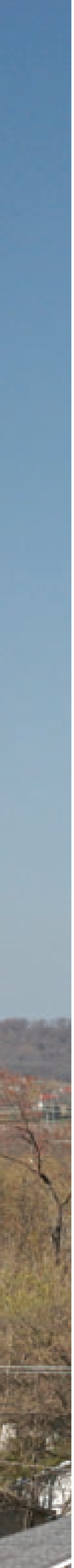
THE HIGH PRICE *of* BEING POOR *in* KENTUCKY

HOW TO PUT THE MARKET TO WORK FOR KENTUCKY'S LOWER-INCOME FAMILIES

THE BROOKINGS INSTITUTION METROPOLITAN POLICY PROGRAM

Contents



Acknowledgments

We are profoundly grateful to the many people who shared their expertise, insight, and resources with us while we prepared this report.

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We would also like to thank numerous people in Kentucky who provided us with critical feedback and insight, including: Bruce Traughber, Cathy Hinko, DeVone Holt, Julia Inman, Maria Gerwing Hampton, Lisa Locke, Rosanne Kruzich, Ron Jackson, Dr. Adewale Troutman, Lauri Andress, Mary Gwen Wheeler, Bill Shreck, Steve Pence, James Clay Smith, Steve Trager, Rodney Berry, Keith Sanders, Blake Haselton, Crit Luallen, Tom Emberton, David Adkinson, and Ed Monahan.

We also want to thank the hundreds of families that took time to talk with us about their experiences with high-cost goods and services and the challenges they face raising families on low incomes. With their input, we were better able to interpret meaning from the quantitative data at the center of this report.

Matt Fellowes is a fellow at the Brookings Institution; Terry Brooks is the executive director of the Kentucky Youth Advocates; Valerie Salley is a Kentucky-based policy analyst; and Mia Mabanta is a senior research assistant at the Brookings Institution. This report is based on Fellowes' 2006 Brookings report *From Poverty, Opportunity*, which is available at **http://www.brookings.edu/metro/pubs/20060718_povop.htm.**

The responsibility for the contents of this report is ours alone.

Note: *The views expressed here do not necessarily reflect those of the trustees, officers, or staff members of the Brookings Institution, the boards or staff of the Annie E. Casey Foundation, or any of the leaders in Kentucky who we consulted during the development of this report.*

Executive Summary

From Ashland to Paducah and every community in between, Kentucky's lower-income working families often pay a premium for goods and services, making it difficult for them to build wealth, save for their children's futures, and invest in their upward mobility.

Higher prices start with the morning drive to work: Lower-income workers in Kentucky (those earning less than $20,000 per year) are more likely to pay above average rates for auto loans, pay nearly $400 more for car insurance, and pay a higher sticker price for their car than their higher-income counterparts. Those who leave for work from a home they own are twice as likely to have a high-cost mortgage as are their higher-income neighbors, often costing thousands of dollars more over the life of the loan. On the way back from work, more lower-income workers use nontraditional financial services, paying higher fees for cashing a check or taking out a short-term loan. Taken together, these higher prices add up to hundreds, sometimes thousands, of dollars in extra costs for already tight family budgets.

The good news is that state and local leaders around the country are rallying behind new, innovative, practical, and low-cost initiatives to lower these prices. With these and other initiatives as models for action, public and private leaders in Kentucky can now also reduce these higher costs of living, and do so in ways that defy the substantial budgetary, economic, and partisan pressures that limit so many efforts to grow the middle class. Through a combination of initiatives that lower business costs, curb unscrupulous behavior, and boost consumer knowledge, public and private leaders can bring down these prices.

This report is a roadmap for how to reach this goal and improve the spending power and economic security of lower-income Kentuckians. In short, we find:

Kentucky's lower-income families tend to pay higher than average prices than other consumers for basic necessities

Depending on where lower-income consumers live and what combination of necessities are consumed, lower-income families can pay up to thousands of dollars more than higher-income consumers every year for basic financial services, cars, car loans, car insurance, home insurance, home loans, furniture, appliances, electronics, and other basic necessities. In particular:

- ***Cashing Checks:*** According to our survey, about 35 percent of regular customers of high-cost check-cashing establishments in Kentucky earn less than $20,000 annually, and about 62 percent earn less than $40,000. Unlike most other states, Kentucky places no limits on the fees that establishments can charge for check cashing. A random survey of such establishments in Kentucky found that fees to cash a check range from 1 to 10 percent of the face value of a check.
- ***Short-Term Loans:*** Nearly 70 percent of regular customers of high-cost payday loan and pawnshops in Kentucky are lower-income residents. In Kentucky, maximum fees for these loans are $15 every two weeks on a $100 loan, or a rate 38 times higher than that charged by the average credit card company for the same

loan amount. Among Southern and border states, such fees range from zero (in Georgia, Maryland, North Carolina, and West Virginia, where this industry is banned) to 17 percent of a loan's value or higher in Alabama and Mississippi. The number of high-cost payday lenders in Kentucky has more than doubled since 1999, from 353 to 779 establishments, opening at a rate of one every four days in 2006.

Kentucky pawnshop fees, another source of high-cost loans in lower-income markets, are limited to 22 percent per month. Fees for pawnshops in other Southern states range from no limit (in Arkansas, Maryland, and West Virginia) to 20 percent or more (in nearly every other state in the region).

- ***Tax Services:*** According to our survey of Kentucky households, about one in three lower-income households pays a for-profit tax preparation service to do their taxes. These same lower-income households are two to six times more likely as all others to use refund anticipation loans, carrying fees that generally range between $10 and $80.[1]
- ***Car Prices:*** More than 72 percent of lower-income households in Kentucky own a car. Nationwide, consumers from lower-income neighborhoods pay up to $500 more, on average, to buy the same car that a consumer from a higher-income neighborhood buys.

- ***Car Loans:*** Nationwide, lower-income consumers pay at least 2 percentage points more for an auto loan than the average among all other consumers. No Kentucky data are currently available to measure auto loans prices in the state.
- ***Car Insurance:*** In a sample of prices from three insurance companies, drivers from lower-income Kentucky counties and neighborhoods pay, on average, $384 more per year for auto insurance than drivers in high-income neighborhoods, holding other factors constant. The highest fees are charged in lower-income neighborhoods in Louisville and in many of Kentucky's rural eastern counties. Prices may be even higher because of other factors—considered by some companies in the calculation of insurance prices—that are correlated with household income, like credit report information, educational attainment, and occupation.
- ***Home Loans:*** In 2005, 41 percent of the mortgages to lower-income households in Kentucky were defined by the Federal Reserve as high-cost mortgages, compared with just 16 percent of mortgages sold to the highest-income households in the state.
- ***Home Insurance:*** In a sample of prices from three insurance companies, homeowners in Kentucky's lower-income neighborhoods pay, on average, at least $363 more annually for home insurance than homeowners in high-income neighborhoods, holding other factors constant. Prices may be even higher because of other factors—considered by some companies in the calculation of insurance prices—that are correlated with household income, like credit report information, educational attainment, and occupation.

- ***Furniture, Appliances, and Electronics:*** Fifty-nine percent of rent-to-own customers earn less than $25,000 a year. Reported prices for buying from rent-to-own businesses can double the price of a product.
- ***Groceries:*** While smaller, and often more expensive, grocery stores are generally found in Louisville and Lexington's lower-income neighborhoods, the statewide picture in Kentucky is quite different. In fact, large grocery stores, which typically offer lower prices, are present in 35 percent of lower-income neighborhoods, while among the highest-income neighborhoods, only 19 percent have large stores.

Kentucky has made substantial investments in helping to boost the income of lower-income workers, but it has done little to address problems on the other side of a family's ledger

Chronicled in the Governor's Summit on Quality of Life report, Kentucky is already moving forward on many fronts to reduce poverty by increasing educational attainment, creating job opportunities, and making work pay.[2] State lawmakers have heavily invested in the quality of education, both at the K-12 and postsecondary levels. The Kentucky Housing Trust Fund is one of several initiatives to build wealth among lower-income families. Statewide outreach to increase participation in programs such as the federal Earned Income Tax Credit (EITC) have ensured that millions of dollars are returned to Kentucky's families and likely spent in the local economy. These efforts, along with other well-established state and federal initiatives, are central to helping lower-income workers move up the economic ladder and join the middle class.

Yet, Kentucky still stands out for its low wages and very high poverty rates. According to the most recent census data, Kentucky has the sixth lowest median income in the country, the fourth highest poverty rate, and the eighth highest child poverty rates. What's more, the Appalachian region of the state is among the poorest areas in country.[3] Thus, although progress has been made, much more is needed.

Among the reasons why poverty in Kentucky has persisted despite the state's antipoverty investments is that Kentucky, like most other states, has focused almost all of its antipoverty investments on strategies to boost the income of the poor. That emphasis makes sense to some extent: Without rising incomes, no one can move up the income ladder. But, earnings and assets represent only one side of the family budget ledger. In fact, the spending side—the cost of living—is also an obstacle to upward mobility. Higher prices for basic necessities diminish the ability of earnings to foster economic mobility by thwarting efforts to save and invest in their children, education, homeownership, and retirement. Higher costs of living also erode the impact of investments in the poor by making these programs more costly than they need to be and preventing more people from climbing up the rungs of the economic ladder.

In fact, some of the highest prices for basic necessities in Kentucky are in its poorest areas, including the Appalachian region, where everything from mortgages to insurance is comparably more expensive than in most other areas of the state. Faced with these higher prices, a dollar earned by these families does less to help them get ahead than if it were earned by someone with a higher income.

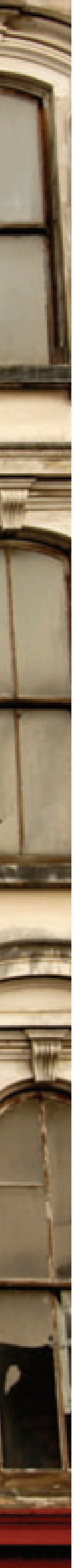
Kentucky can lower these higher prices and do so in ways that defy the traditional politics and fiscal costs of initiatives that focus on boosting the income of Kentucky's poor families. The poor do not need to pay more.

The moment is ripe for public and private leaders to reduce both real and perceived higher costs of doing business with lower-income consumers, curb market abuses that inflate prices, and invest in consumer education

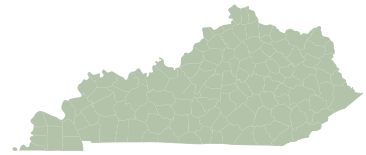
State and local leaders and their private-sector partners should enact reforms that reduce the unnecessary cost burdens faced by these same families. Specifically:

- ***Public and private leaders should lower real and perceived roadblocks to doing business with lower-income markets by promoting market-based solutions.*** Businesses will respond to profitable opportunities to engage lower-income consumers and in doing so create more options for these families to lower their costs and get ahead. Engaging the business community should occur in concert with community outreach to help promote mainstream businesses among lower-income households in Kentucky.
- ***Public and private leaders should weed out high-priced businesses in lower-income neighborhoods.*** At the local level, leaders can use their licensing and zoning authority to curb the development of these businesses. At the state level, leaders can enact stricter regulations as well—as long as there are responsible mainstream alternatives in place.
- ***Public and private leaders should help consumers navigate the complex choices in today's market.*** Ultimately, consumers must be able to make smart bets on getting ahead, which requires considerable consumer savvy amid an increasingly complex market. Among the many choices consumers now face are hundreds of different mortgage products, dozens of mortgage and insurance companies, new breeds of financial services, and the growing importance of credit reports and scores. To increase consumer awareness, Kentucky's leaders should expand access to the Internet (with its wealth of consumer information) among lower-income families (64 percent of Kentucky's lower-income consumers lack such access currently). Kentucky's public and private leaders also should build on financial education investments by a) evaluating the gaps in financial education delivery in their jurisdictions; b) using best practices to fill those gaps; and c) establishing a method for measuring the impact of investments in financial education. ■

Among the reasons why poverty in Kentucky has persisted despite the state's antipoverty investments is that Kentucky, like most other states, has focused almost all of its antipoverty investments on strategies to boost the income of the poor.



Introduction



Lower-income families in Kentucky often pay hundreds, sometimes thousands, of dollars more in higher prices for basic necessities than their higher-income neighbors.[4] Although not a new problem, the costs today are much greater in scope.[5]

Over the past decade, sweeping economic, market, and policy changes in Kentucky all interacted to increase the market demand among lower-income consumers for basic necessities. Most importantly, a growing economy over the last decade, combined with major welfare reform that tied benefits to new work requirements, sent thousands of lower-income families into Kentucky's labor force.[6] In turn, this spurred new demand for all of the many necessities tied to work, including cars to get to a job, houses to invest new paychecks in, and financial services to save for, buy, and protect assets.

As demand increased for these necessities, the supply side of this market too underwent significant change. While mainstream businesses often missed this opportunity to respond to surging demand, numerous higher-priced alternative businesses did. Over the past decade, for instance, hundreds of high-priced non-bank financial services storefronts have popped up in Kentucky to meet rising demand among lower-income households for check cashing, short-term loans, tax preparation, and money wiring services.[7]

At the same time, the growing use of risk-based pricing helped open up numerous lower-income credit markets once eschewed by businesses, and greatly increased lower-income consumers' access to a host of credit products, from credit cards to mortgages.[8]

But, as demand for and the supply of necessities expanded in Kentucky's lower-income markets, many of these new lower-income customers were participating in a marketplace without sound options. Bank accounts with high minimum balance requirements and overdraft fees, for instance, are often not sensible for lower-income workers.

In addition, these lower-income consumers were new (often the first generation in their family to own a home or have a car loan) to many of these markets, such as mortgages and insurance, leaving many of them vulnerable to unscrupulous practices. That is reflected by the fact that Kentucky's lower-income consumers are comparatively less informed when they enter into these transactions. Only 30 percent of lower-income families in Kentucky, for example, have a solid understanding of credit scores and their importance to access and pricing. Similarly, only about 15 percent of Kentucky's lower-income households shop and compare when they buy mortgages, and only about one-half shop around when buying cars.

The result is that today lower-income families in Kentucky are often paying more for basic necessities than their higher-income neighbors, which impedes their ability to get ahead while also holding back economic growth in the state. This report examines the prices charged to lower-income families in Kentucky for basic necessities: financial services, auto-related products, home financing and household goods, and groceries. These products account for approximately 70 percent of a typical household budget.[9]

On the basis of this analysis, our bottom line is clear: for a wide range of goods and services, lower-income families pay more. However, leaders in Kentucky have a range of low-cost, practical, bipartisan, and proven strategies for lowering these higher prices, often in ways that stimulate market opportunities for Kentucky's mainstream businesses.[10]

METHODOLOGY:

Measuring the High Price of Being Poor in Kentucky

We use state and local consumer data from all 120 of Kentucky's counties, supplementing, where necessary, with national data (for more detail on data sources, see below). Where data are unavailable for individual consumers, we rely on neighborhood, county, or ZIP code data. Unfortunately, no comparative data were available for other goods and services than those outlined below, such as health care, entertainment, apparel, and personal insurance.[11]

Basic Financial Services

We analyzed three basic financial services: check cashing, short-term loans, and tax preparation.[12] To determine how much consumers typically pay for these services, we used five major sources of data. The first is the 2004 Survey of Consumer Finances (SCF) administered by the Federal Reserve. This survey estimates the proportion of households in different income groups that use mainstream banking services, such as banks and credit unions. The survey is conducted every three years and was based in 2004 on interviews with 4,522 families.[13] The second source is a survey we commissioned, which is described in more detail below. The third data source is information collected from banking regulators in Kentucky and elsewhere in the country.

