Executive Summary

Public and private leaders have a substantial, and widely overlooked, opportunity today to help lower income families get ahead by bringing down the inflated prices they pay for basic necessities, such as food and housing.

In general, lower income families tend to pay more for the exact same consumer product than families with higher incomes. For instance, 4.2 million lower income homeowners that earn less than $30,000 a year pay higher than average prices for their mortgages. About 4.5 million lower income households pay higher than average prices for auto loans. At least 1.6 million lower income adults pay excessive fees for furniture, appliances, and electronics. And, countless more pay high prices for other necessities, such as basic financial services, groceries, and insurance. Together, these extra costs add up to hundreds, sometimes thousands, of dollars unnecessarily spent by lower income families every year.

Reducing the costs of living for lower income families by just one percent would add up to over $6.5 billion in new spending power for these families. This would enable lower and modest-income families to save for, and invest in, income growing assets, like homes and retirement savings, or to pay for critical expenses for their children, like education and health care.

The policies needed to capture these savings for families will require few taxpayer dollars and true public-private partnership. Together, government, nonprofit, and business leaders can pursue a number of market and regulatory initiatives to bring down the cost of living for lower income families. And unlike most traditional anti-poverty initiatives, limited (strategic) public investments can match or seed innovative market solutions.

This report, analyzing both national data and data from 12 major metropolitan areas across the country, is about this opportunity to put the market to work for lower income families. The report makes the following conclusions:

1. Lower income families tend to pay higher than average prices for a wide array of basic household necessities—often for the exact same items—than higher income households. Depending on where lower income consumers live, and what combinations of necessities are consumed, they can pay up to thousands of dollars more every year for a full range of basic household goods, from financial services to housing to car purchases. For instance:

- ***Check Cashing and Short-Term Loans:*** Lower income consumers are much more likely than higher income consumers to pay high prices to cash checks and take out short-term loans. Most customers of check-cashing businesses earn annual incomes of less than $30,000. To cash a $500 check in one of these businesses, customers would pay an additional $5 to $50 in the selected 12 metro areas. Among the 50 states, the check cashing fee ranges between 1 percent of the face value of a check in West Virginia to no limit (in 19 states).

  Similarly, about 81 percent of the customers that buy high-priced payday loans earn less than $50,000 a year. The fees for short-term loans range from zero (because the industry is banned in some states) to more than 15 percent of a loan's value in Colorado, Delaware, South Dakota, and other states.

- ***Tax Refund Services:*** Lower income consumers are more likely than higher income consumers to pay high fees to get their tax returns quickly. In 2003, lower income tax filers were just as likely as all others to use professional tax preparation services (approximately 60 percent). But, lower income tax filers are nearly three times more likely than higher income households to buy refund anticipation loans. These advance payments on tax refunds are accompanied by interest rates between 70 percent to more than 1,800 percent.
- ***Remittance Services:*** Lower income consumers are likely to pay fees to wire funds to foreign countries, fees less likely to be incurred by high-income households. About 80 percent of remittance clients sending money to Latin America earn an annual income of less than $30,000. To send $200 every other week to Mexico for one year, a customer would be assessed an additional $320 in fees, on average.
- ***Car Prices:*** Nationwide, consumers from lower income neighborhoods pay between $50 and $500 more, on average, to buy the exact same car as a consumer from a higher income neighborhood.
- ***Car Loans:*** Nationwide, 4.5 million lower income consumers pay, on average, two percentage points more in interest for an auto loan than the average, higher income consumer. In 2004, auto-loan customers earning less than $30,000 a year paid an average APR of 9.2 percent for their loan, while the average APR for customers earning $60,000 to $90,000 was 7.2 percent.
- ***Car Insurance:*** Drivers from lower income neighborhoods in the 12 sample metropolitan areas pay between $50 to over $1,000 more per year in higher premiums for auto insurance than those living in higher income neighborhoods. In New York, Hartford, and Baltimore, drivers living in lower income neighborhoods paid $400 more, on average, for 12 months of auto insurance to insure the exact same car and driver risk as those in higher income neighborhoods.
- ***Home Loans:*** Nationwide, 4.2 million lower income homeowners pay, on average, a percentage point more than higher income households in interest for their mortgage. In 2004, the average APR on a first mortgage for lower income households was about 6.9 percent. By contrast, households earning between $60,000 and $90,000 paid an average rate of about 6.0 percent.
- ***Home Insurance:*** Holding other factors constant, homeowners in lower income neighborhoods can pay as much as $300 more for home insurance than those in higher income neighborhoods. For instance, in Chicago, the average quote for a year of home insurance in the city's lowest income neighborhoods was about $1,043, while the quote for households living in neighborhoods with a median income between $30,000 and $60,000, was approximately $755.
- ***Furniture, Appliances, and Electronics:*** Lower income consumers tend to pay more for furniture and appliances because they are much more likely than higher income households to shop at high-priced rent-to-own establishments. Nearly 60 percent of rent-to-own customers earn less than $25,000 a year. In Wisconsin, it is estimated that a $200 television might cost as much as $700 at one of the rent-to-own businesses in the state, after interest.
- ***Grocery Prices:*** Grocery stores in lower income neighborhoods tend to be smaller and more expensive than in higher

income neighborhoods. The average grocery store in our sample of 2,384 lower income neighborhoods is 2.5 times smaller than the average grocery store in a higher income neighborhood. Also, there is about one mid- or large-sized grocer for every 69,055 residents in lower income neighborhoods, half the availability found in other neighborhoods. Access to only small grocery stores results in higher food prices for lower income shoppers. In particular, over 67 percent of the same food products in our sample of 132 different products are more expensive in small grocery stores than in larger grocery stores.

