# ADDRESSING THE USE OF PAYDAY LOANS AMONG HABITAT FAMILIES

PREPARED FOR: HABITAT FOR HUMANITY OF GREATER CHARLOTTESVILLE
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Habitat for Humanity® of Greater Charlottesville

# Table of Contents

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**Disclaimer**

The author conducted this study as part of the program of professional education at the Frank Batten School of Leadership and Public Policy, University of Virginia. This paper is submitted in partial fulfillment of the course requirements for the Master of Public Policy degree. The judgments and conclusions are solely those of the author, and are not necessarily endorsed by the Batten School, by the University of Virginia, or by any other agency.

**Honor Pledge**

On my honor as a student, I have neither given nor received unauthorized aid for this assignment.

O. Owens

# Executive Summary

Predatory lending and payday loans tend to have negative impacts on families and communities across the US (Curry & Neal, 2022). The Pew Charitable Trust found that 12 million Americans take out payday loans each year and spend roughly $9 billion on fees for these loans (The Pew Charitable Trust, 2020). Payday loans are typically unaffordable to those who use them. The average payday loan repayment amount is $430 on the next payday, which amounts to 36% of an average borrower's gross paycheck (The Pew Charitable Trust, 2020); the problem is that most borrowers can only afford no more than 5% while still having to fund their basic expenses (The Pew Charitable Trust, 2020). Habitat for Humanity of Greater Charlottesville has found this problem amongst the families they serve in that there are individuals who have unaffordable debt as a result of payday loan usage. Habitat has the goal of reducing payday loan use among the families they serve, so more families can meet the minimum credit score requirement needed to be considered eligible to receive an affordable home. After an extensive review of the existing literature and considering what Habitat has the resources and capability to do, I consider three alternatives to address the problem of frequent use of payday loans.

1. Maintain the Status Quo
2. Offer Financial Literacy Classes
3. Provide an Alternative Loan Option

After evaluating these three policy options across cost, effectiveness, and administrative feasibility, I recommend that Habitat for Humanity of Greater Charlottesville offer financial literacy classes to its clients. Providing financial literacy for the families they work with will not only reduce their use of payday loans as evident in studies cited in this report, but also provide them with necessary financial knowledge that will help them become more fiscally responsible citizens. To implement this alternative, the Family Services department of the affiliate would need to get funding approved by the CEO, market the classes to the target group of families they intend to help, update their financial literacy curriculum, and check to ensure that the computers, projectors, TVs and the room where the classes will be held are both up to par. All these different steps are estimated to only take roughly 8 days.

# Introduction

**Problem Statement**

Virginia's residents have long since been users of predatory loans. High interest loans serve as a barrier to low-income and African American families on their journey to owning a comfortable place to call home (Lusardi, 2011). With Habitat for Humanity being one of the main suppliers of affordable housing for low-income families in Charlottesville, they have found that many of the families seeking eligibility status to be selected for an affordable home have these debts in their credit reports that severely affect their credit score. These debts come from payday loans that families struggle to pay back due to the high interest rates. With the inability to repay these loans, those seeking eligibility will continue to struggle on their journey to owning their own home. Homeownership helps minimize social burdens along the lines of health outcomes, education achievement, and crime (Yun & Evangelou, 2016). Habitat for Humanity of Greater Charlottesville is interested in figuring out how they can mitigate the effects of predatory lending and more specifically, payday loans amongst their current and future partner families, so more families can experience the benefits of having stable shelter. In this policy analysis, I looked at what a payday loan is, the advantages associated with it, the impacts it has on society, some actions taken in the past and in the current moment to help minimize the problem, and finally, I offer recommendations as to how Habitat for Humanity can use their resources to initiate and influence actions to limit the effects of payday loans among their clients.

**Client Overview**

Habitat for Humanity of Greater Charlottesville exists to bring people together to build and rebuild homes and communities while catalyzing new pathways to safe, decent, affordable housing. Their mission is oriented towards building stable communities through helping families owning their own home. They take on an adaptive approach where they teach potential homeowners effective financial management skills that are necessary and central in owning and maintaining your own home.

# Background

**What is Predatory Lending?**

Ament explains that predatory lending is defined by Housing and Urban Development (HUD) and the Department of Treasury as actions exercised by creditors, brokers, or home improvement contractors that involves deception or fraud, that manipulates the borrower through aggressive sales tactics, or taking advantage of a borrower's ignorance regarding loan terms; these practices make the borrower more vulnerable to abusive practices (Ament, pp.374). Under the body of this literature review, I analyze predatory lending generally while also looking at payday loans as these are more prevalent among those my client serves.

