services is a form of economic injustice that leaders in government and the private sector must work together to address. With the release of this report, I am announcing a series of consumer protection initiatives by the Office of the Attorney General to address some of the most serious disadvantages that poor consumers face in obtaining financial products and services.

I hope that the information in this report – and in subsequent reports on the high cost of being poor – helps to galvanize support for new consumer education initiatives, necessary legislative reforms, more vigorous enforcement of consumer protection laws, and improved credit-related services for our lower-income neighborhoods.

Sincerely,

Office of the Attorney General Initiatives
to Address the High Cost of Being Poor

April 26, 2007

In cooperation with: District of Columbia Council, Department of Insurance, Securities and Banking, Department of Consumer and Regulatory Affairs (Office of Consumer Protection), Legal Counsel for the Elderly, and the Urban Institute.

(1) Convene a series of town hall meetings to learn more about the challenges faced, and to identify additional services needed, by District residents who currently use financial and retail services intended primarily for low-income consumers.

(2) Work with the D.C. Council to enact:

(a) the Payday Loan Consumer Protection Act of 2007 or similar legislation aimed at capping interest rates on all short-term consumer loans at the current District usury ceiling of 24%;

(b) legislation that lowers the District's statutory cap on check-cashing fees when applied to government-issued checks;

(c) legislation to be proposed by the Department of Insurance, Securities and Banking, or similar legislation, that requires money transmitters to use standard price disclosures, thereby allowing consumers to compare the total costs – including foreign exchange costs – of using particular companies to wire money abroad;

(d) legislation to require mortgage lenders to provide borrowers with clearer disclosures regarding the potential monthly payments and prepayment penalties associated with non-conventional mortgage loans;

(e) legislation that protects homeowners from foreclosure rescue scams and other predatory foreclosure practices that seek to defraud them out of the equity in their homes;

(f) legislation that requires standard price disclosures by rent-to-own furniture and appliance dealers in the District and that caps the total interest charged in rent-to-own sales; and

(g) legislation that requires that the prices charged to consumers in rent-to-own and credit sales be *bona fide* retail prices, based on standard retail markups used in comparable cash sales.

(3) Create a working group of investigators from the Department of Insurance, Securities and Banking and attorneys from the Office of the Attorney General and the Federal Trade Commission to investigate and prosecute predatory mortgage lending under the District's Consumer Protection Procedures Act and the District's banking laws. Seek court orders halting deceptive and unconscionable practices and providing restitution and other equitable relief for consumers.

(4) Investigate and prosecute foreclosure rescue scams under the District's Consumer Protection Procedures Act and refer egregious cases to the U.S. Attorney's Office for criminal prosecution.

(5) Develop and disseminate consumer education materials – co-branded with cooperating agencies or nonprofits – that address basic money management issues, including banking, retail credit and rent-to-own sales, tax preparation, home mortgage lending, and foreclosure.

The High Cost of Being Poor in the District of Columbia:

Financial Products and Services

A Report to the Attorney General for the District of Columbia
April 2007

Acknowledgements

Research and writing assistance for this paper provided by:

Jillian Aldebron, Delvin Davis, Leslie Parrish, and Peter Smith
Center for Responsible Lending
Washington, D.C.

and

Peter Tatian
Urban Institute
Washington, D.C.

Table of Contents

EXECUTIVE SUMMARY

Low-income households in the District of Columbia pay higher prices than more affluent households for the same basic goods and services. Minority populations are among the worst hit by these cost inequalities, which are further exacerbated by disparities in the quality and range of goods and services available to poorer communities. The "poverty premium" is most striking in the financial services sector, where the absence of reasonably-priced products forces poorer households to rely on "alternative" financial services whose excessive cost and bad terms can rise to the level of abuse. Alternative financial service providers target households in greatest need, as is demonstrated by their disproportionately high concentration in low-income neighborhoods and communities of color. Research shows that low-income households lose out on:

- ***Check cashing*****:** consumers without bank accounts can spend up to five percent of their take-home pay to cash their paychecks. Four percent of a tax refund and five percent of a government benefit payment can be lost to check cashing fees.

- ***Payday loans*****:** the average borrower pays $708 to take out a $325 loan—a 341 percent APR. District residents pay an estimated $3.3 million to payday lenders each year.

- ***Remittances*****:** the average household sending money to relatives abroad spends nearly $150 in remittance fees a year, in addition to paying a very high currency exchange rate. District residents sent $154 million to Latin America in 2006.

- ***Refund anticipation loans*****:** a taxpayer getting a refund anticipation loan (RAL) pays an average 133% APR for the typical 10-day loan—not counting the cost of paid tax preparation. Nearly half of households getting the earned income tax credit (EITC) take out RALs. RALs cost District residents over $3 million in 2003.

- ***Rent-to-own*****:** households that do not have ready cash to buy furnishings outright pay rent-to-own companies double or triple the price of the same merchandise in a department store.

- ***Automobile financing*****:** low-income car buyers pay up to 3.7 percent more on car loans; African Americans pay up to 10 percent more on the purchase price of a car.

- ***Subprime mortgages*****:** low-income homebuyers may get loans with prepayment penalties and fully-indexed rates that can result in 90 percent of their post tax monthly income going to mortgage payments.

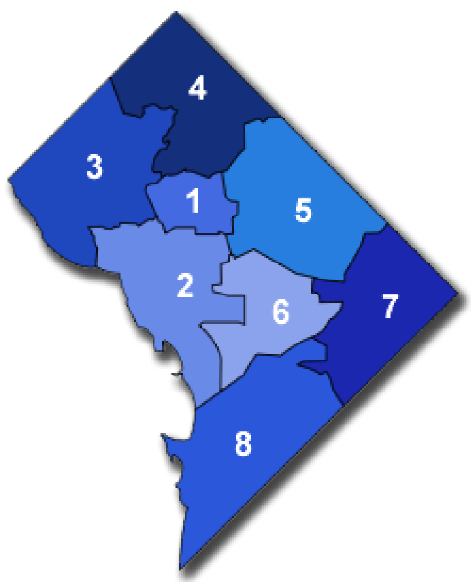
These high-cost financial products and services can drain scarce resources from already-vulnerable District households. Low-income residents need responsible, affordable financial products that satisfy short-term needs and offer the promise of building wealth.

I. PROLOGUE—THE EVERYDAY COSTS OF BEING POOR

It's a daily struggle for low-income households everywhere to make ends meet. But low-income households in the District—those earning 80 percent or less of the area medium income—face special challenges because basic goods and services are more expensive than in most parts of the country. The District has the twelfth highest cost of living among 364 metropolitan areas nationwide. It also has one of the highest rates of poverty. A quarter of the District's population makes less than 125 percent of the federal poverty line.

As shown in Table 1 below, poverty in the District is most prevalent east of the Anacostia River, in wards 7 and 8. Ward 1 (including Columbia Heights) and ward 6 also have poverty rates slightly above the District average. The poorest neighborhoods also have the highest concentrations of minorities, with wards 7 and 8 averaging 95 percent African-American, although overall just 61 percent of District residents are African American.

Table 1: Poverty Rate and Race/Ethnicity, by Ward



Ward	% Poverty	Minority Population % African American	% Latino
1	22	46	25
2	19	20	10
3	8	6	7
4	12	79	12
5	20	88	3
6	21	63	3
7	25	97	1
8	36	93	1
D.C. Average	**20**	**61**	**8**

Source: NeighborhoodInfo DC, using 2000 Census data

While low-income households have traditionally lacked access to financial services and credit, today they are virtually besieged by a multitude of alternative financial service providers clamoring to get their business. These enterprises are disproportionately located in low-income neighborhoods.