Our fourth source of data is Federal Deposit Insurance Corporation (FDIC) records of bank branch locations. We supplemented these data with information on non-bank financial services in Kentucky obtained from a direct data request of the Kentucky Office of Financial Institutions. We also purchased data on credit unions and other basic financial service providers maintained by InfoUSA, a private data vendor. In total, we examined information on 2,963 providers of basic financial services, from mainstream banks and credit unions to nontraditional financial services, such as check-cashing establishments, payday lenders, and pawnshops. We then used Census 2000 data to estimate the median income in the neighborhood where each establishment is located.

Transportation

In Kentucky, approximately 72 percent of lower-income households own at least one car. We focus on three types of costs associated with automobile ownership, including the purchase price of the car, the cost of a loan, and the cost of car insurance.[14]

To gauge purchase price differences, we rely on Scott Morton, Zettelmeyer, and Silva-Risso's model that estimates the independent effect of a buyer's income on the price paid for a car.[15] Using a unique national database of more than 650,000 car purchases, these researchers developed a unique model to control for more than two dozen factors that might influence the price that different customers pay for the same automobile, including race-ethnicity, educational attainment, renter status, and neighborhood income.[16] Using this model, we can estimate the average mark-up fee drivers from lower-income neighborhoods typically pay.

To assess what different households pay to borrow the same amount of money for an auto loan, we again use the 2004 SCF.[17] We also analyze the price of insuring the exact same car and driver in different parts of state. On the websites of three large insurers in the state—Geico, Allstate, and Progressive, which together account for about 23 percent of the national auto insurance market—we entered a similar profile of a car and driver and obtained auto insurance premium quotes for the minimum amount of legally required insurance.[18] To generate as conservative an estimate as possible, we selected an optimal set of characteristics for the driver: 35 years old, married, with a clean driving record, a short (five-mile) daily commute to work, and limited annual mileage (between 10,000 and 15,000 miles). The car was a five-year-old Ford Taurus, which is approximately equal in value to the median value of automobiles owned by individuals in the lowest income quintile, according to the 2004 SCF.

We entered this car and driver profile for every ZIP code in the state. With this data, we then used the Census 2000 survey to estimate the median income in each of these ZIP codes.[19] In this way, we were able to analyze the relationship between neighborhood income and the price of auto insurance.

The analysis is not without limitations. It does not, for example, account for the credit or insurance score of the driver and the role that this information can play in shaping auto insurance premiums.[20] The analysis also omits several factors commonly believed to raise the price of auto insurance for lower-income drivers, including the driver's occupation and educational attainment.[21] Stronger disclosure laws in Kentucky would make such an analysis possible.

In this study, we define lower-income neighborhoods as any census tract in Kentucky whose median income is lower than 80 percent of all other census tracts in the country.

Housing

Our analysis of housing costs includes prices paid for mortgages, home insurance, and furniture and appliances. Although this does not exhaust the list of important housing-related costs—such as maintenance, rent, and property taxes—no data suggest that prices for any of these necessities are higher for lower-income families than other households in Kentucky.[22]

To examine how mortgage prices vary by household income, we looked at two data sets. The first is the 2004 SCF. These data allow us to compare how the typical amount borrowed and the typical rate charged for mortgages vary across different income categories.

We supplemented this analysis with data from the 2006 Home Mortgage Disclosure Act (HMDA), which provides information on a large share of mortgages originated in the state. These data flag high-priced loans, defined by the Federal Reserve Board as those with an annual percentage rate (APR) of 3 percentage points above comparable Treasury notes for first liens, and 5 percentage points above for junior liens. The Federal Reserve Board estimates that this definition captures more than 95 percent of the subprime market. Recent comparisons with private data, however, suggest that the board's definition of "high cost" captures a substantially smaller share of the subprime market.[24]

To analyze the price of home insurance, we used a method similar to that described above for auto insurance. To assess the price of furniture and appliances, we used two different resources. The first is survey data collected by the Federal Trade Commission, which analyzed various characteristics associated with 12,000 customers of rent-to-own stores.[25] The second resource is the InfoUSA database described above. Using these data, we were able to build a profile of rent-to-own customers, while also illustrating where these establishments are geographically concentrated, by median household income, across Kentucky.

Groceries

Unfortunately, we were not able to directly assess the price of food at different stores across the state.[26] However, because store size is strongly correlated with the price of products, we can make inferences about prices based on store size.[27] To do this, we relied on a comprehensive database—maintained by TDLinx—of all grocery stores in Kentucky, from "mom-and-pop" corner stores to Wal-Mart—in other words, a very diverse group of stores. This database contains information about each establishment's location, size, and annual revenue.

Lower-Income Families Defined

In this study, we define lower-income neighborhoods as any census tract in Kentucky whose median income is lower than 80 percent of all other census tracts in the country. Lower-income households are defined as any household in Kentucky that earned less than $20,000 in 2006, or about 60 percent of the median income in the state.

As with any measure of poverty or lower income, there are important limitations. First, a low income can go farther in small towns such as Hazard or Pikeville than in cities such as Lexington or Louisville, suggesting that a place-specific measure of low income may be more ideal. Second, not all surveys measure the same units. A family with children earning the median income in the state is certainly less well off than an individual living alone with the same income. Unfortunately, the data do not allow us to make these distinctions. Similarly, ideally we would have distinguished between individuals, households, and families, but those distinctions were unavailable in the datasets used in this report. For these reasons, we refer to "lower-income" households, consumers, and neighborhoods throughout the results section of this analysis, and contrast these units to either all other households in Kentucky or specifically "higher-income" households, consumers, and neighborhoods.

The Survey of Kentucky Consumers

The Brookings Institution commissioned the University of Kentucky's Survey Research Center to administer a statewide survey of Kentucky households in winter 2007.[28] Households were selected using a modified list-assisted Waksber-Mitofsky random-digit dialing procedure, which ensures every residential telephone line in Kentucky had an equal probability of being called. Calls were made from January 19 through February 24, 2007. Callers made up to 15 attempts with each number in the sample. In addition, callers made up to 10 scheduled return calls to those who were reached at an inconvenient time. Callers also made a one-time attempt to convert refusals. This procedure results in a representative sample of the Kentucky population of households based on 830 completed interviews. The response rate for the survey was 33.7 percent. The margin of error is approximately 3.4 percentage points at a 95 percent confidence level. A full review of the survey is included in the appendix. ■

Income thresholds for households and neighborhoods

	Households	Neighborhoods
Lower Income	Below $20,000	Below $33,392
Moderate Income	$20,000 – $39,999	$33,392 – $42,006
Middle Income	$40,000 – $59,999	$42,007 – $51,613
Higher Middle Income	$60,000 – $79,999	$51,614 – $67,301
High Income	$80,000 and up	$67,302 and up

FINDINGS:

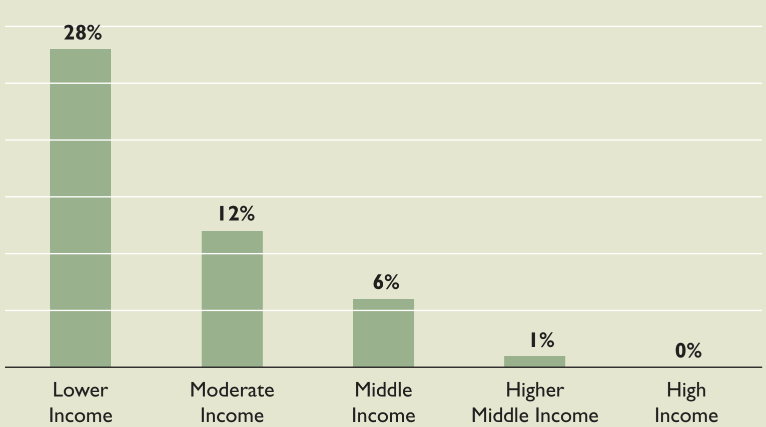
Kentucky's Lower-Income Consumers Face Higher Prices

I. BASIC FINANCIAL SERVICES

Kentucky's lower- and moderate-income consumers are more likely to buy high-priced basic financial services than higher-income households

Lower-income families in Kentucky tend to pay more for basic financial services than higher-income families because of their greater reliance on high-cost non-bank financial service companies, including check cashers, payday lenders, pawnshops, and tax preparation firms that sell refund anticipation loans. Depending on where lower-income families live and the types of services they consume, these higher costs can range from a few dollars to more than $2,000 annually.[29]

More than one-fourth of lower-income consumers surveyed do not have a checking account



Source: Authors' analysis of a statewide survey commissioned by The Brookings Institution, and administered by the University of Kentucky's Survey Research Center

Note: For a definition of income thresholds see table on page 13.

Lower-income consumers are much more likely than higher-income consumers to pay high prices to cash checks and take out short-term loans.[30]

Higher prices for Kentucky's lower-income families start with the most basic of financial services: cashing a check. More than one-fourth (28 percent) of lower-income consumers surveyed lack a checking account to deposit their checks in. That's reflected by the fact that about one in five lower-income households in Kentucky report that they have used higher-cost check-cashing businesses. Of these, 31 percent use these services regularly. In contrast, just 5 percent of high-income consumers in Kentucky have ever used this service. Also, about 35 percent of regular customers of high-cost check-cashing establishments in Kentucky earn less than $20,000 annually, and about 62 percent earn less than $40,000. Together, these statistics

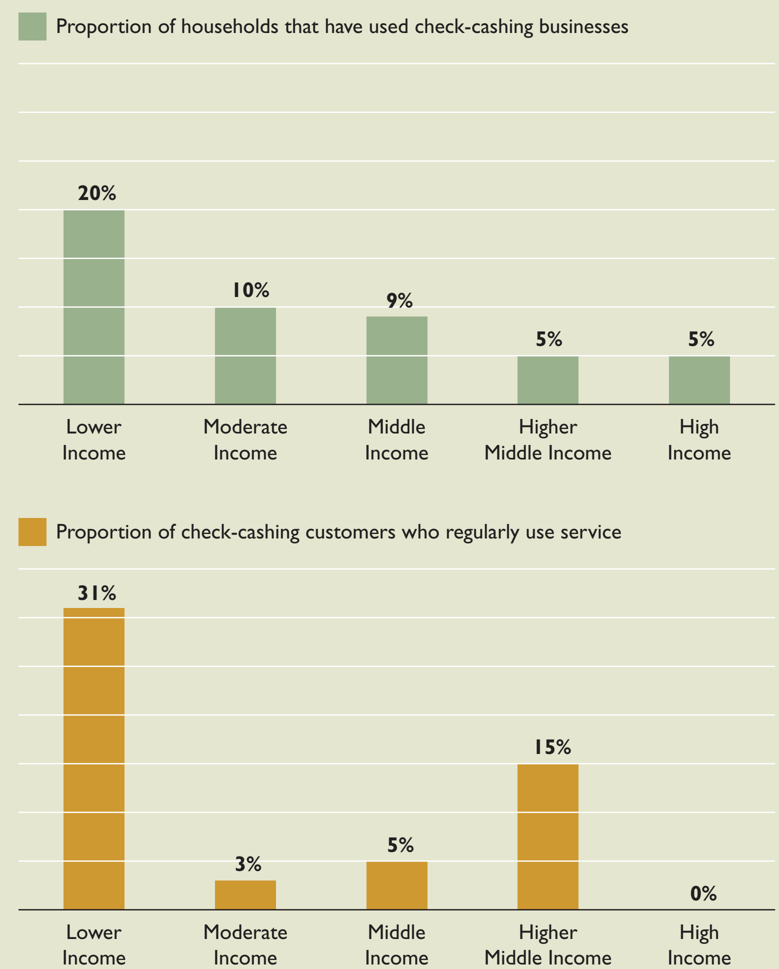
point to the broadly higher demand for check-cashing services among Kentucky's lower-income households compared to those with a higher income.

Unlike most other states, Kentucky places no limits on the fees that can be charged for this service. A random survey of such establishments in Kentucky found that fees to cash a check range between 1 and 10 percent of the face value of a check; and the median fee that Kentucky's check-cashing customers report paying is about 5 percent of a check's value.

For the customer earning an after-tax income approximately equal to the minimum wage in the state, or $10,500 annually, paying to cash a check (at 5 percent of the check's face value) adds up to more than $500 annually.

Certainly, check-cashing businesses provide an essential service for some of these unbanked lower-income families, particularly those who lack the paperwork (e.g., a driver's license) that most banks require of prospective customers, or who had trouble maintaining bank accounts in the past. Yet, that service comes with a steep price because the check casher's business model is built around and sustained by very high prices. Where banks pay for their operating costs, such as employees, utilities, and brick and mortar retail branches, by selling a suite of financial services, most check-cashing businesses only sell a handful of financial service products. With fewer products to sell and similar capital costs, check-cashing establishments must sell their smaller number of products at comparably higher prices.

Many more lower-income households use check-cashing services than high-income households



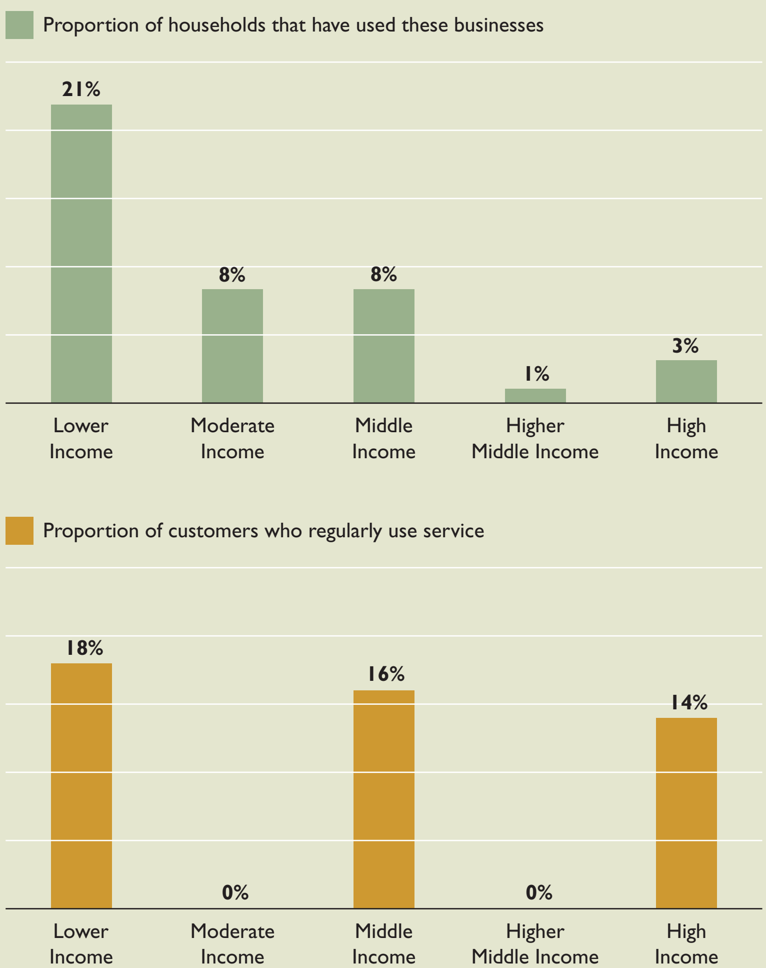
Source: Authors' analysis of a statewide survey commissioned by The Brookings Institution, and administered by the University of Kentucky's Survey Research Center

Note: For a definition of income thresholds see table on page 13.

