

The High Cost of Being Poor

Throughout the United States, low-income people face high costs for many necessary services and items, from basic financial services to housing to food to insurance to transportation. The high costs paid by low-income people added to already low incomes present a barrier to the asset-building which is necessary for financial stability and movement to the middle class.¹

There are two themes that recur in almost every section of this report. The first is lack of access to mainstream financial institutions that offer services developed for the needs of low-income consumers. The second is a need for better financial literacy education to help low-income consumers make the best choices they can among competing financial service options.

Basic Financial Services and the Problem of Predatory Lending

Low-income people may not be able to take advantage of the basic financial mechanisms like savings and credit that many Americans take for granted.² This can leave them vulnerable to predatory financial service providers who charge significantly higher fees and interest rates than traditional financial institutions like banks and credit unions.

***Problem:* Access to bank branches and affordable basic financial services.** There are few bank branches located in the lowest-income areas of Providence (more Providence-specific data forthcoming soon).³ Research has shown that while the physical inaccessibility of bank branches matters in whether low-income people use banks, the lack of appropriate product lines and customer service norms offered at these banks presents a more significant barrier to use (appropriate services include: low-cost accounts with no minimum balances, non-traditional hours, short-term emergency loans, etc.). About 10% of the U.S. population is “unbanked,” meaning that they don’t have either a savings or checking account. Low-income, minority, younger and less-educated people are less likely than others to have bank accounts.⁴

- ❖ ***Promising Practice:*** Banks and credit unions can tailor more services to low-income customers who need free and low-cost savings and checking accounts and who may keep low levels of funds in their accounts. These financial service providers can also provide other services such as check-cashing, direct deposit, loans and money wiring services at prices significantly below what “predatory” financial institutions charge (ex: Union Bank of California “Cash & Save” outlets that offer check-cashing, money-orders and low-cost savings accounts in the same place). Community banks may be the most likely to lead the way in providing these types of services⁵ (ex: Washington Trust in Providence). Public-private partnerships can also work to improve access (ex: Bank on San Francisco and the “banking development districts” in New York City).⁶
- ❖ ***Promising Practice:*** Governments and Community organizations can draw attention to Community Reinvestment Act (CRA) ratings as a way to leverage action from banks. Banks can improve their CRA ratings by providing services in low-income and minority areas or providing services to low-income and minority clients.

***Problem:* High cost and predatory check cashing and short-term loans.** Low-income residents are more likely than people with higher incomes to use high-fee, high-interest and predatory financial service providers (like check cashers and payday lenders). These institutions are also more likely to be located in low-income areas of the city. According to data from the Brookings Institution, there are at least 5 check cashing institutions and 2 payday lending institutions in Providence.⁷ Generally, low-wage workers who rely on check-cashers end up

spending 2 to 3% of their income just to get their pay. If low-income workers cannot repay payday loans on time, they may pay interest calculated at annual percentage rates as high as 470%.⁸ Typically, payday borrowers pay back \$793 on a \$325 loan. The 205 costs of payday lending in 2005 in Rhode Island are estimated to be around \$3 million.⁹

- ❖ *Promising Practice:* Employers can offer payment options that actually reduce the costs to both employers and employees (ex: direct deposit costs employers about \$1 less per check than traditional payments, and employees don't have to pay fees for the checks to be cashed).¹⁰
- ❖ *Promising Practice:* Employers can also reduce administrative costs and make employee access easier and faster through the use of payroll debit or declining balance cards (ex: Ruth's Chris Steakhouse and WHSmith Booksellers).¹¹
- ❖ *Promising Practice:* Employers can offer payroll-backed lines of no-interest and no-fee credit for small loans to their employees (ex: Reliance Standard Life Insurance and Whirlpool).¹²
- ❖ *Promising Practice:* Government regulation can limit the number of licenses for payday lenders and check cashers, regulate the interest charged by financial service providers, and ban other predatory lending practices.¹³

Problem: Tax refund services and Refund Anticipatory Loans (RALs). National research has shown that the average \$200 preparation fee paid by low-income tax filers only enables claimants to receive their tax refunds about one to two weeks earlier than if they did not use such costly private services.¹⁴ Tax preparers and lenders take over \$1.5 billion in fees annually from earned income tax credits paid to working families.¹⁵

- ❖ *Promising Practice:* Access to bank accounts with direct deposit or a stored value debit card can be linked with low-fee or free tax preparation services to help maximize the EITC and tax credits received by low-income residents.¹⁶
- ❖ *Promising Practice:* Outreach and financial education regarding free tax preparation services can help to prevent low-income people from using high-cost tax preparation services.