Affordable financial services are critical for people earning barely enough to get by. They can improve household stability by bridging short-term cash needs, provide a safety net that prevents temporary setbacks from becoming long-term disasters, and pave the way to building sustainable wealth. All too often, however, those in greatest need are also those who are targeted for abusive financial practices. These households end up paying more than their higher income counterparts for comparable services. As a result, economically fragile households are rendered still more vulnerable by the depletion of their already meager resources.

The following report summarizes recent research on the cost of alternative financial services and products, one or more of which are used by low-income District households. The report also shows the disproportionately high concentration of these service providers in low-income neighborhoods and communities of color.

II. THE TWO-TIERED FINANCIAL SERVICES MARKETPLACE

Basic financial services are increasingly divided into a two-tiered system, with low-income households depending on alternative providers rather than on banks, credit unions, and other conventional institutions for their everyday transactions and credit needs. While more affluent households can get free checking accounts, reasonably priced lines of credit, low-interest credit cards, prime-rate mortgages and other mainstream products, low-income families must often resort to check cashing, payday loans, subprime mortgages, and other expensive products and services. The providers of these "alternative" financial services tend to be conveniently located in the neighborhood, keep extended business hours, and gear their marketing toward low-income and minority communities. In addition, they may demand less financial or personal information, have less rigorous credit checks, or perform no credit underwriting. The ease and convenience of obtaining their services, however, comes at a premium. Consumers pay higher fees and interest rates to cash a paycheck, send money to distant family members, get a short-term loan, purchase necessary household furnishings, buy a car, or become a homeowner. Table 2 summarizes the average cost to low-income households of some of these alternative financial services.

Table 2: Summary of Average Fees Charged for Alternative Financial Services

Financial Services	Fees Charged
Check Cashing	2.6% for a Government Check 2.2-2.4 % for a Paycheck 10% for a Personal Check
Payday Loan	$42.50 fee to borrow $325 for two weeks
Money Transmitting (Remittance)	3-4% of amount transmitted, plus the cost of currency exchange
Paid Tax Preparation and Refund Anticipation Loan	$150 tax preparation fee $91 refund anticipation loan (RAL) fee 4% to cash RAL check
Rent-to-Own	2-3 times the price in a conventional store
Automobile Financing	3.7% higher APR on loan
Subprime Mortgage Loan	Unaffordable after initial "teaser" rate expires, prepayment penalty of six months' interest

These fees can have a large impact on a lower-income family's budget. For example,

- A worker bringing home $20,000 a year pays about $440 a year to cash their paychecks at a check casher.
- The average payday borrower ends up paying $708 to borrow $325.
- A household sending $245 abroad 15 times a year—the average—pays $110 to $147 in fees annually, plus the cost of currency exchange, which typically exceeds the bank rate.
- An EITC recipient getting a $2,500 tax refund pays $331 for a refund anticipation loan, tax preparation fee, and other associated costs.
- A household pays $1,000-$1,500 for rent-to-own furnishings that would cost $500 if purchased at a department store.

- A low-income car buyer financing a $5,000 vehicle purchase will pay $526 more than a higher-income car buyer over the life of a five-year loan.
- Homeowners with a subprime mortgages may face a prepayment penalty of six months' interest—which equates to $6,400-7,200 on a $200,000 subprime mortgage at the typical 8-9 percent initial "teaser" rate. These borrowers typically have a debt-to-income ratio approaching 90 percent when the "teaser" interest rate expires after the first two to three years. That means 90 percent of their post-tax monthly income would have to go toward paying their mortgage, with only 10 percent remaining to meet other living needs.

What follows is a snapshot of the cost and accessibility of alternative financial services used by many low-income District residents.

Check Cashing

Consumers with no bank account often depend on check cashing outlets to convert their paychecks, tax refunds, and government benefits into cash. These storefront operations are largely located in low- to moderate-income areas, have evening and weekend hours, and offer a variety of services in addition to cashing checks, including payday loans, remittances, lottery ticket sales, and collecting utility bill payments. Despite the low transaction cost of cashing a check and the minimal risk—the average cost of processing a check is four cents and less than one percent of checks are returned—check cashers extract excessively high fees in return for their services.[1]

The District regulates the maximum fee that can be charged for cashing a check, which varies depending on the check's origin. Check cashers may charge a minimum fee of $4.

Check Cashing Charges Allowable in DC

5% of face value of government check
5% of face value of payroll check
7% of face value of insurance check
10% of face value of personal check or money order
— or $4, whichever is greater.

For a person with a $20,000 a year after-tax income, using a check casher could cost up to $1,000 annually if they are charged the maximum allowable fee of five percent to cash their paycheck.[2] By contrast, the average cost of maintaining a conventional checking account, where a paycheck could be deposited and withdrawn at no charge, is about $30 annually.[3] A paycheck can usually be presented to the issuing bank, as well, and cashed for free or at a nominal charge.[4]

The Consumer Federation of America recently conducted a study of check cashing rates nationwide, including at several shops in the District. Table 3 shows the results of this study, with updated fee rates based on a telephone survey conducted by the Center for Responsible Lending in March 2007. Fees vary widely by store and type of check cashed, with the vast majority of check cashers surveyed reporting that they will not cash personal checks. While the District check cashers surveyed generally reported that their fees were lower than the legal maximum, they charged more than the national average to cash government and personal checks. It is particularly troubling that District check cashers charge slightly more, on average, to cash government checks than similar service providers in other parts of the country given that these checks often carry the lowest risk. Telephone calls to check cashers revealed that the fees to cash tax refund checks were nearly twice that of cashing government benefit checks.

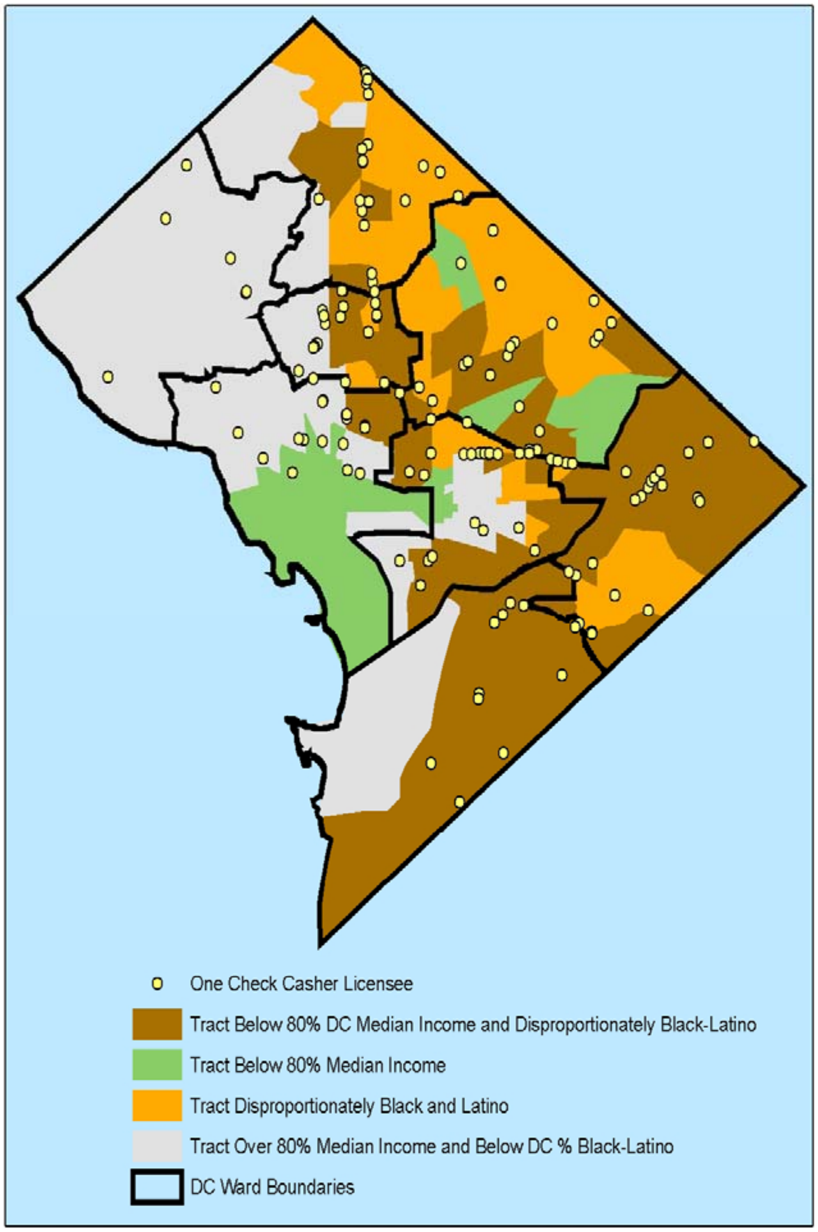
Table 3: Survey of Check Cashing Costs (fees are a percentage of the check's face value)