Yet, there is growing market pressure to lower those higher prices. Recent industry reports suggest that a growing number of banks have started offering accounts with no maintenance fees, no minimum balance requirements, and no check-cashing fees.[31] This fits with our finding in the statewide survey we commissioned: Only 15 percent of Kentuckians report paying a monthly fee to maintain an account, including only about 27 percent of the lower-income households that already have a checking account. As that trend spreads, banking accounts should look increasingly more attractive to lower-income consumers in the state.

Another promising trend for lower-income families are the grow-

Demand for payday and other nontraditional loans are much higher in lower-income households, and lower-income households are slightly more likely to use these services regularly



Source: Authors' analysis of a statewide survey commissioned by The Brookings Institution, and administered by the University of Kentucky's Survey Research Center
Note: For a definition of income thresholds see table on page 13.

ing use of stored value cards. Banks sell these password protected debit cards to employers. Employers in turn deposit employees' pay on a debit card instead of issuing a paycheck. Banks see these products as a way to improve their value to corporate customers, and employers see this as an easy way to promote savings and wealth among their employees, while saving money on check processing and printing.[32]

Unfortunately, it is difficult to know how widespread either market trend is in Kentucky, making it incumbent for policy leaders to sort out and promote appropriate banking products in the state's lower-income markets. In neighborhoods where they already exist, leaders should promote and market those products; where they do not, leaders need to use one of the various incentives discussed at the end of this report to foster a profitable market for these products.

Higher prices paid by Kentucky's lower-income households go beyond just cashing a check. For those 72 percent surveyed who already have checking accounts, more than 20 percent has used a high-priced payday loan, pawnshop, or title-lending establishment for short-term cash advances, instead of or in addition to lower-priced credit cards. In contrast, just 3 percent of higher-income consumers have used this product. What's more, nearly 70 percent of regular customers of high-cost payday loan and pawnshops in Kentucky have a lower income.

The market for these high-priced services in Kentucky is vast and rapidly growing. Between 1999 and 2006, the number of payday lender retail locations grew by 121 percent in Kentucky. New establishments now open in Kentucky at the rate of one every four days, collecting an estimated $145 million in fees from their mostly lower- and moderate-income customer base.[33] This growth was even faster at the national level, however. In 1992, there were about 300 such establishments in the country, but by 2006 that number had grown to more than 20,000, issuing $40 billion annually in loans. Together with other high-priced non-bank lenders, they collected more than $10 billion in fees.[34]

In Kentucky, fees add up so quickly because these businesses are allowed to charge up to 38 times more than the fee charged by

The number of payday loan services in Kentucky has more than doubled since 1999

Source: Authors' analysis of data from the Kentucky Office of Financial Institutions

the average credit card for the same loan amount. To put that number in perspective, a family with one salaried worker netting $30,000 a year would pay about $270 to borrow $300 six times a year from a payday lender. Several states have barred such services, including Georgia, Maryland, North Carolina, and West Virginia.

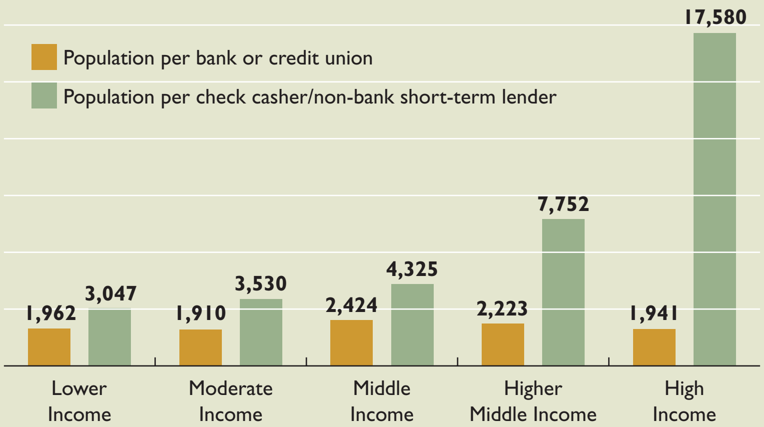
Consumers who overdraw their checking accounts, effectively using them as a source of short-term loans, can also pay high prices.

Lower-income families are also more likely than higher-income families to use pawnshops.[35] In Kentucky, pawnshop fees range up to 22 percent *per month*. Although lower than fees charged by payday lenders in the state, that rate is still 10 times higher than that charged by the average credit card company. In comparison, fees for pawnshops in other Southern states range from no limit (in Arkansas and West Virginia) to 20 percent or more (in nearly every other state in the region).

Consumers who overdraw their checking accounts, effectively using them as a source of short-term loans, can also pay high prices.[36] For instance, one major bank in Kentucky charges more than $30 per overdraft, or bounced check. Used six times in a year, this "service" would cost $180—still high, but less than the $270 to borrow $1,800 from a payday lender. If that family splits that overdraft fee between two bounced checks, though, these fees can quickly outpace charges levied by alternative sources.

But, unlike payday loan customers, who tend to be lower and moderate income, higher-income households are about as likely as lower-income households to bounce a check. According to our survey of Kentucky households, approximately 42 percent of lower-income households report having bounced a check compared with about 44 percent of the highest-income households. *Overdraft fees associated with those bounced checks will add up to steep prices for all income groups.*

Payday loan and check-cashing services are disproportionately located in lower-income neighborhoods



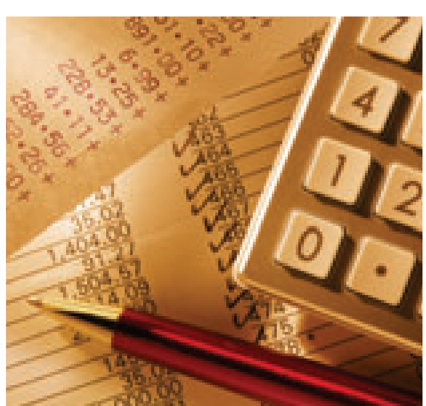
Source: Authors' analysis of data from the Kentucky Office of Financial Institutions, Federal Deposit Insurance Corporation, and InfoUSA

Note: For a definition of income thresholds see table on page 13.

Lower-income consumers are also more likely than higher-income consumers to pay high fees to get their tax returns quickly

According to our survey of Kentucky households, more than 29 percent of lower-income consumers pay to have their taxes prepared compared with 52 percent of all other households.[37] Demand may be lower among Kentucky's lower-income households for tax preparers because fewer of these households file taxes, and there are now widespread efforts in the state to provide free tax preparation services for the state's lower-income households.

Nevertheless, demand exists among the state's lower-income households for fee-based tax preparation services in part because of their higher relative demand for refund anticipation loans, another short-term loan product that advances the estimated tax refund for a fee. In fact, our survey of Kentucky households indicates that about 33 percent of lower-income households that use a paid tax preparer claim the refund anticipation loan. That compares with 17 percent of households in Kentucky earning between $20,000 and $39,999; 19 percent of households earning between $40,000 and $59,999; 6 percent of households earning between $60,000 and $79,999; and 5 percent earning more than $80,000.[38] Although no nationwide or regional estimate of the cost these loans exists, one recent study suggests that fees generally range between $10 and $80.[39]



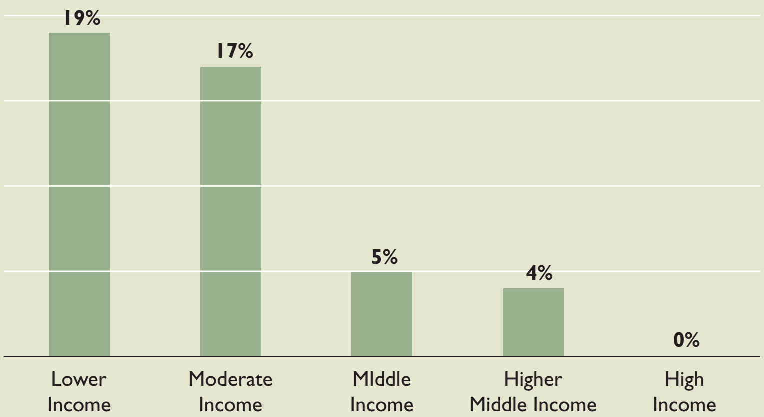
The higher demand among lower-income consumers in Kentucky for non-bank, high-priced financial services is reflected in the dense concentration of these businesses in Kentucky's lower-income communities

The highest per capita concentration of alternative check-cashing and short-term loan providers is found in the lowest-income neighborhoods statewide.[40] There are 997 alternative financial services in the state. In the lowest-income communities, there is one of these establishments for every 3,047 residents. In contrast, communities in Kentucky with the highest income have one establishment for every 17,580 residents.

These statewide trends are reflected in the state's population centers: Louisville, Lexington, and Owensboro. Among these areas, Louisville shows the starkest contrast across its neighborhoods, with one of these alternative financial services for every 2,457 residents in its lower-income neighborhoods. In contrast, there is just one of these establishments per 56,704 residents in Louisville's highest-income neighborhoods

However, mainstream financial institutions are poised to more aggressively compete with these alternative providers. Besides the fact that over 72 percent of Kentucky's lower-income households already have a checking account; statewide, 57 percent of the lower-income neighborhoods surveyed have at least one bank or credit union. Moreover, each county in the state has at least one bank or credit union. In fact, a majority of these high-cost non-

Lower- and moderate-income families surveyed are more likely to have fallen behind on a mortgage payment



Source: Authors' analysis of a statewide survey commissioned by The Brookings Institution, and administered by the University of Kentucky's Survey Research Center

Note: For a definition of income thresholds see table on page 13.

bank financial service companies are often just down the street from mainstream banks and credit unions. Among Kentucky's communities with an alternative financial provider, 87 percent also had a mainstream financial institution.

In Kentucky, the most often cited reason for unbanked households to not use banks and credit unions is that they have never really thought about opening up a bank account.

Why do lower-income consumers face these higher-priced financial services?

Three major market dynamics drive consumers' purchasing decisions, each of which can be targeted by policymakers.

Banks and credit unions face both real and perceived higher costs of doing business with lower-income consumers. With smaller amounts of money to cover the costs of living, lower-income consumers are much more likely to fall behind on credit and loan bills compared to other borrowers.[41] While that propensity can be overstated, it still exists and helps drives up the costs of selling basic financial services to the poor, and deters banks and credit unions from marketing products to lower-income consumers.[42] At a minimum, lower-income consumers, for example, need a checking account with no or very low minimum balance requirements, an affordable overdraft protection plan, and no or very low maintenance fees.

Banks in Kentucky and elsewhere are also at a disadvantage in these markets because of regulatory requirements that require substantial paperwork and private financial information for opening accounts, requirements not imposed on alternative financial services. Traditional banks are also at an unfair advantage given the high fees alternative services can charge, as noted above. Together, these market dynamics mean that introducing new products and services in lower-income markets can be relatively expensive for banks and credit unions, creating both real and perceived costs of selling mainstream financial service products to Kentucky's lower-income consumers.

Questionable business practices also drive up prices in lower-income markets. In some cases, this means that regulatory protections are insufficient. As this section has noted, for instance, Kentucky's

check-cashing businesses have no limit on the fees they can charge for check-cashing services, compared to states like West Virginia and New York, where fees are capped at under 2 percent of the face value of a check. Similarly, Kentucky's short-term loan providers can charge a rate that is 35 to 40 times higher than the average rate charged by credit card companies. In reaction to the high prices charged by short-term loan providers, other Southern and border states, like Georgia, Maryland, North Carolina, and West Virginia, have banned payday lending altogether, and Virginia has set a maximum monthly pawn fee of 10 percent.

Finally, there is a consumer education gap between lower- and higher-income consumers, driving lower-income consumers to buy financial service products that are not in their best financial interest. In Kentucky, the most often cited reason for unbanked households to not use banks and credit unions is that they have never really thought about opening up a bank account; the next most cited reason is that these consumers do not trust banks with their money; and the next is that there is too much paperwork. These responses point to the very real opportunity that Kentucky's leaders have to bring more Kentuckians, particularly those with a lower income, into the financial mainstream. There is not a good reason to do otherwise.

II. CARS

Lower- and moderate-income consumers are more likely than higher-income households to pay higher prices for cars and related products.

About three of every four lower-income households surveyed in Kentucky owns a car. Although many of these cars are less expensive than those owned by higher-income families, evidence suggests that households in lower-income neighborhoods tend to pay higher prices for cars, auto loans, and insurance.[43]

Consumers from lower-income neighborhoods typically pay between $50 and $500 more for the same car than consumers from higher-income neighborhoods

Most lower-income households surveyed in Kentucky own at least one car. In such a rural state, cars are often imperative to travel between work and homes.

Most lower-income car owners will have paid a higher price for the exact same car than higher-income households. Although several studies have attempted to explain this dynamic, Scott Morton and her colleagues' is probably the most rigorous (see the Methodology section for a description).[44] After controlling for several factors known to influence car prices (make and model of car, when sold, and so forth), they find that race, education, homeowner status, and neighborhood income all help drive up prices by a typical amount of between $50-$500 in extra charges

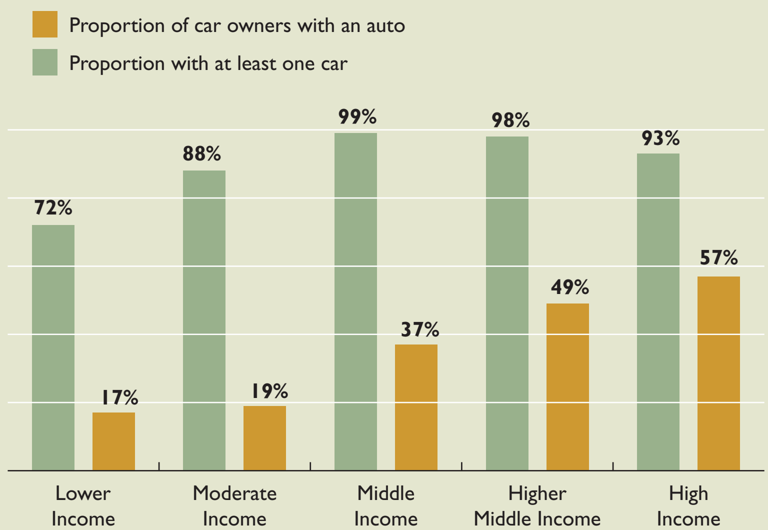
for these consumers. No data are available on the Kentucky car market that would allow for a similar analysis. There is no reason to suspect, however, that Kentucky is insulated from the market dynamics that give rise to these findings.

