The High Cost of Being Poor: Kentucky Families Speak Out

Kentucky Youth Advocates

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Acknowledgments

Kentucky Youth Advocates would like to thank the many parents, grandparents, and other study participants who gave of their time to share honest responses to a series of very personal questions about their finances. We recognize that it is difficult to share life experiences that impact one's ability to provide for his or her children's future. It is our hope that by telling their stories, low-income families are presenting evidence that they often pay higher costs for basic goods and services than their higher-income neighbors. Armed with this information, policymakers and community leaders can be innovative and responsive in their approach to bringing down the "High Cost of Being Poor in Kentucky."

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To better understand how the "high cost of being poor" is affecting local families[1], Kentucky Youth Advocates conducted in-depth interviews and focus groups throughout the Commonwealth. KYA talked with families about how they manage the costs of basic goods and services, and what they think is needed to help bring down these costs.

What we heard – and present in this snapshot – is that low-income families across Kentucky have very few options in the mainstream financial market that meet their needs. As a result, many are bypassing banks and traditional purchasing options, in favor of payday loans, tax refund anticipation loans, and high-interest home loans. Families, in general, do not think that they have access to traditional financial tools and wealth-building opportunities.

Because they are raising families on very limited resources, many families rely on informal networks, bartering, and high-cost short-term loans to meet financial obligations from month to month. As a result, they often pay more than necessary to purchase basic goods and services. In short, they are doing whatever it takes to raise their children and get by from day to day – on low incomes – even if it means paying more than their higher income neighbors for the same goods or services.

KEY FINDINGS

Financial Services

- One hundred percent of participants said the product that would be most beneficial to them is a short-term loan from a mainstream financial institution. Without such an alternative, more than half of participants relied on high-cost payday lenders.

- Though participants knew that payday lenders charged, in effect, extremely high interest rate, very few families knew exactly how much payday lenders charged, or had an estimate of the effective interest rate the amount reflected.

- Sixty-five percent of families surveyed used commercial tax services, and 63 percent of all participants obtained a rapid anticipation loan even though they understood getting the loan significantly reduced their tax refund check

[1] The phrase "high cost of being poor" has been discussed in many essays, including the 2003 National KIDS COUNT essay, published by the Annie E. Casey Foundation. In that essay, Douglas W. Nelson, President of the Annie E. Casey Foundation, presents evidence related to three types of "high costs" that lower income families experience, including costs related to going to work, basic necessities, and costs related to financial services and building assets.

Housing

- Very few families surveyed thought that home ownership was an option available to them.
- More than one in four participants lived in mobile homes and a consistent financial goal for these families was to own the land on which their homes were located.

Consumer education

- Almost none of the participants used the Internet for financial transactions or comparison shopping.
- Fewer than twenty percent of participants who had credit cards knew the annual percentage interest rate they were being charged.
- Among families in the survey who had explored mortgage options, none had used the Internet as a comparison shopping tool.

ABOUT THE SURVEY

In November 2006, KYA asked Kentuckians about the costs of basic necessities and how these costs impact their ability to support their families. The study included twenty in-depth interviews and four additional focus groups from across the state.

Many families in the sample reported extended family member inclusion in the household. In many cases, this meant adult children – and their own children – living with a parent. In many cases, it meant the inclusion of four generations in the same household.

Forty-three percent of participants were adults living in two-parent households, while 57 percent were from households headed by a single mother

As a group, the participants' incomes placed them well within the bounds of "low-income," with more than three-fourths of participants reporting annual incomes of between $11,000 and $18,000. Incomes represented ranged from three individuals who reported no income during the last six months to one participant with an annual salary of $28,000.

Finding 1: Financial Services – Families need alternatives to high-cost financial products.

Checking Accounts

Many families surveyed thought that mainstream financial institutions were complicated and unnecessary. There was a strong message from low income families that they most often conducted their financial transactions without using mainstream financial institutions, using instead family support, social networks, and alternative financial services, such as payday lenders.

Almost half of those interviewed had bank accounts, but the other half either relied on relatives' bank accounts to receive cursory banking services or went to other institutions, ranging from the neighborhood grocery store to payday lenders to their local church. Fewer than half of those surveyed used checks to pay their bills. Instead, they used cash or money orders as their primary method of paying bills. Most families without bank accounts said they could open a checking account if they wanted, but they did not see the benefit of having one.