	Government-Issued Checks	Payroll Check (computer generated)	Payroll Check (hand written)	Personal Check
Check Cash One	2-4	2	3	n/a
ACE Cash Express	2.5-4	2.5	3.5	10
Check Cash Best	1.5	1.5	1.5	n/a
A One Cash Inc	2	1	1	n/a
Checks Cashed	2-3	2	2	n/a
Check Cash Depot	1.5	1	1	n/a
Barmy Wine & Liquor	4	4	4	n/a
Van Ness Liquors	4	4	4	n/a
Safeway Grocery	1-1.5	1-1.5	1-1.5	n/a
DC Checkashers	2.5-4	2.5	2.5	10
D.C. Average[5]	**2.6%**	**2.2%**	**2.4%**	**10%**
National Average	**2.4%**	**2.5%**	**4.1%**	**8.8%**

Source: Consumer Federation of America and Center for Responsible Lending

While check cashing outlets are distributed throughout the District, they are most heavily concentrated in the northeast and southeast, particularly along the Georgia Avenue corridor, H Street NE, and Pennsylvania Avenue SE. (Figure 1.)

Figure 1: Check Cashing Outlets in the District of Columbia



Source: DC Department of Insurance, Securities, and Banking. Areas designated as "disproportionately Black-Latino" are those exceeding the D.C. average of 61 percent African-American and/or 8 percent Latino.

Payday Loans

To qualify for a payday loan, a borrower needs only a checking account and a regular source of income. The borrower gives the payday lender a personal check, which the lender agrees to hold until the borrower's next payday. In return for the check, the borrower receives cash, minus the lender's fee. Payday loan fees are steep and the loans are extended without consideration of the borrower's ability to repay. Consequently, only one percent of payday loans go to borrowers who are able to take out just one loan, pay it back on time, and not return to a payday lender for at least a year.[6] Instead, borrowers usually cannot pay back the loan once it is due in two weeks and must renew the loan or for an additional fee.

Payday lending has been legal in the District since 1998.[7] The law requires payday lenders to be licensed, but exempts payday loans from the District's 24 percent usury cap. The exemption permits lenders to extend loans that result in triple-digit interest rates. The maximum payday loan allowable by law is $1,000. A payday lender can charge up to 10 percent of the loan amount, plus an additional flat fee based on the size of the loan. Research conducted by the FDIC and others has shown that payday lenders often charge the highest fees permitted law, regardless of local market saturation.[8] Depending on the loan amount, the cost of a two-week payday loan in the District can range from 391% (for a $100 loan) to 313% APR (for a $1,000 loan).

Payday Loan Fees Allowable in D.C.
10% of loan amount plus:
$5 for loans up to $250
$10 for loans $250.01-500
$15 for loans $500.01-750
$20 for loans $750.01-$1,000

Nationally, the average payday loan is $325. In the District, a borrower taking out a loan of this size would pay a fee of $42.50 for the initial loan, and another $42.50 each time the loan was renewed. This equates to an APR of 341%. Since the average payday borrower has nine transactions per year, a District borrower taking out a $325 loan ends up paying nearly $708.

Table 4: Average Cost of a Payday Loan

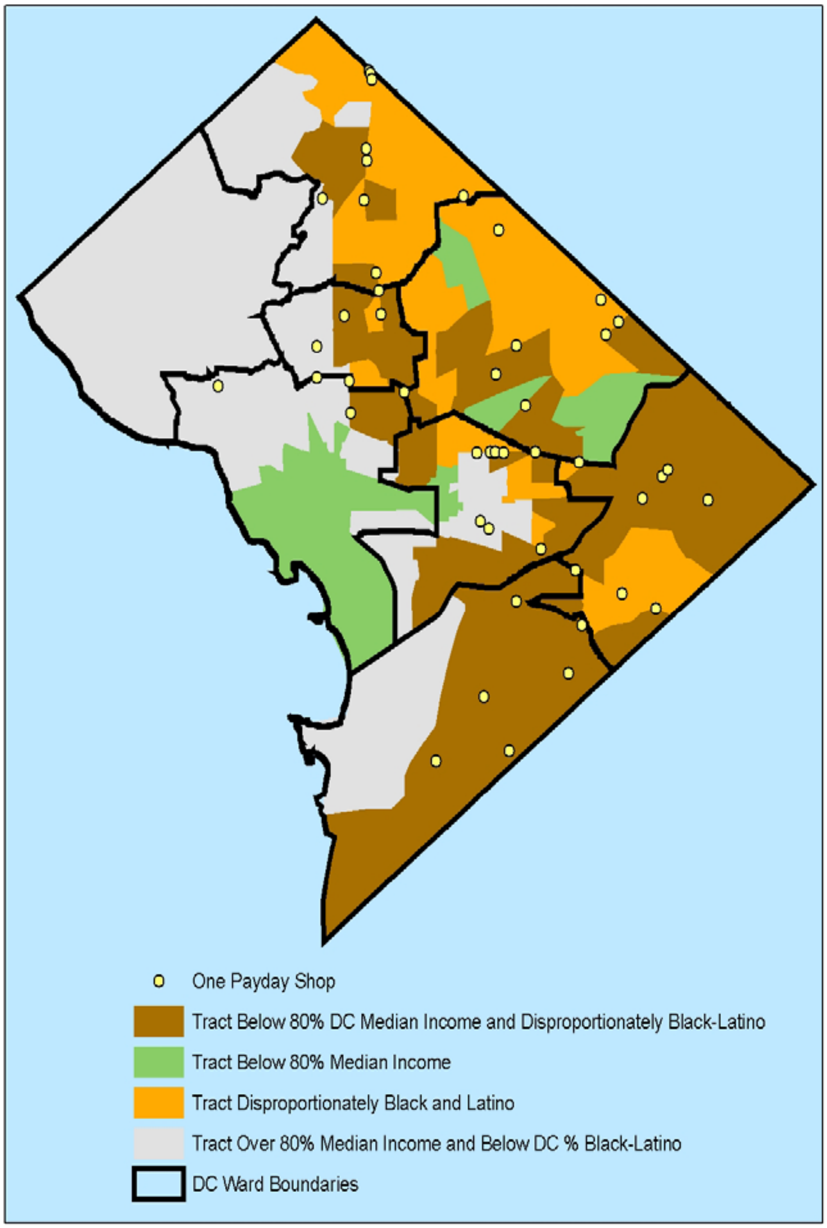
Average principal	$325.00
Typical fee for $325 loan	$42.50
Average number of transactions per year	9
Total interest for original loan + 8 renewals	$382.50
Total principal plus interest paid	$707.50

Source: *Financial Quicksand*, Center for Responsible Lending

Based on national payday lending estimates for 2005, payday lenders in the District had $25 million in loan volume, charging residents a total of $3.3 million in fees. Reports from industry analysts and state regulators that collect data indicate that the vast majority of fees are generated from loans taken out by borrowers trapped in a cycle of payday debt—repeatedly renewing their loans or taking one loan out to pay another. Nationally, 90 percent of loans go to borrowers with five or more loans per year, and 62 percent of loans go to borrowers with 12 or more loans per year.