On average, lower-income consumers pay at least 2 percentage points more for auto loans than higher-income consumers

According to our survey of Kentucky households, approximately one in five lower-income car owners owes money on an auto loan, accounting for about 7 percent of the Kentucky auto loan market. Here again, however, lower-income borrowers tend to pay higher prices for auto loans than higher-income drivers. No data exist on exact amounts charged for loans in Kentucky. However, we can use nationwide surveys to infer the market dynamics in the state. On the basis of national surveys, the average annualized rate of interest paid by lower-income households was 9.2 percent in 2004. In contrast, households earning between $30,000 and $60,000 annually paid an average rate of 8.5 percent. Households earning between $60,000 and $90,000 paid an average rate of 7.2 percent. Those earning between $90,000 and $120,000 paid about a 6.2 percent rate, and those earning more than $120,000 paid about 5.5 percent.

To put those rate differences in perspective, the median lower-income consumer with a $5,000 auto loan—approximately the median value of cars owned by a lower-income household—would pay $1,256 in interest over five years at a rate of 9.2 percent. In contrast, the median household earning more than $120,000 a year would pay $730 in interest over five years. That represents a savings of more than $500 to the higher-income household relative to a lower-income household with a typical, or median, car loan in their respective income brackets.

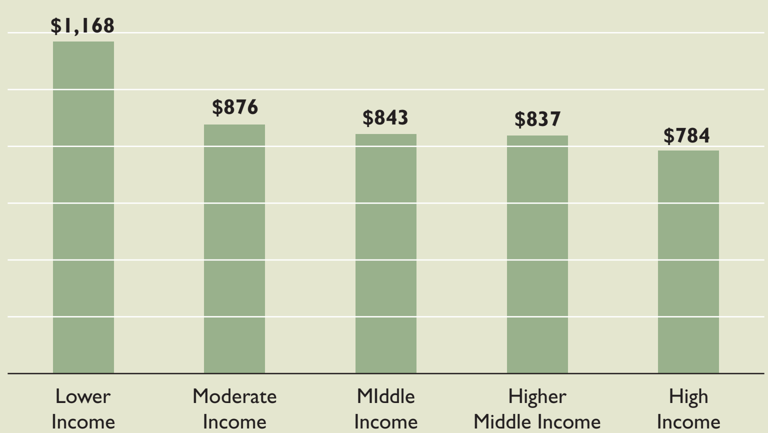
Most Kentucky families surveyed own at least one car, and the proportion with car loans rises with income



Source: Authors' analysis of a statewide survey commissioned by The Brookings Institution, and administered by the University of Kentucky's Survey Research Center

Note: For a definition of income thresholds see table on page 13.

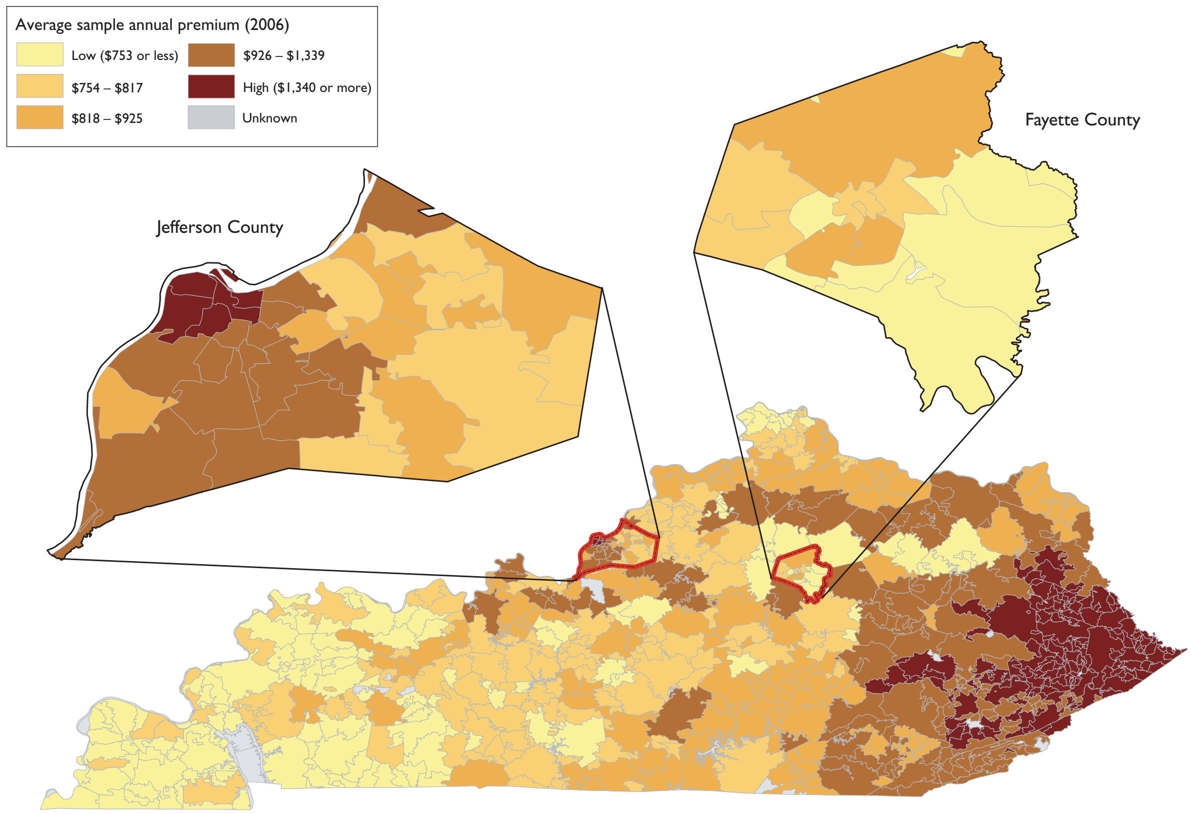
Kentucky residents who live in lower-income neighborhoods pay $384 more (or 49 percent) more in auto insurance premiums than those in high-income neighborhoods



Source: Authors' analysis of data from several of the state's major auto insurance providers

Note: For a definition of income thresholds see table on page 13.

Residents in the eastern part of the state pay the highest auto insurance rates



Source: Authors' analysis of data from major home insurance providers

Notes: Sample rates were obtained for a driver who is 35 years old, married, has a clean driving record, commutes five minutes daily, and drives between 10,000 and 15,000 miles annually. Values are shown by ZIP code. Colors represent quintiles of average sample premiums across Kentucky; the most darkly colored ZIP codes, for instance, have higher average sample insurance rates than those in 80 percent of all other ZIP codes in the state.

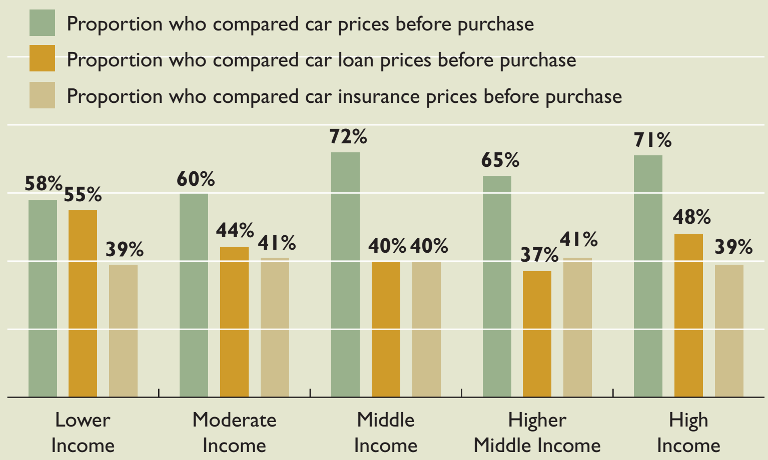
Surveyed drivers from lower-income communities pay, on average, $384 more per year for auto insurance than high-income drivers

Across Kentucky, the highest prices for auto insurance in our sample of quotes from three major insurance companies are found in the state's lowest-income neighborhoods. On average, car owners in lower-income neighborhoods paid $384 more annually to insure the same low-cost car versus in high-income neighborhoods.

Residents of both urban and rural communities pay higher prices for auto insurance. However, the higher prices for insurance are concentrated in the eastern counties of the state, the most dangerous areas of the state in which to drive. In Rowan and Bath counties, for example, a married driver with a perfect driving history and a car worth $5,100 would pay $624 for insurance. That same driver would pay more than $1,600 a year to insure the same car in the eastern counties of Floyd or Johnson.

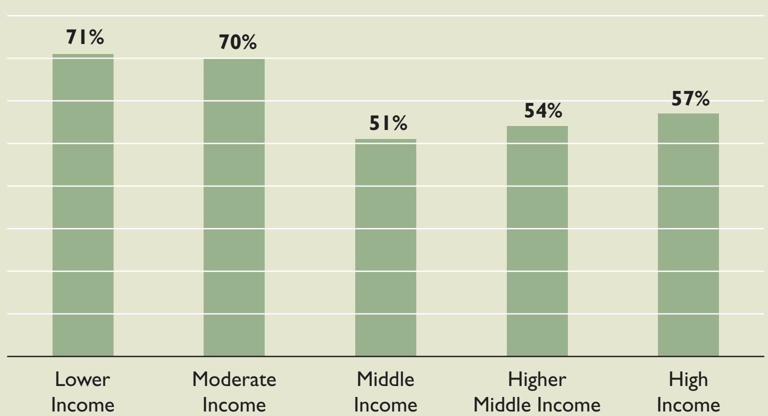
Couple these regional differences with differences by occupation, credit score, and education—characteristics highly associated with income, and also factored into pricing decisions by some companies—and lower-income drivers may pay even steeper prices.[45] This suggests, though it certainly does not prove, that lower-income drivers may systematically pay higher prices for auto insurance. But, more than any other issue we discuss in this report, the dearth of good data impairs our understanding of the relationship between income and insurance prices.

Lower-income families surveyed are less likely than others to compare prices on cars before buying



Source: Authors' analysis of a statewide survey commissioned by The Brookings Institution, and administered by the University of Kentucky's Survey Research Center
Note: For a definition of income thresholds see table on page 13.

More than 70 percent of lower-income Kentuckians surveyed have little understanding of credit reports and the impact they have on pricing for loans and insurance



Source: Authors' analysis of a statewide survey commissioned by The Brookings Institution, and administered by the University of Kentucky's Survey Research Center
Note: For a definition of income thresholds see table on page 13.

Why are these auto and auto-related products more expensive for lower-income households? Three factors cause these higher prices:

Sellers of these auto products face real and perceived risks for of doing business in lower-income neighborhoods. Lower-income consumers in Kentucky are more likely to miss loan payments and to live in areas with higher insurance rates.[46] In the lower-income area of eastern Kentucky, for example, road conditions, the presence of coal trucks, and the limited number of accessible auto repair businesses may each play a part in the higher premiums lower-income drivers pay. Businesses in turn pass on these higher costs to consumers in the form of higher prices. These real higher costs also can foster a perception of higher costs of doing business with these consumers, particularly when measurement of risks is imprecise, such as with insurance pricing.

Questionable business practices inflate the prices charged to lower-income consumers for car-related necessities. Evidence that car dealers systematically charge higher prices for black customers is one example of unscrupulous, price-inflating behavior.[47] Also, the much higher interest rates lower-income drivers pay for auto loans may, in addition to poor credit or payment histories, also stem from unscrupulous businesses inflating

While a modestly higher proportion of lower-income households report that they did not shop around before buying an auto loan, about the same proportion across income groups report that they shopped around before buying a car and car insurance.

prices. One could infer from the faster rise in car ownership rate among lower-income families than among higher-income families that many of these customers may not have the experience or knowledge to spot and avoid unscrupulous businesses that overcharge.[48]

Finally, a consumer education gap exists between lower- and higher-income consumers. More than 70 percent of lower- and moderate-income Kentuckians surveyed have little understanding of credit reports and the impact they have on pricing for loans and insurance compared to about 51–57 percent in higher-income groups. Without that knowledge, unscrupulous car dealers, lenders, and insurance agents can easily justify high prices by confusing the customer about the real risks they pose to the seller. Still, the differences between Kentucky's income groups in consumer knowledge are less pronounced when it comes to buying auto-related necessities compared to other necessities. While a modestly higher proportion of lower-income households report that they did not shop around before buying an auto loan, about the same proportion across income groups report that they shopped around before buying a car and car insurance. This doesn't mean they bring the same amount of information to the bargaining table, but it certainly means they're taking a critical step to gather that information at about the same rates as everyone else in the state.

III. HOMES

Lower- and moderate-income consumers are more likely than higher-income households to pay higher prices for home-related products

Of those buying homes in 2005, more lower-income households surveyed have a high-cost mortgage than higher-income households. Home insurance is also more expensive for lower-income families. When furnishing their homes, more lower-income consumers use high-priced rent-to-own stores than higher-income families surveyed. This section explains each of these higher prices in more depth.

Kentucky's lower-income homebuyers are twice as likely as higher-income households to buy a high-cost mortgage

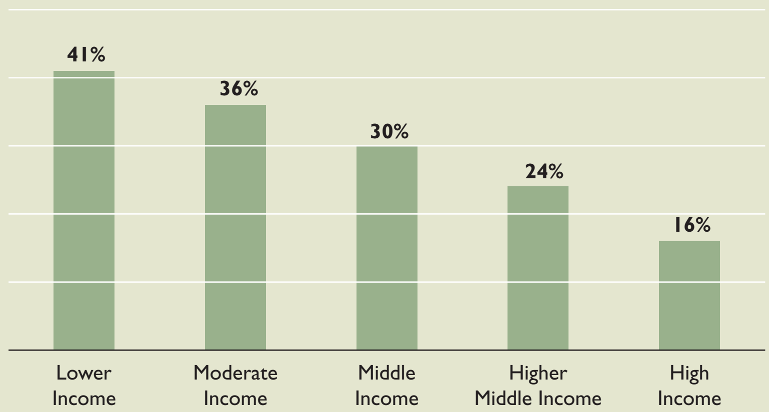
More than 41 percent of lower-income households that bought a home in 2005 have what the Federal Reserve defines as a high-cost mortgage, compared with just 16 percent of high-income households.[49] These high-cost mortgages add up to considerable sums of extra money, which could have been devoted to savings and investments. For instance, the monthly payment on a typical high-cost mortgage for a median-priced home in 2005 would be approximately $807 a month, or about $290,000 over the course of a fixed-rate 30-year loan. In contrast, homeowners with a standard mortgage would pay approximately $605 a month, or $218,000 over the course of a loan, or a savings of more than $70,000 compared with the high-cost mortgage.[50]

Although Kentucky's lower-income consumers are much more likely than other consumers to pay high prices for mortgages, they are not the majority of the high-cost market. In fact, of the 40,000 high-cost mortgages originated in Kentucky in 2005, lower-income households bought only about

2,000 of these, or about 6 percent. Moderate-income borrowers obtained a larger number of high-cost mortgages, totaling 33 percent of all 2005 high-cost mortgages. The remaining 62 percent of the market for high-cost mortgages in Kentucky was middle- and higher-income consumers. Because of their larger numbers, though, a smaller proportion of these higher-income consumers buy high-cost mortgages than lower-income consumers.