**What are Payday Loans?**

Payday loans are small-dollar, high-cost products that rely on the borrower not being able to repay the loan without reborrowing, thus leading to a cycle of debt (Davis & Lupton, 2018). In simple terms, payday loans are usually a small amount of money borrowed with the agreement that it will be paid back when the borrower receives their next paycheck.[1] Payday loans are typically used for everyday expenses such as groceries, utilities and rent (Pino, 2022). This type of loan has Annual Percentage Rates (APR) of up to 400% for a two week loan (Consumer Financial Protection Bureau, 2020). Figure 1 details the APR for payday loans for each state in the US.

[1] This is typically in the next 15 days, which means that if the borrower cannot repay the loan for a year, that loan would be compounded 365/15 = **24.333** times in one year

**Figure 1. Payday Loan Interest Rates for Each State**

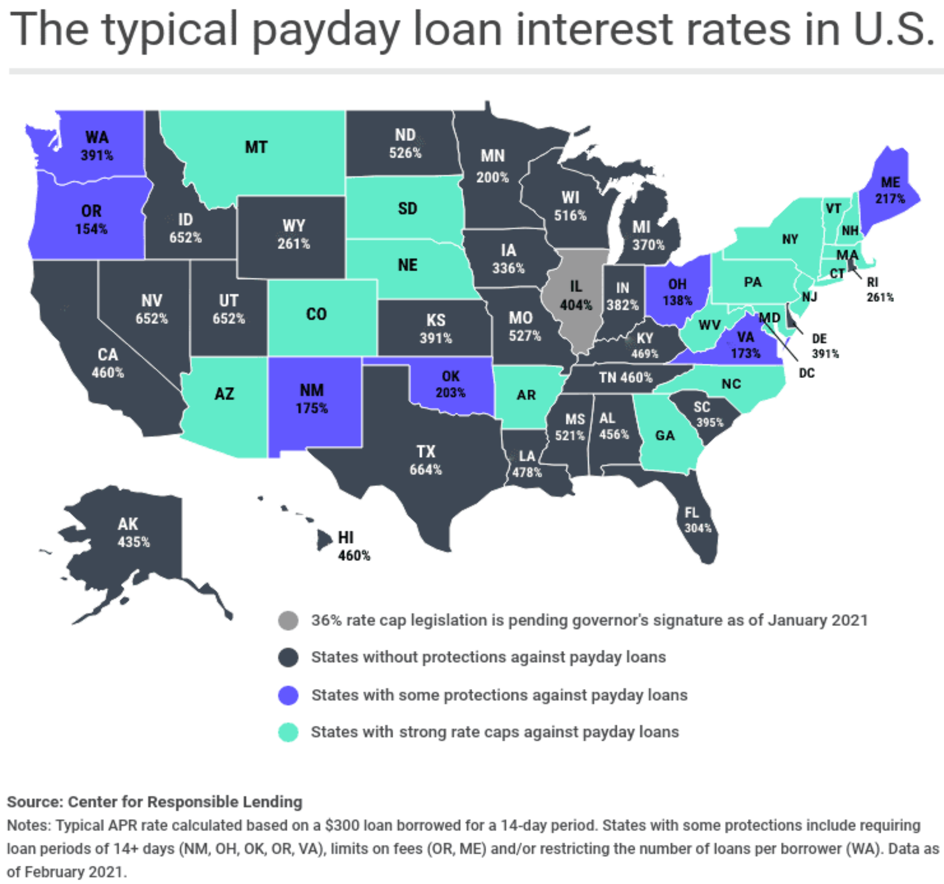



*Image taken from: Leonhardt, 2021*

The important thing about payday loans is that the borrower's ability to repay the loan while meeting other financial obligations is generally not considered by a payday lender (Consumer Financial Bureau Protection, 2022). What happens as a result is that even if the borrower will struggle to repay the loan, which is often the case, the lender will use this as an advantage to have the amount owed to them increase tremendously as the compounding periods are so frequent.

**What are the advantages of Payday Loans?**

Payday loans were designed to provide borrowers with quick and easy access to credit to help cope with short-term costs until they next got paid; this include borrowers with a bad credit (Little Loans, nd). In addition to quick and easy access, payday loans typically have fewer requirements compared to other forms of traditional loans (Little Loans, nd). They provide quick processing which is beneficial to those who find themselves in a tight situation and need to make an urgent payment (Muscroft, 2019). Payday loans also don't limit what you can do with the money received from the loan which provides lots of flexibility for borrowers (Muscroft, 2019). In general, the upside to payday loans is that they provide access to credit for a wide variety of borrowers (those with or without bad credit), with relatively no barriers and restrictions on what borrowers can and cannot do with the credit.