Like check cashers, payday lenders are concentrated on primary commercial corridors in the northeastern and southeaster sections of the District, including along Georgia Avenue, H Street NE, and Pennsylvania Ave SE. (Figure 2.) In fact, all payday lenders in the District hold both check cashing and payday operating licenses. The majority of the 48 payday locations in the District are in close proximity to low-income and minority clientele.

Figure 2: Payday Lending Locations in the District of Columbia



Source: DC Department of Insurance, Securities, and Banking. Areas designated as "disproportionately Black-Latino" are those exceeding the D.C. average of 61 percent African-American and/or 8 percent Latino.

Currently, 11 states have outlawed high-cost credit in excess of the state's usury cap. Borrowers in need of small loans in these states instead turn to consumer finance companies, credit unions, or other financial institutions.[9]

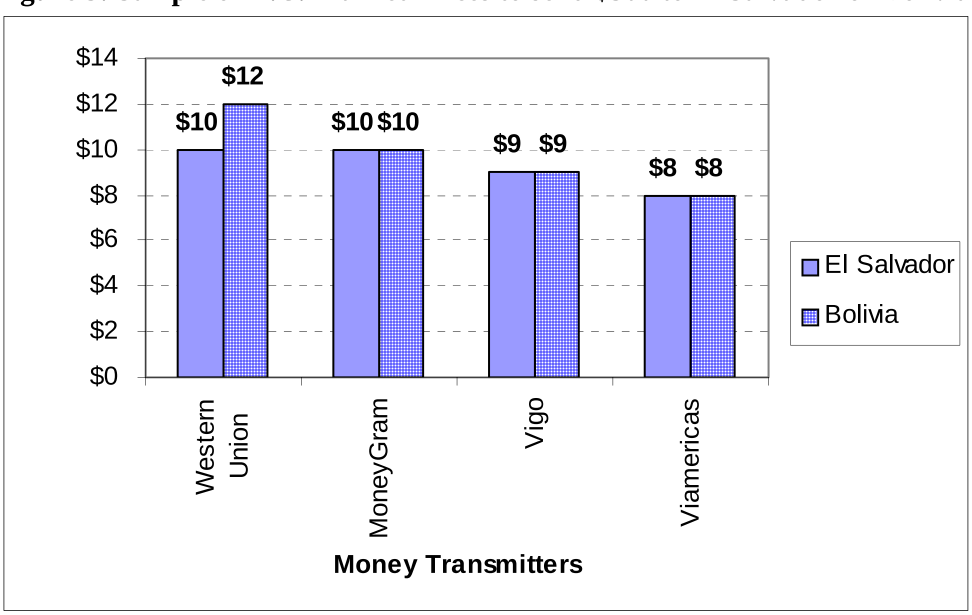
Money Transmitting (Remittances)

An estimated 40 percent of immigrants in the United States send money back to family members who still live in their countries of origin.[10] Although some banks provide these services, many immigrants use money transmitting services such as Western Union or MoneyGram, which are often located in check cashing outlets, grocery stores, or pharmacies. These services are popular because the sites in which they are offered have convenient hours and usually have employees who can speak the remitter's language. Moreover, 43 percent of remitters are unbanked, and therefore may not consider using the services of a bank or credit union for these transactions.[11]

District residents sent $154 million to families living in Latin America in 2006, up 64 percent from 2004.[12] Eighty eight percent of Latin American and Caribbean-born adults living in the District regularly send some of their earnings back to their countries of origin.[13] These households send an average of $245 at a time, 14.6 times per year.[14]

To understand the true cost of remittances for consumers, one needs to consider the two cost components of the transaction separately: (1) the fee for the service, which in the District commonly ranges from three to four percent of the value of the remittance; and (2) the exchange rate spread—the difference between the price the remittance company pays to purchase the foreign currency and the exchange rate it charges customers sending it.[15] Based on the fee alone, a District resident sending $245 nearly 15 times a year would spend $110 to $147 for this service. (Figure 3.) It is more difficult to determine the exchange rate spread since this varies by currency, country and the market on any given day. But some studies have found that the difference can be quite significant. The exchange rate spread for a $300 remittance to Mexico, for example, can range from $1.92 to $10.80.[16]

Figure 3: Sample of D.C. Market Prices to send $300 to El Salvador or Bolivia



Source: 2007 survey of D.C. remittance locations conducted by Manuel Orozco, Inter-American Dialogue.

Paid Tax Preparation & Refund Anticipation Loans

Low- and moderate-income households often turn to commercial tax preparers to file their income tax returns. Many of these households qualify for the Earned Income Tax Credit (EITC) which, in effect, functions as the federal government's largest anti-poverty program by offsetting a portion of the payroll taxes paid by low-wage earners to lift many above the poverty line. These payments are a significant source of additional funds for cash-strapped households—providing money to pay off debt, save for an emergency, or make large purchases. But tax preparation charges and fees for heavily-marketed refund anticipation loans (RALs), which get money into the hands of households sooner, often deplete the benefit of this payment.

Nineteen percent of District residents received the EITC in 2003, compared with a national average of about 15-16 percent.[17] These households are not only eligible for the federal credit, but also a local EITC funded by the District. The District's EITC is 35 percent of the recipient's federal EITC—one of the most generous tax credits of its kind in the country. Depending on family size and other factors, workers making well into the $30,000s can qualify, and refunds can exceed $4,000 per household. For example, a District resident with two children working a minimum wage job would receive $4,400 for the federal credit and $1,540 for the District credit—a total of nearly $6,000.[18] Forty percent of households receiving the EITC live in wards east of the Anacostia River.

The large percentage of EITC recipients who depend on a paid tax preparer can be explained in part by the perception of many eligible households that the process is complicated. Another factor is the concentration and intense marketing of paid tax preparation services in low- and moderate-income neighborhoods. Nearly seven in ten EITC recipients in the District use a commercial tax preparer, compared to just under half of other District tax filers. A national survey found that the average cost of tax preparation is approximately $150.[19] As shown in Table 5, based on this national average, District EITC recipients spend an estimated at $5 million a year for tax preparation services.