Demand for high-cost mortgages in the state is in both urban and rural areas. Lower-income borrowers in rural southeastern Kentucky have high demand for high-cost loans: of the eight counties with the highest rates of these mortgages in the state—where more than one-half of mortgages are high-cost—all are lower-income and in this region. At the same time, more than 8,000 high-cost mortgages were originated in Louisville, representing 20 percent of high-cost mortgages in the entire state. In Louisville's lower-income neighborhoods, 37 percent of mortgages originated in 2005 were high-cost. Another 2,500 of the high-cost loans originated in the state were in Lexington.

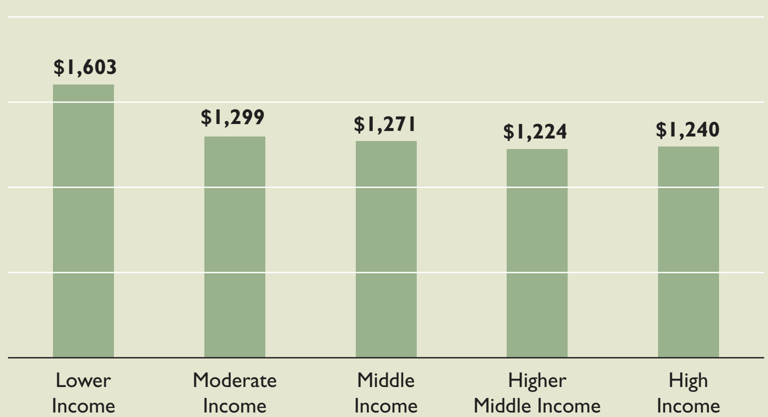
More than twice as many lower-income Kentucky homebuyers have a high-cost mortgage than high-income families



Source: Authors' analysis of data from the 2006 Home Mortgage Disclosure Act

Note: For a definition of income thresholds see table on page 13.

Lower-income homeowners pay $1,603 on average in home insurance premiums annually, or $363 more per year than high-income homeowners



Source: Authors' analysis of data from several of the state's major auto insurance providers

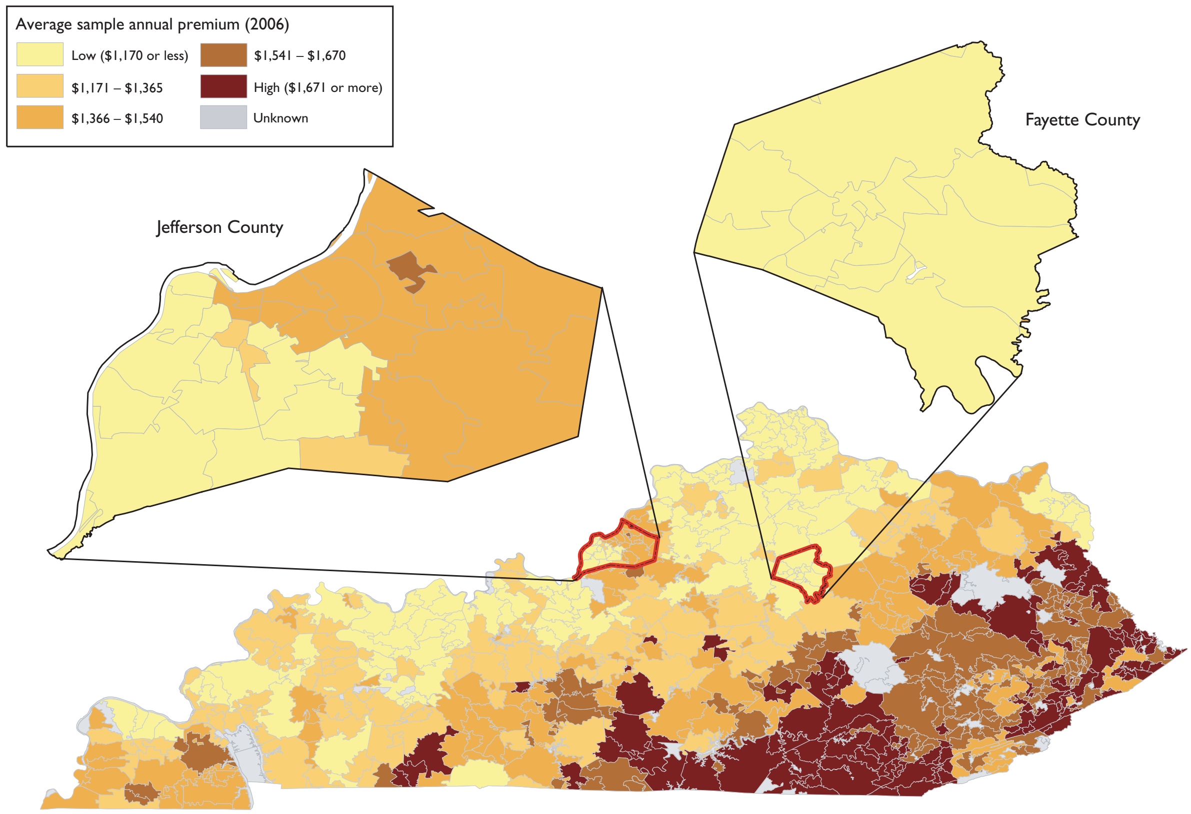
Note: For a definition of income thresholds see table on page 13.

In a sample of prices from three insurance companies, homeowners in Kentucky's lower-income neighborhoods pay, on average, at least $363 more annually for home insurance than homeowners in high-income neighborhoods, holding other factors constant.

As with auto insurance, insuring a home in Kentucky's lower-income neighborhoods is typically more expensive than insuring a comparable home in high-income neighborhoods. Across the state, we find that the average cost of insuring a comparably valued home is $363 higher in Kentucky's lower-income neighborhoods than in high-income neighborhoods.

Unlike auto insurance, however, the highest rates for home insurance in lower-income communities are concentrated strictly in rural areas, rather than in both urban

Lower-income families in rural areas of the state pay the highest home insurance rates



Source: Authors' analysis of data from major home insurance providers

Notes: Values are shown by ZIP code. Colors represent quintiles of average sample premiums across Kentucky; the most darkly colored ZIP codes, for instance, have higher average sample insurance rates than those in 80 percent of all other ZIP codes in the state.

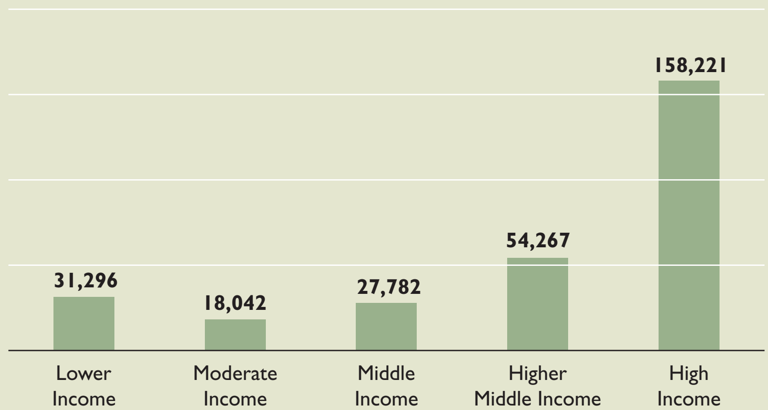
and rural areas as they are for car insurance. Counties in the southern and southeastern sections of the state have average home insurance rates of more than $1,600 a year compared with an average rate of less than $1,200 in the more urban western and northern areas of the state.

Nevertheless, these analyses of home insurance rates are limited in that we only examine how rates vary across neighborhoods, rather than across individuals. Home insurance prices could be higher for lower-income homeowners in Kentucky because some of their personal characteristics raise prices on insurance, such as credit score, occupation, and education, all of which are closely correlated with household income.[51] However, the limited disclosure laws in the insurance industry limit the available data to analyze the full impact of these factors.

Kentucky's lower-income consumers also tend to pay more for furniture and appliances because they more frequently shop at rent-to-own establishments

Lower-income consumers are much more likely than higher-income consumers to buy furniture and appliances from rent-to-own stores. A recent analysis by the Federal Trade Commission (FTC) found that 59 percent of rent-to-own customers earn less than $25,000 a year.[52] Renting to own means that

Lower-income Kentucky communities have a much higher concentration of rent-to-own stores than high-income areas—one store for every 31,296 residents compared with one store for every 158,221 residents in high-income neighborhoods



Source: Authors' analysis of data from InfoUSA

Note: For a definition of income thresholds see table on page 13.

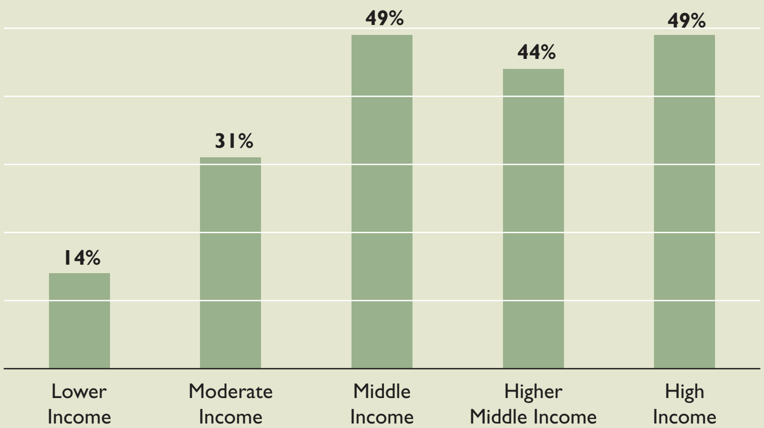
consumers pay more for a piece of furniture or electronics than if they simply bought the item outright because of numerous fees these stores charge.

Because Kentucky's disclosure laws in the rent-to-own industry are limited, statewide estimates of the prices charged by rent-to-own establishments are unavailable. However, analyses from other states suggest that a washing machine could cost more than $1,000 if purchased from a rent-to-own business.[53] In contrast, a consumer who bought that same washing machine with a credit card charging a 24 percent interest rate would pay just $480 over an 18-month period.[54] Processing fees, delivery fees, installation fees, in-home collection fees, home pick-up fees, product insurance fees, and late payment fees all account for these higher prices at rent-to-own establishments.[55]

Kentucky's lower-income consumers know less about the importance of credit reports and scores, two key consumer characteristics that affect prices for mortgages and home insurance.

Kentucky communities with incomes below $51,000 all have a much higher concentration of rent-to-own stores than higher-income areas. Communities in the second lowest income group, those communities with a median income between $33,392 and $42,006, have one store for every 18,042 residents compared with one store for every 158,221 residents in the highest-income communities. More than 70 percent of Kentucky's rent-to-own stores are located in lower- and moderate-income neighborhoods.

Roughly one-half of middle- to high-income homebuyers compare mortgage prices before buying compared with only 14 percent of lower-income homeowners surveyed



Source: Authors' analysis of a statewide survey commissioned by The Brookings Institution, and administered by the University of Kentucky's Survey Research Center

Note: For a definition of income thresholds see table on page 13.

Why are home-related purchases more expensive for lower-income consumers?

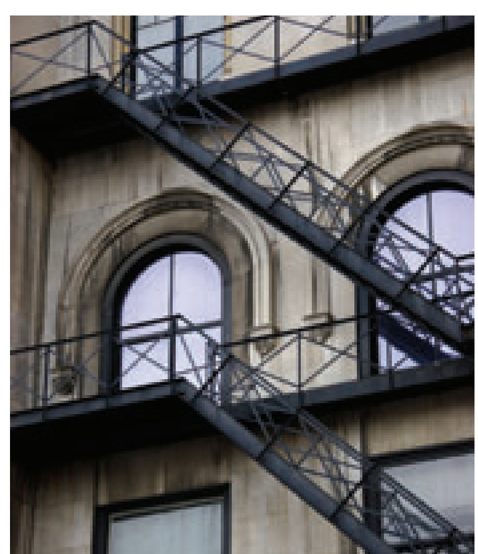
To bring down prices for lower-income families, leaders should address three market dynamics that drive up these prices:

Businesses incur some higher costs of doing business when serving lower-income markets. As reported in an earlier figure, lower-income homeowners in Kentucky are four times more likely to fall behind on mortgage payments than are higher-income homeowners, and therefore lenders face higher costs of doing business with lower-income consumers. These costs are rationally passed on to consumers. Higher delinquency rates among lower-income borrowers also lower their credit scores, which makes these consumers appear more risky.[56] These real higher costs also drive perceptions of higher costs, even when there may be limited data to support those perceptions.

Questionable practices by some businesses drive up housing prices for lower-income families. Research has indicated that as many as 20 percent of all borrowers who purchased a high-cost mortgage could have qualified for a lower-priced mortgage, which would have saved them hundreds, sometimes thousands, of dollars in interest charges every year.[57] Similarly, state regulators are asking whether insurance rating territories—like ZIP codes—and other non-house-related criteria should be used by insurance companies to determine prices, given that several of these criteria vary systematically with household income. "The bottom line" according to Florida's General Counsel to the Office of Insurance Regulation, "is we believe the lowest income strata have the worst credit scores, and they are paying higher rates as a result of that."[58] Here, the theory is that by removing this variable in the calculation of insurance prices, leaders will be able to lower the price of insurance for lower-income households.

Lower-income consumers tend to be less informed than higher-income consumers about mortgages and other home-related purchases. In Kentucky, we found that more than 86 percent of surveyed lower-income homeowners did not compare prices before choosing their mortgage, while 51 percent of higher-income homeowners did so. Research indicates that consumers who comparatively shop pay lower prices than those who do not.[59]

As noted above, Kentucky's lower-income consumers know less about the importance of credit reports and scores, two key consumer characteristics that affect prices for mortgages and home insurance. Without that knowledge, Kentucky's lower-income consumers may buy homes without first assessing whether they would be better off waiting and first improving their credit scores, which will improve the loan and insurance prices for which they qualify.



IV. GROCERIES

With the exception of communities in Louisville and Lexington, Kentucky's lower-income communities tend to have as much access to larger, likely lower-priced, grocery stores as the state's higher-income neighborhoods. However, data are too limited to directly assess prices across these different stores.

Elsewhere in the country, lower-income neighborhoods tend to have fewer per capita large grocery stores (greater than 10,000 square feet) than higher-income neighborhoods. This is important because larger stores tend to sell food at lower prices than small stores.[60] However, Kentucky largely bucks this trend, containing roughly equal numbers of large grocery stores per capita in lower- and higher-income communities. To be sure, not all communities in Kentucky have access to a large grocery store: 21 counties have no mid-sized or large grocery stores. However, fewer than one-half of these are lower-income communities.

Higher costs of doing business in lower-income communities and, perhaps, some questionable business practices, may help drive down access in Louisville's and Lexington's lower-income neighborhoods to large grocery stores.

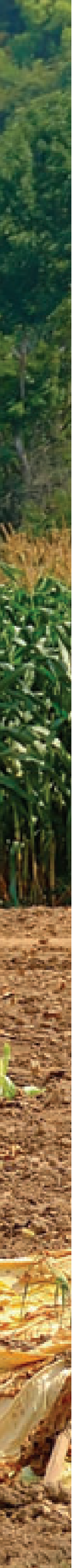
In fact, larger grocery stores are more highly concentrated throughout the state in lower- and moderate-income neighborhoods than in higher-income neighborhoods. In particular, there is one large grocery for every 7,693 residents of the state's lower-income communities, compared with one large store for every 22,603 residents of a high-income community.