Problem: Remittance services. Wiring money to other countries can be very expensive and is particularly draining on the resources of immigrant communities.¹⁷

- ❖ *Promising Practice:* ATM-facilitated transfers can reduce the cost immigrants must pay to wire money to relatives in other countries (ex: Latino Credit Union/Center for Community Self-Help in North Carolina, Citizens Bank pilot program in Boston, MA).¹⁸

Cars and Auto-Related Necessities

Reliable transportation is essential for many working people, yet buying cars and auto-related necessities like car insurance and even gasoline is often more expensive in low-income urban areas.

Problem: High auto purchase prices. Research from the Brookings Institution has shown that, "Consumers from lower income neighborhoods typically pay \$50 to \$500 more for the same care as consumers from higher income neighborhoods."¹⁹

- ❖ *Promising Practice:* Targeted community-based programs that expand automobile ownership opportunities for low-income residents through competitive pricing and reasonable financing options (ex: A Baltimore-based targeted car-ownership program called Vehicles for Change).²⁰

Problem: High-cost car purchase loans. According to a recent Brookings Institution report, “On average, lower income consumers pay two percentage points more for auto loans than higher income consumers.”²¹

- ❖ *Promising Practice:* Auto purchase loan options tailored to the needs of lower-income people through traditional financial institutions like banks and credit unions or through targeted community-based collaborations can provide lower-income people with more affordable financing alternatives when purchasing automobiles.²²

Problem: Predatory car title loans. Car title loans typically have triple-digit annual interest rates, require repayment within a very short time frame and are made for far less than the cars’ values. Because cars are often essential to the economic wellbeing of families, car title loans can threaten a family’s economic security in addition to the risk of losing a material asset.²³

- ❖ *Promising Practice:* Government regulation of the conditions of car title loans, particularly, repayment terms and interest rates.
- ❖ *Promising Practice:* Alternative borrowing options for families who need small emergency loans through more traditional financial institutions.

Problem: High-cost car insurance. The Brookings Institution has also found that, “Holding other factors constant, drivers from lower income neighborhoods pay between \$50 to over \$1,000 more per year in higher prices for auto insurance than higher income drivers.”²⁴ Providence data are not currently available.

- ❖ *Promising Practice:* Government engagement of private insurers in developing low-cost or below-market rate insurance pools for qualifying low-income drivers, mainly those with perfect or near-perfect driving records (ex: California’s 2006 insurance requirements).

Homes and Housing-Related Necessities

Housing, home ownership and related expenses can be higher for low-income people than for higher income people. Low-income households often face higher costs associated with high mortgage interest rates, high homeowner insurance, disproportionately high property tax burdens and predatory practices of “rent-to-own” furniture and appliance stores.

Problem: High cost mortgage loans and the risk of foreclosure. Data from the Brookings Institution showed that during 2004 and 2005, 38% of Providence homebuyers bought homes with high cost mortgages.²⁵ According to the Brookings Institution, a first-lien mortgage (used for initial purchase) is deemed high cost if its annual percentage rate (APR) is at least three percentage points greater than that of a comparable Treasury security. A second-lien mortgage (also called a home equity loan) is deemed high cost if its APR is at least five percentage points higher than that of a comparable Treasury security.