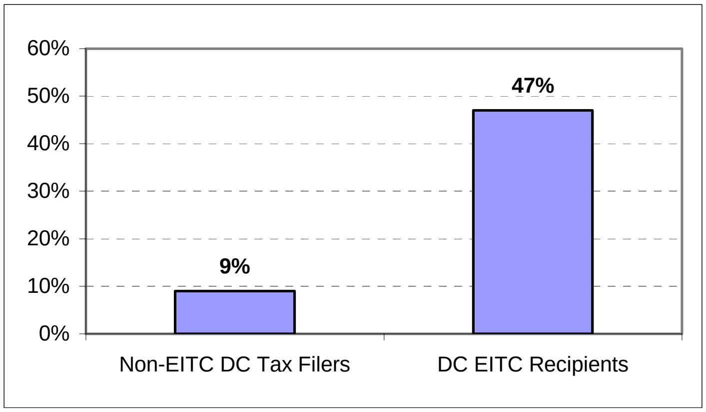
Table 5: Costs of Commercial Tax Preparation for EITC Recipients

Average cost of tax preparation services	$150
Number of District EITC recipients using a paid tax preparer	34,244
Total cost of tax preparation for District EITC recipients	$5,136,600

Source: Calculations using 2003 IRS data tabulated by Alan Berube, Brookings Institution

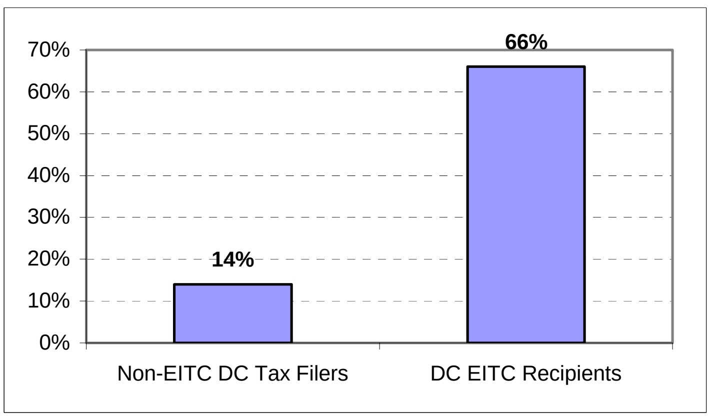
Since most EITC recipients live paycheck-to-paycheck, they are often targets for tax preparers marketing high-cost RALs. The tax preparer provides the tax filer with a check in the amount of their expected tax refund, minus fees, and then pays himself back in one to two weeks when the actual tax refund arrives from the IRS. Nearly half of all EITC recipients receive a RAL. (Figure 4). Since commercial tax preparers are the primary source of RALs, however, looking at RAL rates among EITC recipients who use commercial tax preparation services in instructive. Sixty-six percent of EITC recipients who have their taxes done by a commercial tax preparer end up taking out a RAL to get their refund more quickly, compared to just 14 percent of non-EITC recipients using commercial tax preparation services. (Figure 5.)

Figure 4: Tax Filers Claiming a Refund Who Took Out a RAL, 2003



Source: Calculations using 2003 IRS data tabulated by Alan Berube, Brookings Institution

Figure 5: Take-up Rate for RALs Among Those Using a Commercial Tax Preparer, 2003



Source: Calculations using 2003 IRS data tabulated by Alan Berube, Brookings Institution

Nationally, the cost of a $2,500 RAL can vary significantly by lender, but averages $91, or 133% APR, for a typical 10-day loan term. In 2003, District residents paid over $3 million for the privilege of receiving their refund a week or two early through a RAL. (Table 6.) Furthermore, those EITC recipients without bank accounts may have needed to use a check casher to access their RAL payment, which would have reduced still further the amount of their tax refund that they actually received.

Table 6: Costs of RALs to District Residents

Average RAL cost	$91
Cost to District EITC Recipients	$2,045,407
Cost to District non-EITC filers	$1,375,829
Total	**$3,421,236**

Source: Calculations using 2003 IRS data tabulated by Alan Berube, Brookings Institution

The bottom line is that an EITC recipient getting a $2,500 refund will have nearly $250 skimmed off the top once $150 in tax preparation and $91 in loan fees are deducted from a RAL check. If the individual then has to take that check to a check casher to access the funds, another four percent is lost.[20] EITC recipients and other tax filers can maximize their refund and minimize costs by instead taking advantage of IRS-certified volunteer income tax assistance (VITA) programs or other free tax preparation options, and directing their tax refunds into a bank account, which is becoming a more feasible option as the IRS continues to speed the electronic delivery of refunds.

Money Drained from a Tax Refund Check

$2,500 tax refund due

- 150 tax preparation fee
- 91 RAL fee

$2,259 RAL check

-4% estimated check cashing fee

$2,169 of tax refund received

Rent-to-Own

Many low-income households turn to rent-to-own stores when buying electronics, appliances, furniture or necessities for the home. These stores allow consumers to lease merchandise on a weekly or monthly basis, with the option of owning the item after a certain period of time. This arrangement is attractive to households on a tight budget for two reasons: first, it offers a way to make relatively low regular payments for a household that does not have the ready cash to purchase an item outright; and second, it can serve as an alternative way for someone that cannot otherwise qualify for credit (through a credit card or other means) to pay an item off over time. Indeed, a survey by the Federal Trade Commission of rent-to-own customers found that 67 percent entered the lease with the intention of eventually owning the item.[21]

The problem with rent-to-own transactions is that merchandise purchased in these stores often costs two to three times what it would cost in a conventional furniture, appliance, or electronics store. Table 7 shows the research findings of US PIRG, which compared the average cost of a television and a refrigerator in rent-to-own stores versus department store prices.[22]

Table 7: Rent-to-Own Price Comparisons

	Rent-to-Own Price	Department Store Price
19" Color TV	$746.71	$217.74
14 cf Refrigerator	$1320.78	$516.99

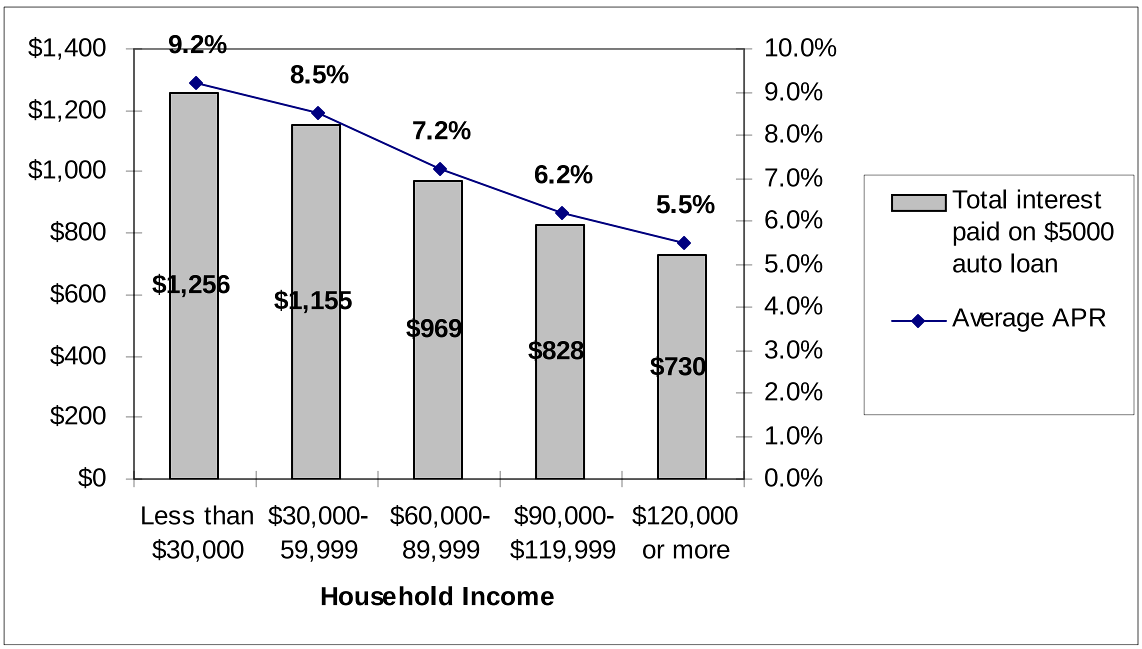
Source: US PIRG

Other concerns associated with rent-to-own stores include repossession of merchandise once a consumer has made substantial payments, adequacy of cost disclosures, and whether consumers know if the merchandise they are leasing is new or used. Most states consider rent-to-own agreements as lease contracts; only a few states regulate them as loans for the eventual purchase of an item. Regulation of rent-to-own contracts as loans triggers APR disclosure requirements and/or compliance with applicable usury rate caps. The District does not have any statutes or regulations that specifically address rent-to-own transactions.