The story is different in Louisville and Lexington, however, where larger grocery stores are more limited in lower-income neighborhoods. In Louisville's lowest-income neighborhoods, for example, there is one large store for every 7,495 residents compared with one for every 14,176 residents of a high-income neighborhood. Residents in Louisville's West End, a lower-income community, must travel through several neighborhoods beyond their own to access larger, and likely lower cost, grocery stores. For families relying on public transportation or those with young children, the extra distance may make such travel difficult, and force them to rely instead on smaller and more expensive stores.

Why might Kentucky's urban lower-income neighborhoods tend to have less access to larger, likely lower-priced, grocery stores?

Higher costs of doing business in lower-income communities and, perhaps, some questionable business practices, may help drive down access in Louisville's and

Lexington's lower-income neighborhoods to large grocery stores. Higher costs are brought about by the unconventional market demand assessments that often are needed in lower-income markets, which comports with recent evidence that there is generally a large amount of unmet market demand in lower-income neighborhoods, largely because of the inadequacy of conventional market demand assessment tools. Social Compact, for instance, has illustrated in numerous studies that traditional methods of estimating market demand systematically undercount demand in lower-income neighborhoods.[61] One company that sees enormous opportunity in lower-income neighborhoods is Wal-Mart, which recently announced plans to open 150 stores in underserved lower-income markets.[62] At the same time, though, relatively more strict zoning requirements, and the higher expense of urban land and development, help drive down access in urban lower-income neighborhoods. Such trends push back against the trend in the industry to build large, one-stop destination supercenters.[63]



SOLUTIONS:

Reducing the High Price of Being Poor in Kentucky

Kentucky's public and private sector leaders can bring down the higher prices lower-income families tend to pay for basic necessities, creating a valuable opportunity for lower-income families in the state to save, invest, pay off debt, and avoid high-cost credit. Many of these strategies can also foster the market dynamics necessary to expand the wealth of Kentuckians over time, along with the economy. In fact, the needed solutions are as much about helping lower-income families as they are about helping to expand mainstream businesses in Kentucky.

To capitalize on this opportunity, Kentucky's public and private leaders should adopt a three-pronged strategy.

First, Kentucky's leaders need to work to bring down the higher costs of doing business with lower-income consumers. This report has shown that the state's lower-income consumers are more likely to fall behind on payments, live in riskier areas of the state, and not have information about the importance of credit scores and reports. On top of that, traditional market products and demand assessments, and perhaps risk assessments too, are often less appropriate and reliable in lower-income markets than in higher-income markets. Together, these characteristics of lower-income consumers drive up costs for businesses, which are then passed on to consumers. Kentucky must look at the examples of other states that have chartered new strategies for bringing down these higher costs for business, which are then passed on to lower-income consumers in the form of lower prices.

Second, Kentucky's lower-income markets are beset by unscrupulous and unnecessarily high-priced businesses. That high-priced payday lending businesses are opening at the rate of one every four days in 2006 should be unacceptable to Kentucky's leaders, given the proven, substantially lower-cost alternatives that are being sold in other markets throughout the country. At the same time, the very high relative number of Kentucky's lower-income consumers that are paying

Finally, this report has provided evidence that Kentucky's lower-income consumers do not have as much information as they need to make sound financial decisions.

high prices for their mortgages and insurance products should be a cause for concern among Kentucky's public leaders, and evidence of a business opportunity for Kentucky's mainstream, responsible businesses to move into these markets with lower-priced alternatives.

Finally, this report has provided evidence that Kentucky's lower-income consumers do not have as much information as they need to make sound financial decisions. They are systematically less likely to comparatively shop among companies when buying goods and services and they know less about the importance of credit reports and scores than their higher-income neighbors. Also, in our survey of Kentucky households, the most common reason given among lower-income consumers for not using a bank was that they never really thought about opening up a bank account; the next most cited reason is that these consumers do not trust banks with their money; and the next is that there is too much paperwork. Together, this set of evidence should be a wake up call for leaders in Kentucky that lower-income consumers in the state are not making the best possible use of their scarce resources, missing important opportunities to get ahead through savings and investments in wealth-building assets.

All three elements of this policy agenda are discussed in more detail below, animated by initiatives in other areas of the country that are striving to bring down higher costs of doing business with lower-income consumers, curb unscrupulous behavior, and boost the consumer knowledge of lower-income consumers.

GOAL ONE:

Promote market-based solutions that lower the higher costs of doing business with Kentucky's lower-income consumers

This report has documented a range of higher costs faced by businesses in Kentucky's lower-income markets, from higher delinquency rates to the need for nontraditional products and customer service, which cost money to develop and bring to market. Therefore, the first step leaders should take to lower costs for their lower-income constituents is to support mainstream businesses in lower-income markets that offer reasonable and competitive prices for basic necessities.

In this section, we outline examples from around the country promoting an array of mainstream products for lower-income families.

Create Employer-Based Payday Lending Alternatives:

North Carolina State Employees' Credit Union

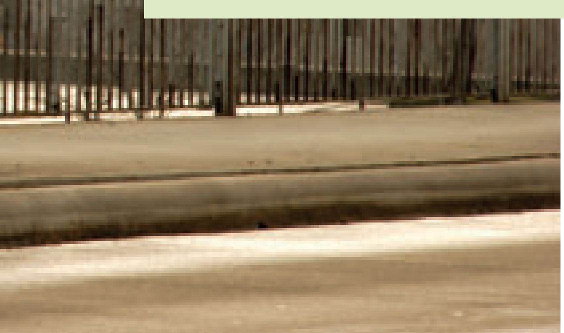
In 2001, the North Carolina State Employees' Credit Union (NCSECU) began offering a payday loan alternative to its 1.2 million members after noticing increased use of payday loans by its members. The Salary Advance Loan (SALO) is a revolving loan, with a maximum outstanding balance of $500, offered at an APR of 12 percent. That compares in Kentucky to the 390 percent APR charged by payday lenders in the state for the same loan amount.

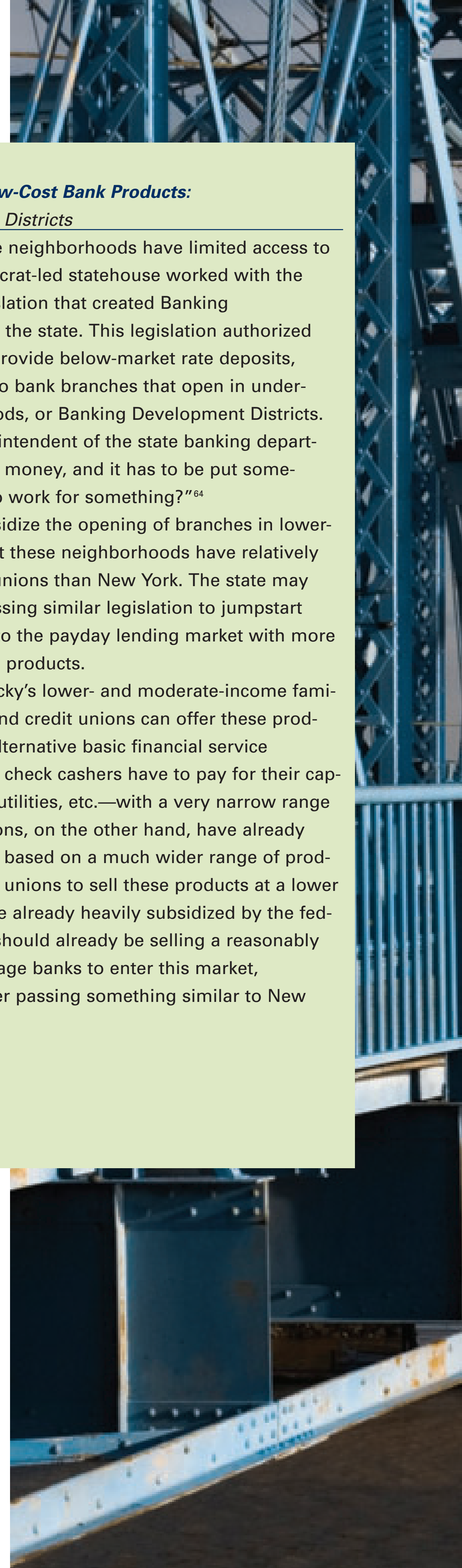
One of the most innovative features of the product is a forced savings component, which requires that 5 percent of each advance be placed in a special savings account. The account is unrestricted, but if the member withdraws savings, he or she cannot access a SALO for six months. This feature is designed to provide members with an incentive to let savings accumulate until the funds are sufficient to ease reliance on borrowing.

Since the product was introduced, NCSECU has loaned $305,405,278, generating $1,919,097 in interest income for the credit union. The mandatory savings component has resulted in more than $6 million in new deposit funds. The mandatory savings feature is popular with NCSECU members, 75 percent of whom report that this is the first time in their lives that they have had any significant savings. It has also reduced NCSECU's credit risk by providing increased security for SALO loans.

For more information:

www.ncsecu.org





Subsidize the Development of Low-Cost Bank Products:

New York's Banking Development Districts

Because New York's lower-income neighborhoods have limited access to bank and credit unions, the Democrat-led statehouse worked with the Republican governor to pass legislation that created Banking Development Districts throughout the state. This legislation authorized the state banking department to provide below-market rate deposits, along with market-rate deposits, to bank branches that open in underserved lower-income neighborhoods, or Banking Development Districts. As Diana Taylor, the former superintendent of the state banking department, says, "The state has all this money, and it has to be put somewhere. Why not put this money to work for something?"[64]

Kentucky does not need to subsidize the opening of branches in lower-income neighborhoods, given that these neighborhoods have relatively more access to banks and credit unions than New York. The state may nevertheless want to consider passing similar legislation to jumpstart banks and credit unions' move into the payday lending market with more reasonably priced short-term loan products.

The potential savings for Kentucky's lower- and moderate-income families is enormous because banks and credit unions can offer these products at lower comparable rates. Alternative basic financial service providers like payday lenders and check cashers have to pay for their capital costs—buildings, employees, utilities, etc.—with a very narrow range of products. Banks and credit unions, on the other hand, have already sunk these costs, paying for them based on a much wider range of products. This allows banks and credit unions to sell these products at a lower comparable rate. Credit unions are already heavily subsidized by the federal and state governments, and should already be selling a reasonably priced alternative. To help encourage banks to enter this market, Kentucky's leaders should consider passing something similar to New York's plan.

For more information:

www.banking.state.ny.us/bdd.htm

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Develop Refund Anticipation Loan Alternative

Bank of Oklahoma

Bank of Oklahoma has partnered with the Community Action Program of Tulsa County and Doorways to Dreams (D2D) to split refunds in its Refunds to Assets Program. By offering a refund anticipation check (RAC) rather than a refund anticipation loan, these partners are able to reduce costs to lower-income tax filers and promote savings. Tax filers who participate can receive part of their refund for immediate use while the remainder is deposited in an account at Bank of Oklahoma or, if they are homeowners, used to make a mortgage payment.

About one-third of the tax filers offered the option to split their refunds do so. As a result, people deposit, on average, $583 into a savings account, which is the equivalent to about one-half of their refunds. Before this product was available, 75 percent of those using it had never had savings in reserve.

For more information:

www.d2dfund.org/r2a/index.php

Form Public-Private Partnerships to Bank the Unbanked

Bank of San Francisco

More than 30 percent of Kentucky's lower-income households regularly turn to high-priced check cashers, costing a typical a minimum wage earner over five years nearly half his or her annual income.

San Francisco instead connected these consumers to reasonably priced products at banks and credit unions. The office of the mayor, the office of the treasurer, the Federal Reserve Bank of San Francisco, and 20 participating banks and credit unions formed four working groups with the goal of converting 20 percent of the unbanked population into bank account holders in two years. The first working group is developing appropriate market products, the second is devising strategies to market those products, the third is working to bring community voices to the process, and the fourth will track progress.[65]

For more information:

www.sfgov.org/site/bankonsf_index.asp?id=46628

Create Low-Cost Insurance Pools

California's Low-Cost Automobile Insurance Program

Kentucky's lower-income families are not alone in facing relatively more expensive insurance premiums. However, other states have taken aggressive steps to lower the price of auto insurance for these consumers, in part to lower the high uninsurance rate in lower-income markets, as well as to promote more affordable options for lower-income drivers already having difficulty making ends meet.

California offers one of the more far-reaching programs to lower the cost of auto insurance. California now requires insurers in the state to offer a low-cost auto liability insurance policy to qualified drivers who earn less than 250 percent of the poverty line in eight urban counties, where large shares of the state's lower-income drivers are concentrated.[66] Insurance under this program costs as little as $314 in San Francisco.

Insurance companies benefit from this program because it pools both the real and perceived higher risks in lower-income markets while also helping to boost the insurance rate in lower-income markets. Lower-income consumers benefit because it lowers the cost of insurance and allows them to buy insurance and protect their assets.

For more information:

www.insurance.ca.gov/0400-news/0100-press-releases/0070-2006/release051-06.cfm

Promote Competition in Insurance Markets

Kentucky's Insurance Shopping Guides

Kentucky, along with numerous other states, have started publishing auto and home insurance shopping guides, which advertise the cost of a comparable amount of insurance sold by each of the licensed insurance companies in the state.[67] Such guides promote competition because they speed up the search time needed by consumers to comparatively shop for insurance prices. Instead of a consumer having to call every insurance company in the yellow pages, for instance, consumers just need to log onto to these state webpages, find the county that they live in, and look at the rates being offered by all of the insurance companies that sell insurance in their county. This one-stop destination is a low cost, easy way to lower the prices that lower-income consumers tend to pay for insurance.

Kentucky's guides illustrate that annual premiums for the exact same line of insurance can vary by over $1,000, depending on the insurance company. Some of this price variance is explained by the different mixes of risk that insurance companies are exposed to in the market, but it also has to do with different pricing strategies across companies.

For these efforts to continue to be effective, however, leaders should aggressively market this resource and keep the information up to date. State and local leaders in Kentucky can work with the media, community leaders, and insurance companies to advertise this resource.

For more information:

www.ins.state.ny.us/homeown/html/hmonguid.htm

Promote Responsible Mortgage Companies

University of Pennsylvania's Guaranteed Mortgage Program

Buying a mortgage is complicated. In addition to choosing from dozens of brokers and lenders, Kentucky's consumers also must choose between dozens of different mortgage products. Such choice allows consumers to buy mortgage products tailored to their financial interests, but it also leaves them vulnerable to unscrupulous brokers and lenders who may take advantage of consumers who do not fully understand their options. Economists, for example, have found that about 20 percent of those who bought a high-cost mortgage qualified for a prime-priced loan.[68]

To help mainstream lenders connect with consumers, and to help promote homeownership, the University of Pennsylvania created a guaranteed mortgage program for its employees. The university entered into an agreement with Advance Bank, GMAC Mortgage Corporation, and Citizens Bank, three lenders in the Philadelphia market. By connecting families to preapproved lenders, the university is ensuring that its employees are connected to responsible mortgage companies that offer reasonable prices. This promotes mainstream companies in Philadelphia's housing markets.