One western Kentucky resident remarked, "I don't see a reason to open a checking account. I won't have anything in it. Once I get paid and pay the bills, I have nothing left. As in zero. Banks want some kind of balance or they penalize you. What's the point of losing money with penalties when you don't have any money to lose?"

Of those participants who used banks, all but one reported using overdraft protection as a regular financial strategy to make ends meet. The overdraft charges cited ranged from daily payback rates of $3-$5 each day until the deficit is covered to more typical flat-rate patterns, which had a broad range from $15 to $35 per overdraft. Overdraft fees varied from region to region.

Payday Lenders

Every participant said what they needed was access to small, short-term loans from local banks. When asked what such loans would be used for, every respondent talked about automobile repairs with over half referenced unexpected home repairs as well. Another reflected the sentiments of many when she suggested that this service would "help when hell was the theme of the month and my ends were simply not going to meet."

Because of the absence of lower-cost, short-term loans in the market, nearly half of the participants had used payday lending with approximately two in five indicating frequent use. For those who were avoiding payday lenders, every person cited bad personal experiences with payday lenders as the reason they avoided the service.

One participant remembered, "My mom and dad got burned on that. They paid forever and I promised myself I would do without instead of getting into that well."

No one in the referent groups used more than two lenders at a time. Those who used payday lenders consistently reflected the sentiment expressed by one participant that,

"They have you in a squeeze. My mom always says, 'They take you for a fool.' but if she won't let me use her bank – which does cause some problems – then it is either the payday place or I don't have cash to pay anything."

Despite the recognition that payday lenders charge what is in effect an extremely high interest rate, very few families that use payday lenders could detail what those rates actually were. One Kentuckian's story was typical of what others said when she observed,

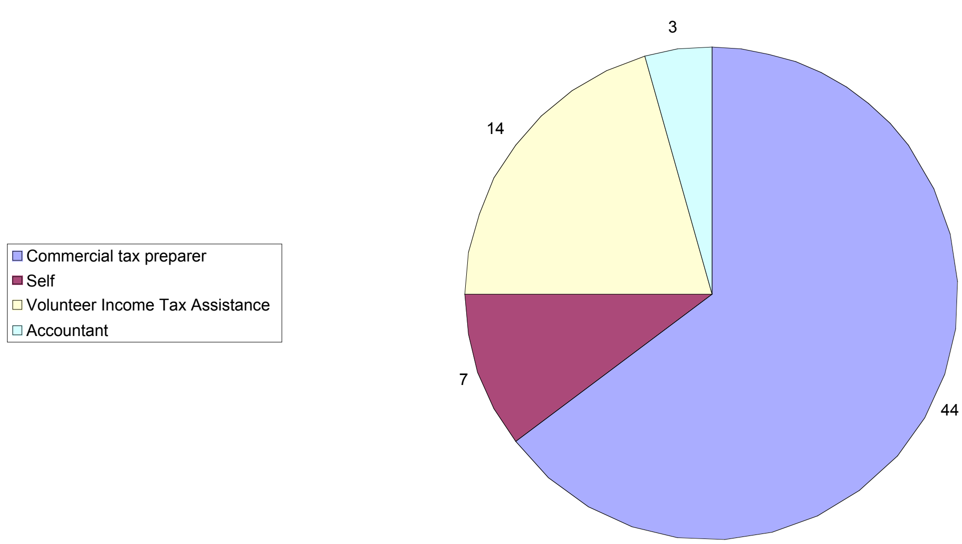
"I think it must have something to do with how long, but I really never know how much it will cost me. Sometime I borrow $250 and it costs me $30 and then I will borrow on a $100 and they charge me $45. Many times, that is my only shot at making it so I worry more than they keep letting me do it than what they are making on me. I hear that if you ask questions, the window just may get closed."

Tax Refunds

Participants spent more time talking about tax preparation and refunds than any other financial service. Every person interviewed expressed that they were making the best choice about tax preparation services available to them. Sixty-five percent of participants used a commercial tax service; 5 percent used an accountant; 10 percent filed taxes by themselves; and, 20 percent used volunteer-based tax assistance centers. Regardless of which service a family chose, they reported being satisfied with their choice.