Automobile Financing

Access to a reliable car can be critical to low-income households—especially those with jobs that are not easily accessible by public transportation. Unfortunately, low-income car buyers tend to pay higher interest rates to finance the cost of a car purchase than higher-income buyers. (Figure 6.) For example, a household earning less than $30,000 per year pays an average 9.2 percent APR on a car loan, while a household earning $120,000 or more per year pays 5.5 percent APR—a difference of 3.7 percent APR, or an additional $526 on a $5,000 car financed over five years.[23]

Figure 6: Pricing Disparities on a $5,000 Car Loan



Source: *From Poverty, Opportunity*, Brookings Institution 2006

Researchers conducting a national study of 650,000 car purchases made in 2004 found that the problem is compounded for lower-income African-American households, which not only pay a two percent higher interest rate on car loans, but also pay $50 to $500 more than higher-income white households to purchase the identical vehicle.[24]

Subprime Mortgage Loans

Regardless of a family's income, homeownership can act as a springboard to greater financial security and an asset that can be passed on to future generations. Many low-income families are served in the subprime mortgage market,[25] where credit-constrained borrowers are vulnerable to abuses in the underwriting and servicing of their loans.

Ideally, the subprime market should contribute to building wealth in low-income neighborhoods. The current state of the market, however, is one where abuses are very common. In more than 80 percent of subprime loans, borrowers are given an adjustable "teaser" rate, where the low initial rate adjusts after the first two to three years to a much larger monthly payment that many borrowers cannot afford. In fact, subprime borrowers typically have a debt-to-income ratio approaching 90 percent after the "teaser" interest rate expires after the first two to three years, which means that 90 percent of their post-tax monthly income goes to paying their mortgage, and only 10 percent is left to meet other expenses and obligations.[26] This virtually guarantees that borrowers will have to either refinance their loan (adding another round of fees,) or sell their home.[27] When the market cools, as is now the case in many District neighborhoods, refinancing or selling may not be viable options, and the homeowners may face foreclosure.

Many subprime mortgage lenders and brokers also strip wealth from borrowers by rolling hidden fees and surcharges into the loan's closing cost. In addition, many subprime lenders do not require borrowers to put property taxes and insurance in escrow. This makes the monthly debt burden of homeownership artificially low: the mortgage payments are smaller, but the borrower still has to come up with a significant additional amount to pay taxes and insurance. Finally, the broker may misrepresent the borrower's income or ability to repay to ensure the loan can be approved.

As Table 8 shows, African-American and Latino homeowners are concentrated in wards 4, 5, 7, and 8. As Table 9 illustrates, these wards also have the highest concentrations of subprime loans in the District.

Table 8: Percent of Mortgages Held by Race/Ethnicity, 2004

	% White	% African-American	% Latino
Ward 1	71	13	5
Ward 2	81	4	5
Ward 3	84	3	5
Ward 4	43	39	12
Ward 5	36	54	6
Ward 6	70	16	4
Ward 7	11	84	4
Ward 8	9	85	4
D.C. Overall	**60**	**27**	**6**

Source: *District of Columbia Housing Monitor*, NeighborhoodInfo DC, Fall 2006

Table 9: Percent of Subprime Home Mortgage Lending by Borrower's Race/Ethnicity, 2004

	Home Purchase	Refinance
Whites	1.8	3.2
African-Americans	15.4	17.3
Latinos	11.5	7.1
D.C. Overall	**5.3**	**10.2**

Source: NeighborhoodInfo DC

Two of the poorest wards—7 and 8—are also among those with the highest rate of subprime loans used for both purchasing and refinancing a home. Wards 4 and 5 also have relatively high rates of subprime loans. As shown in Table 10 below, these are more frequently used to refinance an existing home loan rather than a home purchase.

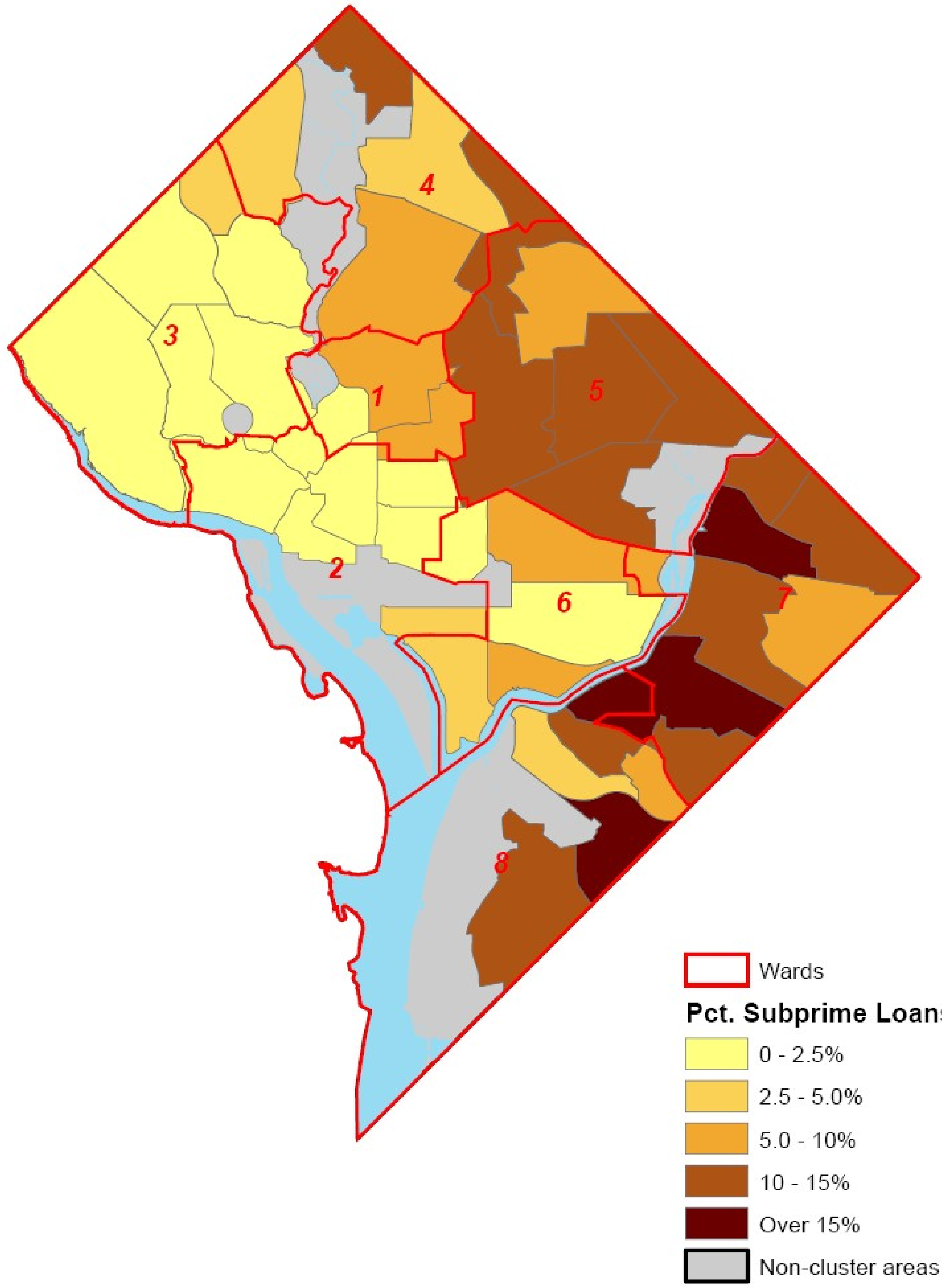
Table 10: Percent of Home Mortgage Loans Issued by Subprime Lenders

	Home Purchase	Refinance
Ward 1	4.9	7.3
Ward 2	1.2	2.9
Ward 3	1.2	1.5
Ward 4	7.8	12.7
Ward 5	11.2	16.7
Ward 6	3.8	7.4
Ward 7	13.9	16.6
Ward 8	10.8	19.6
D.C. Overall	**5.3**	**10.2**

Source: NeighborhoodInfo DC

These findings are further illustrated by Figure 7, which maps the concentration of subprime mortgage loans in the District.