High Cost Mortgages in Rhode Island, 2004

Income	# Mortgages	# High Cost	% High Cost
<\$30,000	603	137	23%
\$30,000-\$59,000	4324	1215	28%
\$60,000-\$89,000	2793	892	32%
\$90,000-\$119,000	873	230	26%
\$120,000+	981	137	14%
Unknown	554	143	26%

High Cost Mortgages in Rhode Island, 2005

Income	# Mortgages	# High Cost	% High Cost
<\$30,000	338	97	29%
\$30,000-\$59,000	3630	1726	48%
\$60,000-\$89,000	3337	1972	59%
\$90,000-\$119,000	1167	572	49%
\$120,000+	1098	322	29%
Unknown	636	226	36%

Data source: Rhode Island KIDS COUNT analysis of Brookings Institution data from the 2004 and 2005 Home Mortgage Disclosure Act.

According to the Center for Responsible Lending, the 2006 Rhode Island predicted rate of foreclosures for homes bought with sub-prime mortgages was 19.5% (similar to the national rate of 19.4%).²⁶ Sub-prime mortgages are home purchase loans targeted at people with poor credit histories. They are often associated with high fees, high interest rates and severe penalties for refinancing or non-payment.

- ❖ *Promising Practice:* Promoting responsible home mortgage lending through partnerships with responsible financial institutions (ex: University of Pennsylvania program connecting local employees with responsible local lenders along with offering financial tools and education).²⁷
- ❖ *Promising Practice:* Creation of low-cost mortgage alternatives to provide market alternatives that can “crowd out” higher-priced lenders. Affordable home purchase loans for low-income residents are associated with lower monthly payments than high cost mortgages, reduced likelihood of foreclosure and increased homebuyer savings every month on their mortgage payments. These products can be created by private lending institutions (ex: Philadelphia PHIL-Plus and mini-PHIL Loan Program).²⁸
- ❖ *Promising Practice:* Home ownership counseling and financial education can help people avoid unnecessary high cost mortgages and predatory lending practices, thereby reducing the risk of foreclosure.²⁹
- ❖ *Promising Practice:* Creation of a committee or task force that can negotiate with companies using predatory practices to eliminate the predatory features of home purchase loan agreements. City ordinances and the support of large loan funders like Fannie Mae can give leverage for this type of negotiation (ex: Citizens for Community Improvement in Des Moines, Iowa).³⁰
- ❖ *Rhode Island Resource:* Rhode Island Housing administers the federally-subsidized first-time homebuyer loan program in Rhode Island, as well as providing other homebuyer and homeowner services and educational opportunities for lower-income residents (www.rihousing.com).

Rhode Island Action

In 2006, the Rhode Island legislature passed a law restricting predatory mortgage lending practices in Rhode Island (RI Law 34-25.2). The law went into effect on December 31, 2006; there is not yet data on its effectiveness in reducing high cost mortgage rates.

Problem: High home insurance rates—According to the Brookings Institution, homeowners in lower income neighborhoods can pay as much as \$300 more each year for home insurance than those in higher income neighborhoods, holding other factors constant.³¹ Providence data are not currently available.

- ❖ *Promising Practice:* Development and promotion of online shopping guides for homeowners insurance by the state government agency responsible for insurance regulation. Data are from the state filings by insurance companies and include comparable prices by insurance territories (ex: New York's Home Insurance Shopping Guide).³²

Problem: Rent-to-own furniture, appliance and electronics stores. Rent-to-own customers nationally pay 2 or 3 times as much for household items such as furniture and appliances than those who can afford to buy the items outright. In the end, only about one quarter of customers end up owning the items they rent.³³ There are at least 6 rent-to-own furniture and appliance stores in Providence, all in low-income neighborhoods.³⁴

- ❖ *Promising Practice:* Encourage quality retailers to locate in low-income neighborhoods, which have an undervalued aggregate buying power. Local development corporations can help with assessment and mapping of neighborhood assets and strengths in a way that will attract more quality businesses. Public-private partnerships can be used to develop unused land and buildings. States can encourage a Community Development Financial Institution (CDFI) industry to locate in the areas and provide loans and services to these underserved neighborhoods.³⁵
- ❖ *Promising Practice:* Government can regulate the maximum interest charges that can be assessed on purchases in the region (ex: in New York rent-to-own businesses cannot charge more than 50% of an item's value in interest).³⁶

Problem: Burdensome and inaccurately-assessed real estate taxes. Homes in low-income neighborhoods in Philadelphia are more likely to be assessed for tax purposes at amounts higher than actual worth, compared with higher-income neighborhoods.³⁷

- ❖ *Next Steps:* The City and/or the Task Force could do an evaluation following the Brookings Institution methodology to determine if this is a problem in Providence. If it is, the City can take further steps to rectify any potential inequities.

