

## Issue Brief From THE FAMILY BUDGET ESTIMATOR Project

# PREDATORY LENDING



### WHAT IS PREDATORY LENDING?

Major banks have historically avoided low-income areas, creating fertile ground for predatory lenders and “fringe” financial institutions. As a result, low-income communities in Texas are inundated with high-cost credit services that exploit working Texans, including:

- **Payday Lending:** A “payday” loan is a short-term, high interest loan intended to bridge a borrower's cash flow gap between paychecks. By targeting low-income families who have difficulty paying back the loans, payday lending drains well over \$350 million annually from Texas workers. Over the past decade, payday lenders have proliferated in Texas. The high loan volume and exorbitant interest rates (400% to 1,000% APR) perpetuates a cycle of debt, as the average borrower uses about ten payday loans per year.
- **Refund Anticipation Loans (RALs):** RALs are extremely high-cost bank loans secured by the taxpayer's expected refund. These loans last 7-14 days until the borrower receives the tax refund and repays the loan. Refund anticipation loans drain approximately \$120 million from taxpayers’ pockets and the Texas economy each year.
- **Rent-to-Own Outlets:** The Rent-to-Own industry offers furniture and appliances in exchange for extended monthly payments. Consumers use these businesses because they lack good credit or enough purchasing power to buy these goods outright. A typical rent-to-own customer pays approximately 200% of the original price.
- **Unpredictable and sub-prime mortgages:** Many home foreclosures are linked to loose lending requirements, risky loans, and exotic features such as “adjustable rate mortgages.” During the “easy credit” years (2001-2006), many homebuyers used adjustable-rate mortgages with low initial interest rates that typically reset at a higher rate within a few years. These “resets” drain home equity and place families at risk of foreclosure. In addition, Texans have the lowest average credit scores in the nation.<sup>1</sup> Low credit scores and credit steering—a practice that places potentially prime customers into higher-cost sub-prime loans—ensure that many Texas homeowners are leaking home equity as they pay high interest rates.

### HAS TEXAS TAKEN ANY STEPS TO CURB PREDATORY LENDING?

Despite its legacy as an anti-debtor state, Texas has not done much to curb predatory lending and protect consumers.

- **Payday Lending and Refund Anticipation Loans:** The Texas Legislature has failed to pass legislation regulating payday lending and has enacted only limited measures to regulate refund anticipation loans and property tax lending. In the area of enforcement, Texas has permitted unauthorized Internet payday lenders to flourish and has allowed payday storefronts to proliferate, despite their questionable legal status.
- **Financial Education:** In 2005, the Texas Legislature enacted a new law to require financial education for high school students and clients in the workforce system.

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<sup>1</sup> Experian National Score Index, August 2007. <http://www.nationalscoreindex.com/>

- **Homebuyer Counseling:** In 2007, the Texas Legislature considered, but failed to pass, a law designed to prevent foreclosures by requiring homebuyer counseling for Texans taking out high-cost and exotic home loans.

## WHAT STEPS SHOULD TEXAS TAKE TO PROTECT CONSUMERS FROM PREDATORY LENDING?

- **Enact legislation to regulate payday lending:** Several bills aimed at predatory lending practices were proposed in the 2007 Texas legislative session, but none passed. Closing loopholes, collecting payday loan data through a third-party vendor system, and establishing rate limits and other lending protections are important steps in curbing exploitative payday loans.
- **Encourage financial literacy:** Instilling basic financial literacy in young Texans would allow them to make more informed decisions as adults. In addition, low-cost credit products should be available to maximize the benefits of financial education.
- **Promote homeownership counseling:** Homeownership counseling remains a key component in efforts to build homeowner equity and stem the rising tide of foreclosures. Requiring homeowner education for first-time homebuyers can be an “ounce of prevention” to forewarn consumers about hidden fees, prepayment penalties, and equity-stripping scams.

## FINANCIAL EDUCATION PROGRAMS AND RESOURCES

- **Consumer Credit Counseling Services:** A nonprofit, community-based organization that provides budget counseling, consumer education, and a variety of personal finance resources. In North Central Texas: [www.ccsnct.org](http://www.ccsnct.org); in South Texas: [www.ccsstx.org](http://www.ccsstx.org)
- **Texas ACORN:** A nonprofit, community-based organization that promotes affordable housing, homeownership, and fair Lending practices. ACORN also offers homebuyer counseling and foreclosure prevention services. [www.acorn.org/index.php?id=4327](http://www.acorn.org/index.php?id=4327)
- **Texas Asset Building Coalition:** An informal network of financial institutions, nonprofits, philanthropic institutions, and local government entities committed to fostering the economic independence of low-income households through asset-based remedies to poverty. [www.covenantcapital.org/html/publicpolicy/texasida.html](http://www.covenantcapital.org/html/publicpolicy/texasida.html)
- **Texas Bankers Association:** Facilitates a grassroots network of volunteer bankers who provide programs to promote financial literacy among all age groups. [http://texasbankers.com/public\\_literacy.php](http://texasbankers.com/public_literacy.php)
- **Texas CDFI Coalition:** CDFIs are specialized financial institutions located in markets that are not adequately served by traditional financial institutions. CDFIs provide a wide range of financial products and services to low-income households and local businesses. <http://txcdfi.org/more-i.html>
- **Texas Department of Banking Financial Education:** A collective information site to address financial education issues in Texas. [www.banking.state.tx.us/dss/fe.htm](http://www.banking.state.tx.us/dss/fe.htm)
- **Texas Jump\$tart:** A nonprofit coalition whose mission is to foster financial literacy among young Texans. [www.txjumpstart.org/index.cfm](http://www.txjumpstart.org/index.cfm)
- **Texas Office of Consumer Credit Commissioner:** Regulates the credit industry and educates consumers and creditors. [www.occc.state.tx.us/](http://www.occc.state.tx.us/)