**Why are Payday Loans Widespread?**

It is argued that payday loans and predatory lending in general are made more prevalent due to poor federal regulations. Ament explains that, "many existing federal laws have loopholes-the best of which only force predatory lenders to adapt their tactics-and states' action, for the most part proving equally ineffective, with the vast majority of state statutes simply mirroring unsuccessful federal regulation" (Ament, 2009, pp. 371). There are three major acts passed by the government in recent years with the goal of preventing predatory lenders taking advantage of vulnerable borrowers.[2]

Another cause of predatory loans is understood to be the lack of knowledge and resources provided to people who are the predominant users of these loans. Charron-Chenier agrees by stating that consumers use payday loans because they do not have the financial knowledge or skills necessary to understand their dangers and hence resort to payday loans even when better alternatives are available (Charron-Chenier, 2020). There is already an existing gap as it relates to access to resources in low-income communities when compared to high-income communities (Cunningham, 2018). This disparity still holds for levels of financial literacy that prevent individuals from getting into difficult economic situations (Thomas Mollenkamp, 2022). With only a certain demographic experiencing the negative impacts, one of the biggest risk factors of predatory lending and payday loans is that they may serve as a force situated against progress that aims to eradicate systematic racism.

Without any intervention, disparities in the homeownership gap between Black and White Americans will continue to grow. As for the state of Virginia and specifically for Habitat for Humanity, Jo Olsen (Director of Neighborhood Revitalization) mentioned that the main causes of the prevalence of predatory lending among those that they work with are systematic racism, high concentration of loan offices, lack of knowledge on the borrowers side, and overall discrimination in lending (Personal communication, October 2022).[3] The client explained that through systematic racism, the demographic they serve are forced to unsafe loan options due to not feeling welcomed or treated fairly in the spaces of traditional banking. It was further explained that the clients of my client reported incidents of being ignored by workers in traditional banks which leaves them with little to no reason to trust in these organizations or to feel comfortable using them as their first-choice credit option. As for the high concentration of loan offices, the client explained that in the city of Charlottesville, there are many payday loan locations readily available for residents with many of them concentrated in Black and low-income communities which leads to disproportionate effects among this demographic. For discrimination in lending, it was explained that the city of Charlottesville had a history of being biased and unfair in its lending practices and the predatory lending practices that the residents of the city are currently experiencing are just bi-products of the city's history. Lack of knowledge

[2] The major acts passed by the government are HOEPA, TILA, RESPA
[3] Unless otherwise mentioned, the information in this paragraph comes from this source.

on the borrower's end is not just limited to Charlottesville, but is common in most cases of predatory lending (Charron-Chenier, 2020). Users of predatory loans almost never fully understand the terms and conditions of the loans they take, this can be attributed to the predatory tactics of these loans or limited financial literacy on the borrower's end.

**Impact on Society**

Predatory lending tends to target low-income families who have struggled economically, individuals who don't have access to traditional banking, recent immigrants, and young adults (Bareham, 2023). Payday and car title lenders target minority borrowers with loans that come with ridiculously high interest rates (Lefrak, 2020). In fact the annual average rate for these kinds of loans in 2020 were 251% for payday loans and 217% for title loans (Lefrak, 2020). Though the focus of my analysis is payday loans, it is worth mentioning that approximately 13,000 Virginians had their cars repossessed for inability to repay a car title loan, with car title lenders issuing roughly 120,000 loans totaling more than $137 million ($1,134 average loan) to about 100,000 borrowers (General Attorney Herring, 2022). Specific for payday loans, it was found that over 80,000 Virginians took out approximately 260,000 payday loans that added up to approximately $111 million (General Attorney Herring, 2022). It is argued that predatory lending in the form of payday loans undermines economic security by forcing borrowers to sell necessary assets with approximately 50% of loan recipients defaulting on their loans, placing existing bank accounts at risk (Peterson, 2013). This argument highlights the fact that people are borrowing at higher rates than which they will be able to pay back. With no assets and increasing debt, predatory lending blocks those who use them from the financial security needed to move up the socioeconomic status ladder. In an ideal world, society as a whole would value a reality where they can borrow safely without putting themselves at risk of losing their home, cars, or being in financial debt indefinitely.