All but one person in the study, who used professional tax preparation services, did not obtain a refund anticipation loan (RAL). A RAL is in essence a short-term loan based on the amount of tax refund a family is expected to receive. Families opt for RALs, even though the interest rate can be very high, because they want to get their refunds immediately instead of waiting several days for the Internal Revenue Service to issue their check.

Most families surveyed used a commercial tax service and obtained a high-cost rapid anticipation loan (RAL)



KYA survey results reflect participants' reporting for tax year 2005. n=68

On a uniform basis, the reasons that tax filers gave for obtaining RALs reflected that families had pressing financial needs and could not afford to wait for their refunds. According to one participant,

"They take a chunk for sure and I don't know if it is fair. But it is worth it because you get your money in a day or two and you don't have to struggle that month."

Another added, "That one month gives you a taste of how you would like to live."

A third observed, "For my kids, this is the only way to have Christmas. And for them, I am willing to lose some of the bottom line."

Another alluded to the same holiday theme saying, "That immediate refund makes February more like Christmas than December. I probably don't use it like I should but sometimes, sometimes, you have to live a little. I mean my kids getting a surprise and going to McDonalds --- is that a crime?"

Several participants, in fact, talked about being advised by the tax preparer not to take advantage of the refund advance. For instance, a young single mother of four recalls, "I was caught between a rock and a hard place. I knew it was too much money to give up but it was an immediate fix. My child's father was not paying child support. My engine had gone out in the car. It was fix the car or lose my job. It was just one of those big fat messes. The guy at the tax place was wonderful. He said, 'Look, this is going to cost you $300-400 of your refund money and you are in here early so you may be able to wait. Can you hold off for 15 days or so?' I explained the mess I was in and he went ahead with the advance but he was very, very, very considerate of me and was looking out for me instead of the business."

Another reason families were satisfied with this service use was that families appreciated the welcoming business environment of tax services. A participant explained,

"I know they are making a little more money off me than they should and I'm not that slow in the head. But they always treat me with a lot of respect. The office is real professional and they don't make me feel like dirt, which is how I feel when I even walk by the bank, much less go in."

A final line of consistency around use of professional tax services was consumer confidence.

"I just feel real comfortable in there," one participant shared, "and I don't feel good about just anyone doing my taxes. The company has a pretty big name and I know they are not going to get me in trouble and I feel like they are on my side against the government." Another suggested, "I have to believe in the long-run that they can get their money and still get me more for myself than if I took it on. Plus, I just don't want another worry and you leave there believing that those people know the business."

Almost none of the study participants used the Internet in any financial dealings, ranging from comparison shopping to online banking. However, every participant who prepared their own taxes used online products, including the one accountant in the study. For the few who filed their own taxes, they were confident in their ability to use the online software:

For those who use the volunteer income tax assistance sites (VITA sites), there was unanimous praise for the volunteers' competency and courtesy. "It's quick. I spend maybe fifteen minutes in there," one consumer observed.

Another cited options – "They can get the check sent to your home; they can split it into checking and savings deposits; they can direct deposit. You don't feel locked in and I don't face the temptation of getting a handful of cash as an advance and then it's gone."

Still another suggested that the additional services that VITA sites offer, that are often the antithesis of "quick," are her reason for going. She said, "The volunteer folks make you take time to hear about ideas on getting along better. At first, I didn't like it because that is not why I went in there. But all of a sudden, the volunteer was making real simple suggestions for stretching my money and I felt like the time I spent was like money. I wish the place was open year round to check on me."

<u>Credit Cards</u>
Nearly half of the participants had no credit cards with reasons ranging from, "I don't trust myself with those," to, "I am the only person in America with such bad ratings that I can't even get a single one."

Those who used credit cards typically had two accounts with other participants reporting having up to eight different credit cards. Account balances per card ranged from $1000 to $9000 with the typical balance averaging $6700. Many participants found credit card Annual Percentage Rate (APR) difficult to understand. In fact, fewer than 20 percent of the credit card users knew, either specifically or generally, what interest rate they were paying.

At least two-thirds said that they used credit cards for emergencies or as a fallback against cash shortages. As described by a mother of three, "Credit cards as a daily substitute for cash isn't the best system. But if I need cash, credit cards are cheaper than payday lenders and available, which money from the bank is not."

Finding 2: Credit Scores – Most families have given up on improving their credit ratings.

