9 Economic impact of financial exclusion

Calculating the actual cost of high interest loans in Leeds is fraught with methodological challenges. National data on the extent of use of doorstep lending is extremely limited; invariably based on supposition rather than empirical evidence. Though it is estimated that there are 3 million customers of moneylenders (Rowlingson 1994) it is difficult to locate the statistical support for this assertion.

Consequently there is a reliance on extrapolating from the figures declared by the large moneylenders. For example, the largest doorstep lender in Britain is Provident plc, who claim to have 1.5 million customers. From this it is assumed that they control half the market and therefore there are 3 million customers of moneylenders. Leaving aside the obvious assumptions in this statement, what this does not tell us is the nature of the relationship between the lender and borrower. After all it is likely that many of the customers are dormant or use the service infrequently.

However, the accumulation of this circumstantial evidence does suggest that between 3-6% of the population will at some stage use a doorstep lender (these figures ignore those who use pawnbrokers and similar agencies). This relatively low proportion could in theory create a statistical anomaly, whereby in a normal general population survey of 1000 respondents the 3% margin of error could result in registering minimal use of moneylenders.

To partially address this issue the Leeds survey within this report examined the wards where financial exclusion was most likely to occur. Therefore, any attempt to extrapolate these figures across Leeds has to be treated with great caution.

Thanks to Murphy (2003) it is possible to assert with some confidence the average interest rate charged by Provident plc on their loans. Through a detailed examination of their financial performance Murphy argued that Provident charged an annual percentage rate (APR) of 185% on a typical loan. This figure was subsequently challenged by Provident who conceded that their typical rates were closer to 177% (BBC 2003, see also Provident's website). By comparison a loan from Leeds City Credit Union will be charged at 12.68%, while a community reinvestment trust, such as East Lancs Moneyline, which serve an identical market to the Provident charged a maximum of 29%.

In the market served by doorstep lenders, the rates charged by high street banks and building societies are irrelevant; firstly, because the customer base have been unable or are unwilling to access these providers; and secondly, the loans required, usually below £500, are unavailable. In addition doorstep lenders will correctly highlight the greater financial risks involved in lending in their market and the cost of service. Both of these have resulted in higher interest rates than charged by the banks.

Confirmation of this is found in the 29% maximum charged by the Community Reinvestment Trusts (CRTs). These not-for-profit lenders charge higher rates to offset financial risks and establish a sustainable business model. It is impossible to compare these ‘open market rates’ with that charged by credit unions, as the interest rate of the latter is legally capped at 12.68%. Such a constrained interest rate means credit unions have had to rely on a business model based on volunteer delivery or utilise guarantee funds to serve higher risks markets. Neither these options are sustainable, so a small number of credit unions have begun to lobby for a relaxation in the interest rate cap.

Provident’s interest rate should not be perceived as exceptional; rather they are probably one of the most cost effective doorstep lender in the market. For example, research into moneylenders (Jones 2002) identified rates in excess of 900%. The interest will also be dependent on the size of the loan; with Murphy (2003) estimating the average loan being £486, and Provident stating it is nearer to £100 (BBC 2003). Some of the difference may be due to the number of loans to a client during a year. During our research in Leeds it was found that agents of moneylenders seek to make at least three loans to a customer per year. If this is correct it explains the apparent discrepancy between the size of the loan, particularly as Provident describe £100 loans as the ‘most common’, while Murphy uses a mean average.

Based on the preceding discussion it is possible to broadly estimate the probable upper and lower limits of the impact of using doorstep lenders in Leeds.

Low-end estimate

This assumes that 3% of the population of Leeds use moneylenders and they each borrow £100 at an interest rate of 177%, paying back £5 per week (25 repayments of £5 and one of £3.55).

Based on a population of 715,402 in Leeds, 21,462 people use doorstep lenders, each borrowing £100 at 177% APR. This equates to £28.55 in annual interest per person, or **£612,740** in total.

In contrast if the same customers were to borrow £100 over 26 weeks from Leeds City Credit Union they would pay £4 per week for 25 weeks and a final payment of £3.55. The total interest paid would be £3.11 each, or £66,746.82.

However, if the client was unable to access a credit union loan but could use a community reinvestment trust loan at 29% they would repay the loan after 22 weeks (21 weeks at £5 pw and one at £0.51). The total interest paid would be £5.51 each, or £118,255.62

Consequently the use of doorstep lenders for a high risk borrower instead of a community reinvestment trust is costing the people of Leeds **£494,484.38**

Mid-range estimate

This assumes that 4.5% of population of Leeds use moneylenders and they each borrow £200 at an interest rate of 177% over 48 weeks

Based on a population of 715,402 in Leeds, 32,193 people use doorstep lenders, each borrowing £200 at 177% APR over 48 weeks (£6.48 per week). This equates to £111.52 in annual interest per person, or **£3,590,163.30** in total.

In contrast if the same customers were to borrow £200 over 48 weeks from Leeds City Credit Union (£4.41) they would pay £11.68 each in interest, or £376,014.24
However, if the client was unable to access a credit union loan but could use a community reinvestment trust loan at 29% they would repay £4.69 each week. The total interest paid would be £25.12 each, or £808,688.16

Consequently the use of doorstep lenders for a high risk borrower instead of a community reinvestment trust is costing the people of Leeds **£2,781,475.20**

Top-end estimate
This assumes that 6% of population of Leeds use moneylenders and they each borrow £486 over a year at an interest rate of 177%

Based on a population of 715,402 in Leeds, 35,770 people use doorstep lenders, each borrowing £486 at 177% APR over a year (£14.49 per week). This equates to £285.48 in annual interest per person, or **£12,253,943** in total.

In contrast if the same customers were to borrow £468 over a year from Leeds City Credit Union (£9.56 per week) they would pay £29.12 each in interest, or £1,249,946.80 in total

However, if the client was unable to access a credit union loan but could use a community reinvestment trust loan at 29% they would repay £10.22 per week. The total interest paid would be £63.44 each, or £2,723,098.50

Consequently the use of doorstep lenders for a high risk borrower instead of a community reinvestment trust is costing the people of Leeds **£9,530,845**

This money is lost to the local economy. Moreover, as seen in the survey, the majority of these clients will disproportionately be lone parents, workless households, and residents in disadvantaged areas. It is also interesting to note, by way of comparison, that the whole of the Neighbourhood Renewal Fund for Leeds in 2004/5 is £8.4m.