Figure 7: Percent of Subprime Home Purchase Mortgage Loans, by Neighborhood Cluster

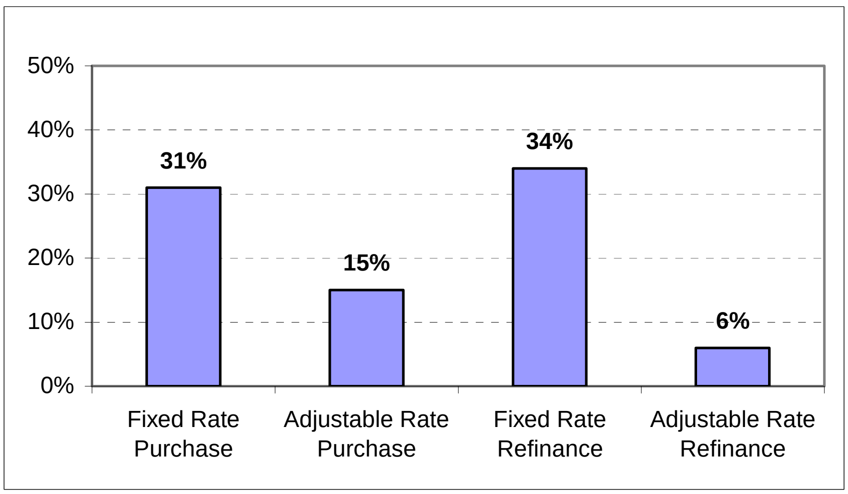


Source: District of Columbia Housing Monitor, NeighborhoodInfo DC, Fall 2006

Many minority homeowners in the District may be unfairly steered toward these subprime mortgages. A recent Center for Responsible Lending study found that African-American and Latino borrowers are at greater risk of receiving higher-rate loans than white borrowers, even after controlling for the effects of credit scores, loan-to-value ratios, and other underwriting factors.[28]

Specifically, African-American borrowers were 6 to 34 percent more likely to receive a higher-rate home loan with a prepayment penalty than white borrowers with similar qualifications. As Figure 8 shows, the precise likelihood depends on the type of interest rate (fixed or adjustable) and the purpose of the loan (refinance or purchase). But in every case, African-Americans were more likely to get a subprime loan with less favorable terms than white borrowers.

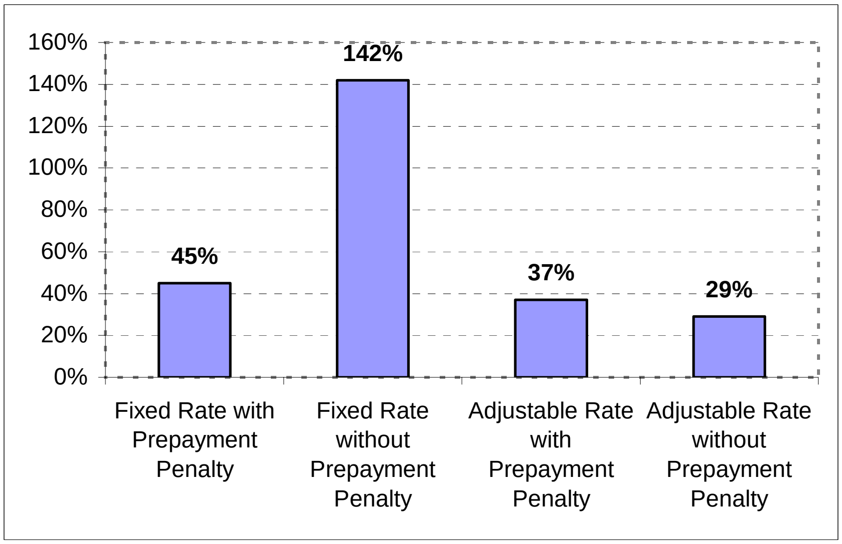
Figure 8: Increased Likelihood that African-American Borrowers Received a Higher-Rate Subprime Loan with a Prepayment Penalty,* versus Similarly-Situated White Borrowers (national data)



Source: *Unfair Lending*, Center for Responsible Lending
*In 2004, approximately two-thirds of all home loans in the subprime market nationally had prepayment penalties.

Similarly, Latino homebuyers were 29 to 142 percent more likely to receive a higher-rate loan than those who were non-Latino and white, depending on the type of interest rate and whether the loan contained a prepayment penalty. (Figure 9.)

Figure 9: Increased Likelihood that Latino Borrowers Received a Higher-Rate Subprime Purchase Loan, versus Similarly-Situated White Borrowers (national data)



Source: *Unfair Lending*, Center for Responsible Lending

Much of the increased price of these subprime loans is contained in "yield-spread premiums"—incentives given to brokers by subprime lenders to inflate interest rates. Subprime lenders also increase loan price by simply failing to apply objective pricing criteria in some cases, steering homebuyers of color into high-cost loans. The lack of investment by lower-cost lenders in these communities leaves low-income borrowers no better choice for owning a home than taking such risky, high-cost loans.

If these borrowers fall behind in their payments, which can happen when monthly fees are more than anticipated, they run the risk of their loan entering default or foreclosure. In recent years, the foreclosure rate on subprime loans in the District was half the national average for subprime loans, at only 6.8 percent. This was due to the area's strong real estate appreciation during this time period, which allowed borrowers at risk of default to refinance out of bad loans or sell quickly. Now that market conditions have worsened, the projected foreclosure rate for District subprime loans originated in 2005 and 2006 is 22.8 percent, compared with 19.4 percent for subprime loans nationwide.[29]

As shown in Table 11, this is especially bad news for African-American and Latino borrowers, who disproportionately receive subprime loans, and stand to be acutely affected by foreclosure. District foreclosures are projected to affect 12 percent of African-American borrowers and 9 percent of Latino borrowers, compared with 4 percent of white borrowers.

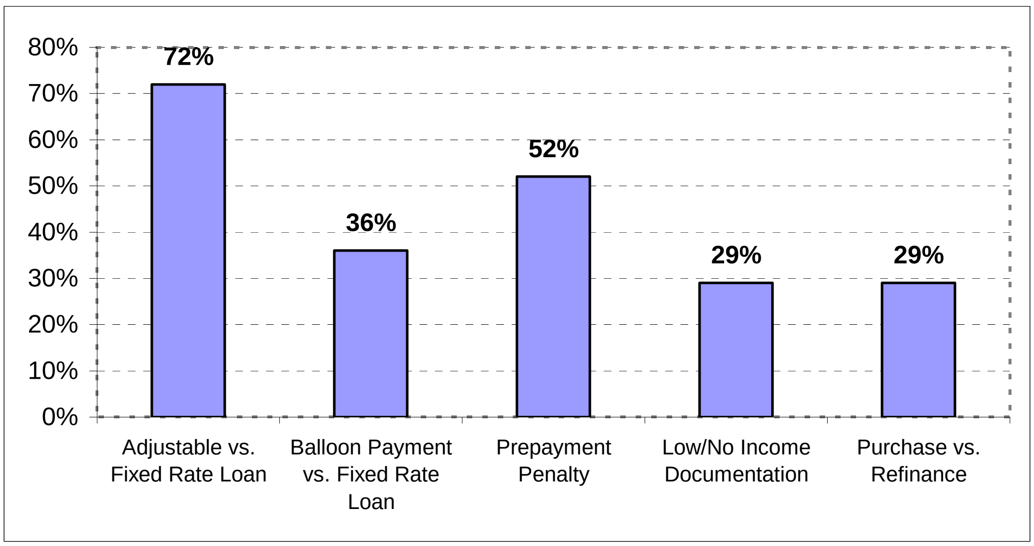
Table 11: Percent of Borrowers Affected by Foreclosure, by Race/Ethnicity

	% of Total Subprime Loans to Racial/Ethnic Groups Nationally	Projected DC Foreclosure Rate (%)	% of District Subprime Borrowers Estimated to be Affected by Foreclosure
African-American	52	22.8	12
Latino	40	22.8	9
White	19	22.8	4

Source: *Losing Ground*, Center for Responsible Lending

Many things can affect the likelihood of a loan entering foreclosure. As Figure 10 shows, several common characteristics of subprime loans, including adjustable interest rate, balloon payment, prepayment penalty, and lack of income documentation, increase the risk of foreclosure.