When asked about credit scores, all but three participants expressed feeling completely overwhelmed as consumers in a system based on these scores. As a group, they had no hope of ever raising their scores. In fact, they expressed such defeatism that they were making no attempt to either learn about or remedy their credit scores.

The sentiment expressed by one grandmother was echoed by many,

"I am going to work on my credit score right after I am on *American Idol*."

Another person, saddened by her attempts to improve her credit, said,

"When you are in my hole, there is no use at looking up."

Participants consistently cited a singular event or crisis as the reason for the drop in their credit scores. One participant recalled, "Long ago, before the beginning of time, I had a fabulous score. Being young at the time, I extended my credit to others. There is still a car on my credit line because I co-signed with someone who messed it up. That one mistake just won't go away. It hammers and hammers and hammers my life."

A college graduate shared how her credit was impacted by medical bills, "In the day, I was about a different life. Then medical bills led to bankruptcy and bankruptcy to one thing after another and my credit left about when my life did. There is no getting either back as I see it."

Unlike the majority of participants, there were three individuals who had worked very deliberately to raise their credit scores.

Finding 3: Housing – Most families are not working toward home ownership.

In many ways, housing issues raised in the study reflected the unique context in which Kentucky families live. For instance, more than one in four participants lived in mobile homes and a consistent financial goal for these families was to own the land on which their mobile home sat.

As the participants look ahead to the possibility of owning a home, there is a distinct lack of hope. One participant reflects a majority sentiment when she remarks,

"I have never even tried to get a mortgage. The whole process scares me."

Others point to concerns as illustrated by a young mother, who insists,

"Everyone I know buys these really lousy houses and everything breaks and they don't have money for repairs and can't do it. So they go through all this. They get excited about owning a home and six months later they are back in a worse rental place than they started or are staying with some relative. At least I know what I got."

While several respondents indicated that they had explored mortgage possibilities at least to some degree with local financial institutions, not a single participant had used the Internet. Several believed that such exploration would cost them advance money to investigate mortgage arrangements while a significant number shared a concern summarized in one middle aged father's response that, "I think the government may be able to see what I am looking for and I don't want my business out there."

Finding 4: Automobiles – Families believe they are getting good deals.

More than 90 percent of families in the study owned a vehicle. When asked about the kind of deal they think they got on their auto purchase, nearly every participant said that they got a good deal. The consistent dissent from that "good deal" assessment was from those whose poor credit resulted in higher loan rates. Most participants did not use the Internet or any other comparison shopping tools before making their auto purchases. The majority of buyers went to only one dealership.

Several participants in the study described bartering in exchange for getting a good deal on their auto purchase.

"I am paying for my car by doing accounting work for the car lot manager," one participant stated.

Another said, "My interest rate was based on how much I was going to watch the car guy's kids so his wife could work in the car place's office. For him, it is like income that doesn't show up. For me, it is the way to get a better car than I could have otherwise."

Finding 5: Groceries –Most families have access to groceries at reasonable prices.

While groceries represent a significant proportion of a family's budget, study participants overwhelmingly agreed that grocery prices were reasonable where they lived. They also reported easy access to grocery stores that provided a wide array of choice. Many cited the proximate location of at least two groceries.

While a small number of respondents reported traveling up to 20 miles for a grocery, most reported multiple options within five miles. Participants cited Wal-mart, Save-a-lot and Kroger's as the dominant grocers throughout the state with Second Street and Meijers also referenced frequently.

Finding 6: Family budget challenges – Families pressed to pay for health care and utilities.

Throughout the study, families discussed the circumstances that cause them to use high-cost services to access cash quickly (e.g. payday loans, rapid anticipation loans) or to borrow from their social networks. These discussions included references to low wages and insufficient income, but also included recurring topics that created a financial strain on their family budgets. There were repeated references to the cost of child care and the lack of effective child support collection. However, health care costs and the cost of utilities elicited the most discussion from the study group.

<u>Health care</u>

Every participant's children participated in the Kentucky Child Health Insurance Program (KCHIP), which was described as "my life-saver" by nearly everyone. Almost half of the participants "had a medical card" through Medicaid. Of those not on Medicaid, fewer than a third had any health coverage. Those without health insurance described visits to local clinics and immediate care facilities as ranging from $15 to $60.