Other High-Cost Items

Problem: Reliance on high-priced small grocery stores and lack of large grocery stores as an alternative. National data show that low income consumers are more likely than higher income consumers to buy their basic food items at higher prices. According to data from the Brookings Institution, there are five large grocery stores in lower-income neighborhoods in Providence and the majority of small grocery stores are in lower-income neighborhoods.³⁸

- ❖ *Promising Practice:* Public-private partnerships can encourage mid-size to large grocery stores to locate in low-income neighborhoods through pre-development grants and loans, land acquisition financing, among other financing supports.³⁹

Problem: Medical debt. Many low-income people and families face medical debt due to lack of insurance, high insurance co-pay levels or treatments and medicines that are not covered by their health insurance. There is mounting evidence that over the past few years, hospitals have been turning accounts over to collection agencies 30 to 60 days after a missed payment (rather than the customary 150 to 210 days). Research has also shown that many hospitals are not providing affordable payment plans for families faced with high out-of-pocket medical expenses. Some families use high interest rate credit cards to pay their medical bills and many others file for bankruptcy. Other financial consequences of medical debt include difficulty getting bank

loans and other lines of credit, loss of housing due to debt and high payments, difficulty affording basic goods and services, and difficulty building savings and retaining assets.⁴⁰

- ❖ *Promising Practice*: Expanding eligibility for public health insurance programs (in Rhode Island, this would apply to RlTe Care and RlTe Share). While not all those who experience significant financial hardship due to medical debt are uninsured, this would impact a portion of those affected.
- ❖ *Promising Practice*: Classes and workshops about how to negotiate medical bill amounts and payment options with doctors. This could be done in tandem with other financial literacy training or as special one-time workshops.

Market & Information Gaps/Building Financial Literacy

Problem: Low levels of asset-building. Assets give people economic security, more life options, and they allow people to pass on opportunities to future generations. Assets have also been found to “have positive social, psychological and civic effects independent from the effects of income.”⁴¹ Washington Trust started a pilot program this year offering free savings accounts with no minimum balances for low-income residents.

- ❖ *Promising Practice*: Individual Development Accounts (IDAs) are savings plans where consumer contributions are matched and used for educational and asset-building expenditures. They have been shown to be successful in increasing home ownership, real assets, and educational attainment, particularly when combined with mandatory and effective financial literacy education.^{42 43}
- ❖ *National Resource*: America Saves is a national organization that works to connect lower income consumers to basic financial services, particularly savings accounts (www.americasaves.org).

Problem: Low levels of financial literacy. Nationally and in Rhode Island, low levels of financial literacy and lack of effective personal financial education lead many consumers to make uninformed decisions that can cost them in both the short and long term. According to a national survey conducted for the Jump\$tart Coalition for Personal Financial Literacy, “High school students in Rhode Island answered less than half of the answers correctly on the personal finance survey. On average, students in Rhode Island answered 48.8% of the questions correctly, which is lower than the national average of 52.4%.”⁴⁴

- ❖ *Promising Practice*: Requiring proven effective financial education curriculum to be taught to high school students and students at public high education institutions.
- ❖ *Promising Practice*: Expanding access to effective financial education and literacy training can empower low-income residents to make better financial decisions generally and can inform them about how to avoid predatory practices as well as what alternatives are available for accessing needed financial services.⁴⁵ Scaling up outreach about and the capacity of financial education programs will be important in ensuring that residents who need these services can receive them. Providence already has some financial education efforts that could be scaled up or duplicated. (ex: John Hope Settlement House; financial literacy training linked with EITC preparation services through the United Way funded VITA sites).
- ❖ *Rhode Island Resource*: The Center for Personal Financial Literacy at the University of Rhode Island provides online resources relating to financial literacy and education for youth and adults in the state (www.uri.edu/hss/hdf/gff/).