For more information:

www.business-services.upenn.edu/communityhousing/mortgagePrograms.html

GOAL TWO:

Curb unscrupulous business practices in lower-income markets

Compared to their higher-income counterparts, Kentucky's lower-income consumers do less shopping around when they buy credit; live in more expensive areas of the state for some types of transactions; and they are more likely to fall behind on payments. Together, these characteristics act to curb the interest of mainstream responsible businesses in the state from serving lower-income markets. In their place, unscrupulous businesses can blossom, charging unnecessarily high prices for everyday goods and services. Left unaddressed, these bad apples in the business community can erode the potential for mainstream businesses to thrive in this market because the high prices they charge for everyday goods and services can erode the financial security of Kentucky's lower-income households.

Kentucky's lower-income consumers do less shopping around when they buy credit; live in more expensive areas of the state for some types of transactions; and they are more likely to fall behind on payments.

To address these issues, many states have used their regulatory power to promote more reasonable prices in lower-income markets. This section reviews some of the more prevalent regulatory efforts in recent years, which Kentucky may consider as options to lower prices for the poor and promote mainstream businesses in the state.

Curb High-Priced Basic Financial Services

Moratoriums on and Price Caps for Check Cashers and Payday Lenders

Leaders in several states have recognized payday lenders and other alternative financial services drain tens of millions of dollars from the pockets of lower-income consumers, and they have taken steps to curb their growth (see Appendix).

Several cities and states have passed moratoriums on business licenses for these companies. Similarly, some cities have passed strict ordinances that specify minimum distances between these establishments. In Pima County leaders banned such businesses from doing opening within 1,200 feet of a similar business or within 500 feet of any private residence.

Other states have banned these businesses outright, or have lowered the prices they can charge. In 2004, Georgia capped the annual percentage rate for short-term loans sold in the state at 16 percent and eliminated the ability of these businesses to rent the charter of banks in states with less stringent laws.

For more information:

www.ncsl.org/programs/banking/paydaylend-intro.htm

Curb Abuses by Car Dealers

Car Buyer Bill of Rights

Getting a good price for a car depends on consumers doing significant research before showing up at the dealership. Prices for cars, loan terms, warranty options, and maintenance histories (if used) are some of the pieces of information consumers should have to ensure that they are offered a fair price. As this and other reports have shown, not everyone gets a fair shake. Consumers in lower-income neighborhoods, particularly those who rent their home, lack a college education, and are black systematically pay higher prices for cars.

Leaders in several states have taken steps to curb these practices by car dealers. With the passage of the Car Buyer Bill of Rights last year, California requires car dealers to itemize components of a buyer's monthly installment bill, and makes it illegal for them to add terms of the contract without first disclosing additions to the consumer. The law also caps the incentive financial institutions can provide to dealers for selling high-priced loans and requires dealers to submit information to the consumer about the role of credit scores in determining auto loan rates. The measure also provides for an optional cooling-off period. Consumers can pay a fee for the right to return the car within 48 hours. Together, these efforts mark an important step forward in educating and protecting consumers.

For more information:

www.dca.ca.gov/legis/2005/miscconsumer.htm

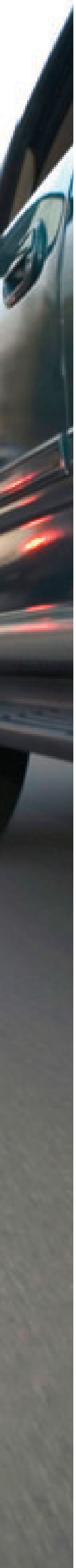
Limit the Variability of Insurance Fees by Income

Regulate the Use of Credit Scores and Territories by Insurance Companies

Leaders in other states have reacted to price variability by taking action to limit the extent to which insurance prices can vary with household income. Florida, Maryland, and Hawaii have banned or significantly curbed insurance companies from using credit report information to set certain insurance rates.[69] During the past two years, state legislatures in at least three states (Washington, Michigan, and West Virginia) have proposed similar bills. In addition, bills under consideration in Tennessee, Missouri, and North Dakota would prevent premium increases on the basis of credit scores, a change that would protect those who fall on hard times after they already have been underwritten. Together, these legislative and regulatory steps are examples for Kentucky's leaders.

For more information:

www.insurance.wa.gov/publications/news/Final_SESRC_Report.pdf



Discourage Questionable Practices in the Mortgage Market

State Mortgage Lending Laws

Leaders in other states have taken action to curb certain questionable practices in the otherwise responsible mortgage industry.[70] In 2006, states considered more than 50 bills to curb abusive practices. One of the stronger laws was passed in New Mexico and includes restrictions on prepayment penalties, limits refinancing practices that strip equity from homeowners, and requires that borrowers receive financial counseling prior to buying a high-cost mortgage. An analysis of its impact found that although the volume of the high-cost market has not been affected, the number of bills sold with unnecessary price-inflating features is substantially lower than in other states without these protections. Leaders in Kentucky should consider these models to limit price-inflating practices.

For more information:

www.responsiblelending.org

Limit Prices at Rent-to-Own Businesses

Rent-to-Own State Laws

The high cost of rent-to-own transactions have prompted leaders in several states to limit the amount by which these businesses can inflate prices. While Connecticut allows rent-to-own businesses to charge as much as 100 percent of the merchandise's price in fees and rental costs, Wisconsin has capped that rate at 30 percent.

Although the first line of action in Kentucky should be to educate consumers on the higher prices they are paying, Kentucky's leaders can also follow the example of other states and cap the prices charged by rent-to-own businesses.

For more information:

www.ftc.gov/reports/renttoown/rtosummary.shtm

Finally, this report has provided evidence that Kentucky's lower-income consumers do not have as much information as they need to make sound financial decisions.

GOAL THREE:

Promote financial responsibility among lower-income consumers

Kentucky's leaders must help lower-income consumers make better financial decisions. Given that unbanked households have seldom even thought about opening up a bank account, or that most lower-income Kentuckians do not understand credit reports and scores and fail to shop around for goods and services, there is clearly great opportunity to bring more Kentuckians into the financial mainstream through better information. This section reviews a handful of states that have are attempting to address this problem. ■

Promote Internet Access and Use

One of the best resources for consumers is the Internet. The best consumer examples include:

- Lendingtree.com, which compares information on mortgages
- Einsurance.com and progressive.com, which compare prices for insurance premiums
- Carbargain.com, cardirect.com, cars.com, and Edmunds.com, which provide prices and other information on new and used cars
- Shopping.com, which compares prices for appliances and electronics
- Prosper.com, which provides high-risk borrowers relatively low-cost loans

In addition to these shopping sites, Kentucky's state departments provide very useful information to consumers. The state's Department of Insurance provides a shopping guide that compares rates for a comparable amount of insurance offered by companies licensed in the state. Such a resource, if made available to Kentucky's lower-income consumers, would give them a much needed leg up to find the lowest possible price for insurance in the state.

However, nearly two-thirds (64 percent) of Kentucky's lower-income consumers do not have regular access to the Internet, compared with just 18 percent on average of all other consumers.[71] Further, very few of those who do have online access report using it to compare prices or do research when buying major goods and services.

Kentucky has a number of options to boost Internet access among lower-income consumers, from continuing to transform their libraries into computer-based learning centers to directly subsidizing computer purchases and Internet access for lower-income households. Whatever option Kentucky chooses, it must with equal vigor ensure that consumers use the online information. Outreach to community and business leaders can help them make this information available to lower-income consumers.

For more information:

www.pewinternet.org

Invest in Consumer Education, Promote Financial Education

Kentucky has one of the most stringent high school financial education requirements in the nation.[72] Yet it is unclear what impact this requirement is having because school leaders are not held accountable for adhering to the requirement. In fact, state education leaders in the state expressed pessimism that children were receiving a financial education of any kind. Clearly, more accountability is needed to ensure that every high school junior is as familiar with the idea of a credit score as he or she is with an ACT or SAT score.

Kentucky's public and private leaders should build on these investments by a) evaluating the gaps in financial education delivery in their jurisdictions; b) determining the best practices that can be used to fill those gaps; and c) establishing a method for tracking the impact of investments in financial education. Together, these three steps can provide a foundation for lower-income consumers to make more responsible decisions.

For more information:

www.chicagofed.org/cedric/financial_education_research_center.cfm

Appendix. Survey Responses, by Household Income

	Household Income				
	Less than $20,000	$20,000 – $39,999	$40,000– $59,999	$60,000– $79,999	$80,000 or more
Homeownership and Home Loans					
Proportion of respondents who own a house	46%	55%	85%	89%	89%
Proportion of homeowners who have an outstanding mortgage	38%	49%	57%	76%	79%
Proportion of mortgage borrowers who have refinanced	33%	33%	35%	51%	46%
Proportion of mortgage borrowers who chose a loan company by…					
…using the Internet to do research	9%	8%	11%	19%	26%
…using the Internet to obtain quotes from companies	5%	7%	10%	20%	18%
…getting a referral from a trusted source	59%	55%	69%	42%	68%
…using advertisements from companies	11%	13%	19%	20%	16%
…obtaining quotes from companies using means other than the Internet	14%	30%	49%	43%	49%
Proportion of mortgage borrowers who have missed a payment	19%	17%	5%	4%	0%
Car Ownership and Car Loans					
Proportion of respondents who own a car	72%	88%	99%	98%	93%
Proportion of car owners who chose a dealer by…					
…using the Internet to do research	11%	14%	31%	36%	47%
…getting a referral from a trusted source	55%	60%	56%	47%	50%
…using advertisements from car dealers	24%	28%	38%	20%	44%
…using the dealer located closest to them	50%	38%	49%	39%	31%
Proportion of car owners who obtained multiple quotes before purchasing	58%	60%	72%	65%	71%
Proportion of car owners with an outstanding auto loan	17%	19%	37%	49%	57%
Proportion of auto loan borrowers who chose their loan company by…					
…using the Internet to do research	4%	9%	27%	25%	20%
…using the Internet to obtain quotes from companies	24%	11%	25%	19%	30%
…getting a referral from a trusted source	86%	51%	56%	37%	50%
…using advertisements from companies	29%	21%	39%	11%	22%
…just using the dealer from which car was purchased	78%	71%	93%	64%	47%
Proportion of auto loan borrowers who obtained multiple quotes before taking out a loan	55%	44%	40%	37%	48%
Proportion of car owners who have auto insurance	93%	98%	100%	100%	100%
Proportion of insured car owners who chose their insurance company by…					
…using the Internet to do research	12%	12%	19%	19%	29%
…using the Internet to obtain quotes from companies	14%	19%	25%	22%	33%
…getting a referral from a trusted source	60%	64%	61%	56%	60%
…obtaining quotes from companies using means other than the Internet	61%	59%	60%	59%	61%

Appendix. Survey Responses, by Household Income (continued)

	Household Income				
	Less than $20,000	$20,000 – $39,999	$40,000– $59,999	$60,000– $79,999	$80,000 or more
Basic Financial Services and Assets					
Proportion of respondents who have a checking account	72%	88%	94%	99%	100%
Proportion of checking account holders who pay a monthly maintenance fee	27%	17%	10%	16%	10%
Proportion of of checking account holders who receive their paycheck via direct deposit	25%	50%	64%	78%	74%
Proportion of checking account holders who have overdrawn their account	43%	52%	42%	41%	45%
Proportion of respondents who do not have a checking account because…					
…there are no banks or credit unions located near their homes	1%	5%	0%	0%	n.a.
…they are not eligible due to a poor banking history	2%	14%	16%	0%	n.a.
…they do not feel welcome at banks and credit unions	2%	2%	11%	0%	n.a.
…they have never considered opening an account before	12%	26%	34%	0%	n.a.
…there is too much paperwork required	10%	12%	11%	0%	n.a.
…they don't trust banks or credit unions	30%	11%	20%	0%	n.a.
…of some other reason	42%	30%	8%	100%	n.a.
Proportion of respondents who have savings or investments, excluding houses	22%	62%	77%	96%	97%
Proportion of respondents who have a savings account	67%	80%	78%	87%	90%
Proportion of respondents who own one or more credit cards	34%	60%	76%	89%	91%
Proportion of credit card holders who have been late on a payment	40%	32%	31%	33%	38%
Proportion of respondents who have used a check-cashing business	20%	10%	9%	5%	5%
Proportion of respondents who have used an alternative short-term loan business	21%	8%	8%	1%	3%
Proportion of alternative short-term loan users who regularly frequent these businesses	18%	0%	16%	0%	14%
Tax Services					
Proportion of respondents who used a paid tax preparer last year	29%	53%	48%	54%	56%
Proportion of paid tax preparer users who claimed a refund anticipation loan (RAL)	33%	17%	19%	6%	6%
Proportion of paid tax preparer users who used this service primarily to claim a RAL	84%	80%	78%	61%	82%
Proportion of paid tax preparer users who used this service because…					
…they did not understand how to fill out tax forms	43%	48%	36%	33%	39%
…they did not want to take the time to fill out tax forms	36%	37%	48%	61%	58%
…it was the only way to claim a RAL	21%	16%	16%	6%	3%

Appendix. Survey Responses, by Household Income (continued)

	Household Income				
	Less than $20,000	$20,000 – $39,999	$40,000– $59,999	$60,000– $79,999	$80,000 or more
Financial Literacy and Awareness					
Proportion of respondents who have regular Internet access	36%	66%	83%	91%	98%
Proportion of respondents who have seen their credit report	35%	58%	75%	78%	82%
Proportion of respondents who have seen their credit report and…					
…found mistakes in it	42%	30%	39%	49%	44%
…found mistakes in it and were able to get them corrected	51%	63%	74%	87%	76%
…found mistakes in it as a result of their identity being stolen	31%	20%	11%	8%	13%
Proportion of respondents who found mistakes and...					
…found mistakes 100% of the time	22%	20%	7%	11%	18%
…found mistakes 50–99% of the time	27%	20%	22%	25%	10%
…found mistakes 25–49% of the time	7%	10%	7%	11%	12%
…found mistakes less than 25% of the time	44%	50%	64%	53%	61%
Proportion of respondents who think that one's credit history can influence…					
…eligibility for a loan	71%	89%	91%	94%	94%
…the interest rate charged on a loan	74%	86%	91%	94%	92%
…eligibility for Social Security benefits	13%	13%	15%	10%	13%
…insurance coverage or premiums	45%	59%	71%	69%	71%
…eligibility for employment	48%	44%	62%	67%	65%
…eligibility to obtain a driver's license	8%	4%	3%	5%	9%
…eligibility to rent a home	60%	75%	85%	83%	84%
Proportion of respondents who know that they can view their credit report for free once annually	55%	69%	74%	81%	83%
Proportion of respondents who know where to obtain a free copy of their credit report	37%	51%	65%	69%	67%
Proportion of respondents who regularly use grocery store coupons	52%	48%	53%	50%	39%
Proportion of respondents who think they would benefit from a free class about price comparison for basic necessities	48%	53%	51%	34%	38%
Average amount respondents would be willing to pay for such a class	$35	$18	$33	$27	$40
Proportion of respondents who would like to see the state fund financial education classes in public schools	88%	91%	93%	90%	86%

Source: Authors' analysis of a statewide survey commissioned by The Brookings Institution, and administered by the University of Kentucky's Survey Research Center

Endnotes

1. This differs from IRS reports because IRS data is based on filers and our survey is based on households (a different universe). Also, the IRS measure of low-income filers includes all those who earn less than the maximum income threshold for Earned Income Tax Credit benefits, which is nearly twice the income level used in our measure of low-income. Annual information about EITC usage around the country can be found at: **http://webapps.brookings.edu/EITC/**.