Figure 10: Increased Foreclosure Risk for Select Loan Terms (national data)



Source: *Losing Ground*, Center for Responsible Lending

The majority of subprime mortgages have one or more of these features. This puts low-income and minority homeowners in the District at increased risk of losing their homes to foreclosure simply because of they received subprime loans with abusive terms.

III. CONCLUSION

It is expensive to be poor in the District. Low-income households struggling to get by face the additional challenge of having to pay more than their more affluent counterparts for comparable goods and services. These households are largely African-American and Latino. Conventional financial products are targeted at higher-income households. Alternative financial products, which are costly and of questionable utility, are vigorously marketed to low-income households. This drains the scant resources of those who can least afford it instead of providing a legitimate benefit that is worth the cost. Low-income District residents deserve responsible, reasonably-priced financial products that satisfy short-term needs and offer the promise of building wealth.

Sources

[1] For more information, see *Cashed Out*, Consumer Federation of America, November 2006. Available at www.consumerfed.org/pdfs/CFA_2006_Check_Cashing_Study111506.pdf

[2] While charging five percent to cash a paycheck is legal, DC check cashers were found to charge 2.2 –2.4 percent on average for this type of transaction, which would cost a worker making $20,000 after taxes at least $440 a year. Though this is significantly cheaper than the potential $1,000 in fees, it is still far more expensive than the typical checking account, which costs an average of $30 a year to maintain.

[3] Bankrate.com's *Fall 2006 Checking Study: Fees Rise Again*. Available at www.bankrate.com/brm/news/chk/chkstudy/2006_fall_checking_study_main.asp?prodtype=chksav.

[4] *Cashed Out*, Consumer Federation of America, November 2006. Available at www.consumerfed.org/pdfs/CFA_2006_Check_Cashing_Study111506.pdf.

[5] In cases where a range of fees was provided by a single check casher, the average of those fees was used to calculate the DC average. For example, Checks Cashed reports a charge of 2-3% to cash a government-issued check. In this case, 2.5% (the average of 2% and 3%) is used in the calculation of the overall DC average.

[6] For more information, see *Financial Quicksand*, Center for Responsible Lending, November 2006. Available at www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf.

[7] DC Stat. § 26-319(c).

[8] See *Payday Lending: Do the Costs Justify the Price?* FDIC, June 2005. Available at www.fdic.gov/bank/analytical/cfr/cfr_wp2005/CFRWP_2005-09_Flannery_Samolyk.pdf.

[9] Connecticut, Georgia, Maine, Maryland, Massachusetts, New Jersey, New York, North Carolina, Pennsylvania, Vermont, West Virginia.

[10] For more information, see *Financial Access for Immigrants: Learning from Diverse Perspectives*, Brookings Institution, October 2004. Available at www.brookings.edu/comm/conferencereport/cr19.

[11] *Billions in Motion: Latino Immigrants, Remittances, and Banking*, Pew Hispanic Center and the MultiLateral Investment Fund, November 2002. Available at www.pewhispanic.org/reports/report.php?ReportID=13.

[12] D.C. page of *Remittances from the US to Latin America 2006*, Inter-American Development Bank. Available at http://www.iadb.org/mif/remittances/usa/USA.cfm?language=English&ID_STATE=DC

[13] Ibid.

[14] Average remittance amount and average times per year a household remits payments for District households was unavailable for 2006. This data is from the D.C. page of *Remittances from the US to Latin America 2004*, Inter-American Development Bank. Available at http://www.iadb.org/mif/remittances/usa/usa2004.cfm?language=english&id_state=DC.

[15] For a more detailed discussion on the cost of currency exchange rate spread, see *Creating a Fair Playing Field for Consumers: The Need for Transparency in the U.S.-Mexico Remittance Market*, Appleseed, December 2005. Available at http://www.appleseednetwork.org/servlet/GetArticleFile?articleFileId=216.

[16] Ibid.

[17] This and other 2003 tax filer data calculated using IRS data tabulated by Alan Berube at the Brookings Institution. Available at www.brookings.edu/metro/eitc_legislativedistricts.htm.

[18] See Testimony of Ed Lazere, Public Hearing on the Fiscal Year 2007 Budget Request from the Office of Tax and Revenue of the Chief Financial Officer, Committee on Finance and Revenue, April 5, 2006. Available at http://www.dcfpi.org/4506bud.pdf.

[19] Information regarding the costs of tax preparation and refund anticipation loans from *One Step ForWard, One Step Back*, National Consumer Law Center and Consumer Federation of America, January 2007. Available at www.nclc.org/action_agenda/refund_anticipation/content/2007_RAL_Report.pdf.

[20] As noted in the check cashing section of this report, District check cashers often charge a higher fee to cash tax refund checks than other government-issued checks. Many of these check cashers stated a four percent check cashing fee for refund checks when surveyed by the Center for Responsible Lending.

[21] For more information on the cost of rent-to-own transactions and customer experiences, see *Survey of Rent-to-Own Customers*, Federal Trade Commission, April 2000. Available at www.ftc.gov/reports/renttoown/renttoownr.pdf.

[22] *Don't Rent to Own: The 1997 PIRG Rent-to-Own Survey*, U.S. Public Interest Research Group. Available at www.pirg.org/consumer/rtotext.htm.

[23] 2004 Survey of Consumer Finance data tabulated for *From Poverty, Opportunity: Putting the Market to Work for Lower-Income Families*, Brookings Institution, 2006.

[24] For more details on this study, see Fiona Scott Morton, Florian Zettelmeyer, and Jorge Silva-Risso, *Consumer Information and Price Discrimination: Does the Internet Affect the Pricing of New Cars to Women and Minorities?*, 2001.

[25] Subprime loans are defined here as either first-lien loans with APR's more than three percentage points above the Treasury rate of comparable maturity, or subordinate-lien loans with APR's more than five percentage points above the Treasury rate.

[26] See the Testimony of Martin Eakes, "Preserving the American Dream: Predatory Lending Practices and Home Foreclosures," U.S. Senate Committee on Banking, Housing, and Urban Affairs, February 7, 2007. Available at http://www.responsiblelending.org/pdfs/martin-testimony.pdf.

[27] For more information, see *Losing Ground*, Center for Responsible Lending, December 2006. Available at www.responsiblelending.org/pdfs/foreclosure-paper-report-2-17.pdf.

[28] For more information, see *Unfair Lending*, Center for Responsible Lending, May 2006. Available at www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf.

[29] *Losing Ground*, Center for Responsible Lending, December 2006. Available at www.responsiblelending.org/pdfs/foreclosure-paper-report-2-17.pdf.