- ❖ *National Resource:* The Federal Deposit Insurance Company (FDIC) runs a national “Money Smart” program that provides literacy training curriculum and training to collaborative programs run by local non-profits and banks. Participating in these programs can help banks improve their CRA ratings. (www.fdic.gov/consumers/consumer/moneysmart/)

Problem: Access to small and micro-business lending. Low-income people can face difficulties qualifying for small business loans, particularly those who have low credit scores or low-wage jobs. Yet micro-entrepreneurship can raise incomes, tap into many local resources and provide access to reasonably priced goods and services in low-income neighborhoods.

- ❖ *Promising Practice:* Immigrants are an often-overlooked segment of small business owners in urban areas. Local investors and community development agencies should explore opportunities for harnessing the energy in these existing communities of expertise and supporting the growth of new local entrepreneurs.⁴⁶
- ❖ *National Resource:* Accion International/Accion USA is an international organization that provides small business loans to low-income business owners in the U.S. and across the world (www.accionusa.org). The micro-enterprise loans offered by Accion USA are tailored to the needs of low-income business owners, offered in multiple languages (including Spanish, Creole and Portuguese), and can help improve credit scores “credit builder” loans.

¹ 2003 AECF Kids Count Data Book Essay.

² 2003 AECF Kids Count Data Book Essay.

³ Rhode Island KIDS COUNT analysis of data from the Brookings Institution, April 2007.

⁴ Kim, Anne. (2003). *Taking the poor into account: What banks can do to better serve low-income markets.* Washington, DC: Progressive Policy Institute.

⁵ 2003 AECF Kids Count Data Book Essay.

⁶ From poverty, opportunity: Putting the market to work for lower income families. (2006). Washington, DC: The Brookings Institution, Metropolitan Policy Program.

⁷ Rhode Island KIDS COUNT analysis of data from the Brookings Institution, April 2007.

⁸ Kids Count Data Book Essay. (2003). Baltimore, MD: Annie E. Casey Foundation.

⁹ Financial quicksand: Payday lending sinks borrowers in debt with \$4.2 billion in predatory fees every year. (2006). Washington, DC: Center for Responsible Lending.

¹⁰ Kids Count Data Book Essay. (2003). Baltimore, MD: Annie E. Casey Foundation.

¹¹ Kids Count Data Book Essay. (2003). Baltimore, MD: Annie E. Casey Foundation.

¹² Kids Count Data Book Essay. (2003). Baltimore, MD: Annie E. Casey Foundation.

¹³ Policy Matters: State Policies that Work: improving the Economic Success of Families (Brief #1), Washington, DC: Center for the Study of Social Policy.

¹⁴ Kids Count Data Book Essay. (2003). Baltimore, MD: Annie E. Casey Foundation.

¹⁵ Refund Anticipatory Loans Overview. Washington, DC: Center for Responsible Lending (www.responsiblelending.org).

¹⁶ *Options for VITA Sites.* National Consumer Law Center (www.nclc.org).

¹⁷ Kids Count Data Book Essay. (2003). Baltimore, MD: Annie E. Casey Foundation.

¹⁸ Kids Count Data Book Essay. (2003). Baltimore, MD: Annie E. Casey Foundation.

¹⁹ From poverty, opportunity: Putting the market to work for lower income families. (2006). Washington, DC: The Brookings Institution, Metropolitan Policy Program.

²⁰ Vehicles for Change (www.vehiclesforchange.org)

²¹ From poverty, opportunity: Putting the market to work for lower income families. (2006). Washington, DC: The Brookings Institution, Metropolitan Policy Program.

²² From poverty, opportunity: Putting the market to work for lower income families. (2006). Washington, DC: The Brookings Institution, Metropolitan Policy Program.

²³ The Center for Responsible Lending (www.responsiblelending.org/issues/cartitle/).

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- ³⁷ The price is wrong: Getting the market right for working families in Philadelphia. (2005). Washington, DC: The Brookings Institution, Metropolitan Policy Program.
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- ⁴³ Kids Count Data Book Essay. (2003). Baltimore, MD: Annie E. Casey Foundation.
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