2. Governor's Summit on Quality of Life in the Commonwealth, cosponsored by the governor's office, the Kentucky Cabinet for Families and Children, National Governors Association, the Kentucky Community and Technical College System, and the Ford Foundation, October 17, 2002.

3. Based on an analysis of three-year averages from the Census Bureau's American Community Survey.

4. This section of the report is adapted from Matt Fellowes, *From Poverty, Opportunity: Putting the Market to Work for Lower-income Families* (Washington: Brookings Institution, 2006).

5. See, for example, David Caplovitz, *The Poor Pay More* (New York: Free Press, 1967).

6. U.S. Census Bureau, Administrative and Customer Services Division, Statistical Compedia Branch, U.S. Department of Commerce, Bureau of Economic Analysis.

7. See Matt Fellowes, "Grounds for Competition: The Basic Financial Service Infrastructure in Lower-Income Neighborhoods." Presented at the 2006 Louis L. Redding Public Policy Forum, University of Delaware, 2006, available at **http://www.brookings.edu/metro/speeches/20060317_financialserv.htm** (April 2006).

8. More on this time trend can be found in Matt Fellowes. 2007. "Making Markets An Asset for the Poor." Harvard Law and Policy Review. 1(2); and Brian Grow. May 11, 2007. "The New Poverty Economy." *BusinessWeek*.

9. Authors' analysis of the 2004 Survey of Consumer Expenditures.

10. Because of limits on data availability, we do not examine the other parts of a typical family's budget, including utilities, health care, or entertainment.

11. The remainder of this section is adapted from Fellowes, *From Poverty, Opportunity.*

12. Credit cards and debit cards are two other financial service products often thought of as "basic," but no data are available to compare prices for these products.

13. For more information about this survey, see Brian K. Bucks, Arthur B. Kennickell, and Kevin B. Moore, "Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances," *Federal Reserve Bulletin* 92 (February 2006): A1-A38.

14. There may be other types of higher auto-related costs, such as the cost of gasoline and the cost of maintaining a car. Gas may cost more in lower-income neighborhoods because of the higher costs of security and because stations are more likely to be located in urban neighborhoods. Maintaining a car may be more expensive because lower-income households are much more likely to drive a used car than higher-income households. Unfortunately, we were unable to find data on these costs.

15. 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?" Working Paper 8668 (Cambridge, MA: National Bureau of Economic Research, 2001). Also see Ian Ayers and Peter Siegelman, "Race and Gender Discrimination in Bargaining for a New Car," American Economic Review 85 (1995): 304-21; David W. Harless and George Hoffer, "Do Women Pay More for New Vehicles? Evidence from Transportation Price Data," *American Economic Review* 92 (2002): 270–279.

16. For more information about direct, indirect, and total effects, see Rex Kline, *Principles and Practice of Structural Equation Modeling* (New York: Guilford Press, 1998).

17. The SCF is the only resource of which we are aware that assesses how prices for auto loans vary by household income. However, for a local market assessment see Anne Kim, "Taken for a Ride: Subprime Lenders, Automobility, and the Working Poor" (Washington: Progressive Policy Institute, 2002).

18. According to the Insurance Information Institute, Allstate has about 10 percent of the auto insurance market, Progressive has about 7 percent, and Geico has about a 6 percent market share. See **http://www.iii.org/media/facts/statsbyissue/auto/** (accessed April 2006). We chose the minimum insurance amount because we wanted as conservative an estimate as possible. A downside, however, is that these estimates should not be compared across the metropolitan areas in our analysis given that we consider a different amount of insurance across each of these areas. For a comparable assessment of average prices, see publications by the National Association of Insurance Commissioners or data available from the Insurance Information Institute (**www.iii.com**).

19. This methodology is derived from a series of studies that have analyzed price variance across ZIP codes. See, for example, Scott E. Harrington and Greg Niehaus, "Race, Redlining, and Automobile Insurance Prices," *Journal of Business* 71(3) (1998): 439-469; R. Klein, "Urban Homeowners Insurance Markets: Problems and Possible Solutions." Working Paper (Washington, DC: National Association of Insurance Commissioners, 1995); Missouri Department of Insurance, "Affordability and Availability of Personal Lines Insurance in Underserved Communities" (St. Joseph: 2004).

20. The Washington Office of the Insurance Commissioner, Texas Department of Insurance, the Michigan Office of Financial and Insurance Services, and the Missouri Department of Insurance have all undertaken analyses to estimate the relationship between credit scores and driver income. A forthcoming Federal Trade Commission analysis promises to be generalizable to other states.

21. See, for example, Albert B. Crenshaw and Caroline E. Mayer, "Geico's Risk Criteria Challenged: Insurer Denies That Education and Occupation Are Used to Discriminate," *Washington Post*, p. D01, March 21, 2006.

22. But see evidence of systematic differences in tax assessments: Matt Fellowes and Bruce Katz, *The Price Is Wrong: Getting the Market Right for Philadelphia's Working Families* (Washington: Brookings Institution, 2005).

23. Robert B. Avery, Glenn Canner, and Robert E. Cook, "New Information Reported Under HMDA and Its Application in Fair Lending Enforcement," *Federal Reserve Bulletin* (Summer 2005).

24. For more information about this comparison, see Keith S. Ernst and Deborah N. Goldstein, "Comment on Federal Reserve Analysis of Home Mortgage Disclosure Act Data." CRL Comment #1 (Durham: Center for Responsible Lending, 2005).

25. James M. Lacko, Signe-Mary McKernan, and Monoj Hastak,"Survey of Rent-to-Own Customers" Bureau of Economics Staff Report (Washington: Federal Trade Commission, 2000).

26. For other examples of grocery baskets used in this line of research see Lashawan Richburg Hayes, "Do the Poor Pay More? An Empirical Investigation of Price Dispersion in Food Retailing." Industrial Relations Section Working Paper no. 446 (Princeton, NJ: Princeton University, 2000); Phillip R. Kaufman, James M. MacDonald, Steven M. Lutz, and David M. Smallwood, "Do the Poor Pay More for Food? Item Selection and Price Differences Affect Lower-income Household Food Costs." Agriculture Economic Report no. 759 (Washington: U.S. Department of Agriculture, Economic Research Service, 1997); Trinity Center for Neighborhoods, "Food Pricing in Hartford, Connecticut: Supplement to the Self Sufficiency Study" (Hartford: 2002).

27. Evidence suggests that smaller stores charge higher prices than larger stores. Because lower-income neighborhoods generally have much less access to larger stores than higher-income neighborhoods, we can infer that food is, on average, more expensive in lower-income neighborhoods. For evidence of the relationship between store size and price see Phillip R. Kaufman and Charles R. Handy, "Supermarket Prices and Price Differences: City, Firm, and Store-Level Determinants." Technical Bulletin Number 1776 (Washington: U.S. Department of Agriculture, Economic Research Service, 1989); Howard Kunreuther, "Why the Poor Pay More for Food: Theoretical and Empirical Evidence," *Journal of Business* 46 (1973): 368–383.

28. University of Kentucky, Survey Research Center, **http://www.survey.rgs.uky.edu**, (859)323-4684.

29. Assuming a charge of 5 percent for a payroll check, a family in Lexington with a net income of $30,000 a year earned from one salaried worker can pay up to $1,500 to cash checks from a private company. If they also occasionally took out a payday loan or a pawnshop loan, in addition to paying for a tax preparation service and refund anticipation loan, this family would pay at least $2,000 in fees.

30. We jointly analyze these companies because an increasing number of establishments that provide one service also sell other services. For evidence of this market trend, see Patrick Bolton and Howard Rosenthal, editors, *Credit Markets for the Poor* (New York: Russell Sage Foundation, 2005). Also see Sheila Bair, "Low Cost Payday Loans: The Opportunities, the Obstacles." (New York: Annie E. Casey Foundation, 2005).

31. Jane J. Kim, "Banks Sweeten Promotions for New Checking Customers; Rates Creating Profit Pressures—Bounced-Check Fees, Other Penalties Rising" *Wall Street Journal.* April 2, 2006.

32. For more information see Center for Financial Services Innovation, **www.cfsi.org** (February 2007).

33. Authors' analysis of Kentucky Office of Financial Institutions data. Data do not include Internet-based short-term loan providers that Kentucky consumers can access in addition to those licensed in Kentucky.

34. Katy Jacob, "Highlights from the Inaugural Underbanked Financial Services Forum" (Chicago: Center for Financial Service Innovation, 2006).

35. John P. Caskey, "Fringe Banking and the Rise of Payday Lending." In Patrick Bolton and Howard Rosenthal, eds., *Credit Markets for the Poor* (New York: Russell Sage Foundation, 2005).

36. Late payments on a credit card can also exceed the APR charged by these alternative short-term loan companies.

37. This differs from IRS reports because IRS data is based on filers and our survey is based on households (a different population universe). Also, the IRS measure of low-income filers includes all those who earn less than the maximum income threshold for Earned Income Tax Credit benefits, which is nearly twice as high as our measure.

38. This is among the population of Kentucky households that use a paid provider.

39. Alan Berube, Anne Kim, Benjamin Forman, and Megan Burns, "The Price of Paying Taxes: How Tax Preparation and Refund Loan Fees Erode the Benefits of the EITC" (Washington: Brookings Institution, 2002).

40. We jointly analyze these companies because an increasing number of establishments that sell one service also sell the other service. See Bolton and Rosenthal, *Credit Markets for the Poor.*

41. Matt Fellowes and Mia Mabanta. 2007. "Borrowing to Get Ahead, and Behind: The Credit Boom and Bust in Lower-Income Markets." Washington, DC: The Brookings Institution.

42. For instance, in the appendix we report that while lower-income homeowners in Kentucky are much more likely than higher-income homeowners to fall behind on mortgage payments, lower-income households with credit cards are about as likely as all other households to miss payments. Also, we find that the propensity to overdraw accounts is about the same across income groups. There is some selection bias limiting inferences from these results—i.e., the 25 percent of unbanked lower-income households are probably systematically different, as a group, than the 75 percent that are banked.

43. This section of the report is largely adapted from Fellowes, *From Poverty, Opportunity*.

44. Scott Morton, Zettelmeyer, and Silva-Risso, "Consumer Information and Price Discrimination." See also Ayers and Siegelman, "Race and Gender Discrimination in Bargaining for a New Car," and Harless and Hoffer, "Do Women Pay More for New Vehicles?"

45. See, for example, Crenshaw and Mayer, "Geico's Risk Criteria Challenged."

46. Fellowes and Mabanta, "Borrowing to Get Ahead, and Behind: The Credit Boom and Bust in Lower-Income Markets."

47. Ayers and Siegelman, "Race and Gender Discrimination in Bargaining for a New Car."

48. Bureau of Transportation Statistics, Transportation Statistics Annual Report (Washington: U.S. Department of Transportation, Research and Innovative Technology Administration, Bureau of Transportation Statistics, 2005).

49. These loans are defined by the Federal Reserve Board as 3 percentage points above comparable Treasury notes for first liens and 5 percentage points above for junior liens. In using this definition, the board estimated they would capture more than 95 percent of the subprime market. For more information, see Robert B. Avery, Glenn Canner, and Robert E. Cook, "New Information Reported Under HMDA and Its Application in Fair Lending Enforcement," *Federal Reserve Bulletin* (Summer 2005). Note, however, that recent comparisons of private-sector data with these public data suggest that the Federal Reserve's definition of "high cost" mortgages misses a large proportion of this market. For more information about this comparison see Ernst and Goldstein, "Comment on Federal Reserve Analysis."

50. What is considered "typical" was assessed using supplemental information from the SCF.

51. See, for example, Crenshaw and Mayer, "Geico's Risk Criteria Challenged"; Matt Fellowes, "Credit Scores, Reports, and Getting Ahead in America"; Washington Office of the Insurance Commissioner, "Washington Insurance Underwriting and Pricing." Submitted to the state legislature, December 2003.

52. Lacko, McKernan, and Hastak, "Survey of Rent-to-Own Customers." But see Association of Progressive Rental Organizations (**www.rtohq.org**) for an industry perspective on its customer base.

53. State of Maryland, Office of the Attorney General, "Rent-to-Own: Worth the Convenience?" (Baltimore: 2003), at **www.oag.state.md.us/consumer/edge109.htm** (April 2007).

54. According to one recent survey, the average credit card APR was 12.6 percent in 2004 across 146 different credit card products. For more information, see San Francisco Consumer Action. "2005 Credit Card Survey" (San Francisco, 2005).

55. State of Wisconsin, Department of Financial Institutions, "Rent to Own, (Madison, no date), available at **www.wdfi.org/wca/consumer_credit/credit_guides/rent-to-own.htm** (April 2006).

56. Fellowes, "Credit Scores, Reports, and Getting Ahead in America."

57. Howard Lax, Michael Manti, Paul Raca, and Peter Zorn. "Subprime Lending: An Investigation of Economic Efficiency," *Housing Policy Debate* 15 (3) (2004): 531–571.

58. Harriet Johnson Brackey," Insurers, State Duel Over Role of Credit Scores in Auto and Home Insurance Rates," *South Florida Sun-Sentinel*, July 13, 2006.

59. Austan Goolsbee and Jeffrey Brown, "Does the Internet Make Markets More Competitive? Evidence from the Life Insurance Industry," *Journal of Political Economy*, 110 (2002): 3.

60. Fellowes, "From Poverty, Opportunity: Putting the Market to Work for Lower Income Families."

61. To view these studies, see **www.socialcompact.org**

62. Robert Berner, "Wal-Mart's Urban Renewal." *BusinessWeek*, April 4, 2006.

63. LISC has a number of interesting resources on grocery store development in urban areas, including successful examples from around the country at **http://www.lisc.org/content/article/detail/2857**

64. Clint Riley, "New York Uses Banks to Kick-Start Renewal," *Wall Street Journal*, March 21, 2006.

65. For an excellent assessment of recent efforts by banks and credit unions to compete with high-priced, short-term loan providers, see Bair, "Low Cost Payday Loans."

66. The auto insurance quotes from California presented in the results section of this report were open-market quotes, and do not reflect the substantial cost savings available through this program.

67. New York's Department of Insurance, Consumer Shopping Guide for Homeowners and Tenants Insurance (Albany: 2002).

68. Lax, Manti, Raca, and Zorn, "Subprime Lending."

69. See the Washington Office of the Insurance Commissioner, "Washington Insurance Underwriting and Pricing."

70. For an excellent review of these bills, and the effect that they have had on the market, see Wei Li and Keith S. Ernst, "The Best Value in the Subprime Market: State Predatory Lending Reforms" (Washington: Center for Responsible Lending, 2006).

71. Authors' analysis of statewide survey commissioned for this report.

72. National Council on Economic Education, "Survey of the States: Economic and Personal Finance Education in Our Nation's Schools in 2004" (Washington: 2005).

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The Metropolitan Policy Program was launched in 1996 to provide decision makers cutting-edge research and policy analysis on the shifting realities of cities and metropolitan areas.

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