There was a general sense of acceptance among the group that many adults simply have no health insurance. One participant said,

"It used to be in America you got taken care of either because you could afford it or the company took care of you or docs cared. I don't think it is going to be fixed. I don't think the people in power even understand it. Fifteen years ago you heard a lot of complaining. Now most folks I know just accept it as part of life and move on. Health care for me means that you try a lot of over the counter medicines and you try your kids' medicines and you are just blessed that your kids are taken care of through the state and you pray for no calamity to the adults."

<u>Utilities</u>

Whether they owed their home or rented, participant families cited paying for basic utilities as a recurring problem. Nearly 90 percent of the respondents referenced frequent difficulties in meeting these expenses. The solution expressed by one Kentuckian -- "If I don't have it, mama pays it." – was illustrative of the answers of more than half of those interviewed. These families shared an almost monthly reliance on a network of relatives and friends to help them pay their utility bills.

Additionally, 75 percent of participants said that external agencies such as the Salvation Army or local churches provided significant help to prevent utility shut-offs. When questioned about whether they had worked with the utility companies around partial payments or other consumer plans, fewer than 5 percent had ever pursued either of these options.

SEEKING SOLUTIONS

Study participants identified three key issues to address the high costs that they face:

1) Create alternative, lower-cost financial products
2) Align support systems so that building your family's education, employment skills, and wealth-building can work together
3) Improve consumer awareness by making institutions more accessible

First, every family said that they needed short-term loans to meet the demands of their family's budget. Although high-cost, payday loans can meet the immediate need a family is experiencing (e.g. auto repair, prevention of utility shut-off), these loans are based on a model that relies on low-income families maintaining debt, often for several months.[2] Instead, what families need are financial products that bridge temporary gaps in their budget, but then allows them to get back on track.

Second, many participants talked about a sense of incongruity in support systems. For instance, several in the study shared perceptions on how being employed actually hurt one's economic well-being. A participant from central Kentucky said, "My husband and I busted it to get enough for a down payment [for a house] and then we come to discover that we would have gotten a better rate because of government help if we were not working."

Another described her family's dilemma as, "My husband is a full-time student but we couldn't get assistance unless he was working twenty hours a week. If he quits school and doesn't work, then we can get assistance. He and we are being penalized because we are trying. We're drowning because we are trying to make a better life."

Another observed, "I just wish they would get program eligibility together. Can't they talk to each other in Frankfort? I qualify for this program. I don't qualify for that. Oops, I got a job so I don't qualify for that anymore and so I have actually lost money. Oops, I don't have a job so now I lose that benefit. It is impossible to figure out the best way to help your family."

Objectively, some of the system incongruities cited by participants are not accurate. However, from these interviews and focus groups, there was a palpable sense that "the system" is a maze that cannot be understood and may be purposefully designed to work against the poor.

Finally, participant after participant expressed the strong conviction that institutions – be they banks or schools, the government or the medical community – were, in the words of one participant, "trading in secrets for profit. They hide opportunities so they make more money."

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[2] Low-Cost Payday Loans: Opportunities and Obstacles, by Sheila Bair, Isenberg , University of Massachusetts at Amherst, prepared for the Annie E. Casey Foundation. June, 2005

This ardent belief that there are secrets to the system that could help low income families, was expressed as one participant recalled, "I had gone back to a payday lender. Once before, I had bounced a check to them for $400. I was completely broke and they were not going to lend me anything. I lost it. I lost it and was screaming and crying. And the guy said, 'Call the utility company. They will help." And they did. I couldn't believe it. Real nice people. Made it possible for me to keep on the power. But then I started thinking, 'Why do they keep it a secret?. No one I knew even knew about it. And if you don't know help is out there, then you are not going to be asking for it. People are afraid of companies and companies should not play on those fears like they do."

These observations illustrate the powerlessness that consumers feel in the marketplace. Combined with findings from this study that show very limited Internet product research or comparison shopping among participants, it is clear that more effective community outreach and consumer education is warranted.

KENTUCKY YOUTH ADVOCATES

Kentucky Youth Advocates (KYA), a non-partisan, non-profit, children's advocacy organization, represents a voice for Kentucky's most precious asset—its youth. KYA delivers Kentucky children's message to the state legislature, the community, and the media. We insist that our young citizens be given the opportunities and resources to ensure their productive development and health. KYA listens to children, their families, and service providers who are reluctant or unable to raise questions about existing policies. In short, we act as a liaison between the powerless and the powerful.

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