2. A combination of real and perceived market risks, market abuses, and uneven consumer access to market information contribute to these additional costs incurred by lower income consumers.

There a number of market realities and market failures that help drive the costs of consumer products for lower income households.

- ***Companies—from banks to insurance companies— face both real and perceived higher costs of doing business with lower income consumers.*** Lower income borrowers are much more likely than higher income borrowers to fall behind on their payments, declare bankruptcy, and have low credit scores. Within a metropolitan area, they are also more likely to live in urban areas, where car or home insurance is more expensive. Given these risks, businesses will rationally pass on those risks in the form of higher costs to lower income consumers. Importantly, the existence of these higher costs will also drive perceptions of higher costs, even when there may not be data available to support or properly measure perceived risks. This also drives up prices.
- ***The dense concentration of businesses that sell high-priced products and services in lower income neighborhoods can serve to limit the choices of poorer consumers.*** Today, over 23 percent of lower income households do not have a checking account, and another 64 percent do not have a savings account. Certainly, these millions of lower income consumers represent an unmet market demand. However, if the businesses that fill that void are primarily those that that tend to charge high fees or interest rates, then lower income consumers are not being exposed to a broader array of mainstream, competitively-priced products.

    For instance, nearly all of the high-priced, basic financial service companies—alternative check cashers and short-term loan providers, tax preparation firms, and wiring companies—tend to be much more densely concentrated in lower income neighborhoods than higher income neighborhoods. The number of check cashers and short-term loan providers, in particular, is twice as dense in lower income neighborhoods as they are in other neighborhoods. That relative density—with twice as many businesses per capita—in lower income neighborhoods than other neighborhoods is true for remittance services and rent-to-own establishments.
- ***Unscrupulous business practices drive up prices in lower income markets.*** For instance, research on mortgage pricing suggests that between 14 and 20 percent of all borrowers who purchased a high-cost mortgage could have qualified for a better priced mortgage product. Even for those who cannot qualify for prime loans often face unnecessary additional features on mortgage products, such as long-term prepayment penalties and broad insurance plans, all contributing to the higher price. In other cases, the market abuses arise from lax regulatory protections that enable companies to charge APRs of over 400 percent for check-cashing services, short-term loans, and refund anticipation loans in some states.
- ***Finally, lower income consumers lack access to good market information about many goods and services.*** Lower income consumers are generally much less likely than other consumers to compare prices before buying goods and services, making them more susceptible to bad deals. Similarly, they are less likely to

have access to the Internet and its price-comparison tools. Further, studies also show that the lower a consumer's income, the less financial knowledge he or she is likely to have. This would result in limited knowledge about basic financial management, the use and management of credit scores, and the differences in values among key products, such as a checking account versus relying on check cashers. Finally, language barriers, along with cultural obstacles, can steer lower income families toward high-priced financial services.

3. Public and private leaders can reduce the cost of living for lower income consumers by reducing both real and perceived market risks in doing business with such consumers, curbing market abuses that inflate prices, and investing in making lower income consumers the savviest shoppers in the marketplace.

Reducing the additional costs that lower income families pay for standard household goods and services is a powerful and widely underutilized opportunity to help families get ahead. To seize that opportunity, leaders need to connect the competitive, mainstream economy to lower income consumers. There are a number of existing models and emerging initiatives from around the country that federal, state, and local leaders can replicate.

In general, public and private leaders need to embrace three types of reforms:

- ***Public and private leaders need to encourage mainstream businesses to serve lower income markets, where there remains great demand for services and products.*** In concert with community outreach efforts to dispel myths and misperceptions, political and community leaders need to engage the business community to take down the roadblocks to entry into lower income markets. In some cases, businesses have failed to recognize this market opportunity. In other cases, the market opportunity is stunted by real, higher costs of doing business in lower income neighborhoods. To address the particular opportunities that exist in their communities, leaders need to be fact-driven and entrepreneurial. Businesses will respond to profitable opportunities. Already, innovations are underway to encourage businesses to reach out to lower income consumers and produce new low-cost products and services, and in turn, to encourage lower income consumers to turn to mainstream business products.
- ***Public and private leaders need to crack down on alternative, high-priced businesses that have blossomed in lower income neighborhoods.*** At the local level, leaders can use their licensing and zoning authority to curb the development of these businesses in lower income neighborhoods. At the state and federal level, leaders need to enact regulations that limit the fees and interest rates charged by fringe businesses, while funding research that addresses questionable business practices. As always, efforts to create lower-cost alternatives, as mentioned above, will also reduce the demand for alternative, high-priced businesses.
- ***Public and private leaders need to promote consumer responsibility and empower lower income consumers with better market information.*** Ultimately, consumers need to take responsibility to make smart bets on getting ahead, which means knowing which companies to buy from, what goods and services to stay away from, and how to manage day-to-day budget demands. But, the growing complexity of the market makes this difficult for everyone. Among the many choices consumers now have, there are hundreds of different mortgage products, often dozens of mortgage and insurance companies to choose from, new breeds of alternative financial service providers, and growing applications of credit reports and scores. There are a number of examples of market innovations that local and state leaders can embrace that create better electronic tools and information to help lower income consumers navigate today's maze of market choices and price variations. ■