**Political Salience of the Problem**

The ongoing prevalence of predatory lending practices and payday loans have garnered interest from state and federal governments. In the state of Virginia in particular, though payday loans are not outright illegal, there are regulations that strive to minimize its effects. The Fairness in lending Act for example, is a bi-partisan legislation passed in 2020 to prohibit loans with large final payments and rationalizes what had been a disparate regulatory structure, governed by a patchwork of laws that allowed payday and auto title loans with unaffordable payments and unnecessarily high costs, and exposed borrowers to financial harm, including repeated borrowing and high rates of vehicle repossession (The Pew Charitable Trust, 2020). Additionally, interest on a payday loan is capped at 36% annually, with lenders only being allowed to charge a monthly maintenance fee of 8% of the principal amount up to a maximum of $25 (General Attorney Herring, 2022). A success model at the state level is that of North Carolina's SB 1149. In 1999, North Carolina became the first state to enact legislation to curb predatory mortgage lending (SB 1149 North, 1999). The North Carolina law has proven its effectiveness in curtailing predatory lending while preserving a robust subprime lending market (SB 1149 North, 1999).

At the federal government level, there are many different laws and regulations that were created in response to the increasing negative effects of predatory lending practices and payday loans. The ones discussed in detail in this report are the Truth in Lending Act (TILA) and the Equal Credit Opportunity Act (ECOA). TILA is a federal law enacted in 1968 to help protect consumers in their dealings with lenders and creditors (Consumer Financial Protection Bureau, 2015). Essentially, it was implemented by the Federal Reserve Board to increase borrowers' awareness and knowledge through transparency and clarity from lenders and creditors (Consumer Financial Protection Bureau, 2015). Years later, ECOA was passed by congress in 1974. This law made it illegal for a lender to impose a higher interest rate or higher fees based on a person's race, color, religion, sex, age, marital status or national origin (Fay, 2012).

Other governmental policies include the Home Ownership and Equity Protection Act (HOEPA) enacted in 1994 as an amendment to the Truth in Lending Act, this was to protect consumers from excessive fees and interest rates. Loans that are considered "high cost" are subject to additional disclosure requirements and restrictions (Fay, 2012). Generally, the political stance on predatory lending and payday loans are that they can have negative impacts on those who don't understand them and there is need for better regulations around them. Research has shown that 70 percent of borrowers believe payday loans should be more regulated (Pew, 2017). This could imply that this issue might be low in salience for politicians or they just haven't invested the required time and effort needed to implement effective and lasting solutions and regulations that are suitable enough for the liking of citizens who use payday loans.

**Evaluating the Effects of TILA**

The agencies that are charged with enforcing TILA are: Consumer Financial Protection Bureau, the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), the Federal Trade Commission (FTC), the Department of Transportation (DOT), the Farm Credit Administration (FCA), and the Agricultural Marketing Service (AMS) of the U.S. Department of Agriculture (USDA). During the year 2016, only the Bureau, FDIC and FRP reported finding institutions that violated TILA. The three of these combined required 34 institutions to reimburse an estimated 57,889 consumers approximately $5.2 million (CFPB, 2019). For the year 2017, these same 3 agencies plus the NCUA required 41 institutions to reimburse an estimated 9,334 consumers approximately $1.5 million (Annual Report on the Truth, 2019). Though the number of institutions required to provide reimbursements increased, the number of consumers reduced significantly. There are not many resources or reports that document any effectiveness or impacts of the TILA other than cited reports. This report shows a decrease in the number of customers who were users of predatory lending, but this is not sufficient evidence to say that there are any casual impacts of the regulation. There is also no way to generalize these findings and hence makes it difficult to conclude if this act was beneficial to the city of Charlottesville and in turn helped decrease the rate at which Habitat families are using payday loans.

**Evaluating the Effects of ECOA**

The 11 agencies with enforcement authority of ECOA are: the Bureau of Consumer Financial Protection (CRPB), the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), the Federal Trade Commission (FTC), the Department of Transportation (DOT), the Farm Credit Administration (FCA), and the Agricultural Marketing Service (AMS) of the U.S. Department of Agriculture (USDA), Securities and Exchange Commission (SEC), and Small Business Administration (SBA) (Fair Lending Report, 2021). The Fair Lending Report of the Bureau of Consumer Financial Protection showed that the number of institutions cited for ECOA violations have decreased over the 6-year period from 2014-2022; these numbers went from 271 in 2014 to 81 in 2020 (Fair Lending Report, 2021). The agencies assigned enforcement authority under section 704 of ECOA must refer a matter to the DOJ when there is reason to believe that a creditor has engaged in a pattern or practice of lending discrimination in violation of ECOA (Fair Lending Report, 2021). The number of referrals made to the DOJ from 2012 to 2020 added up to 122 with 2013 having the highest number of referrals: 24 for the year (Fair Lending Report, 2021). Though the number of violations of ECOA decreased between 2014 and 2020, the number of referrals made to the DOJ fluctuated. There is also no evidence showing the effects this act had on different states and cities, therefore, there is no room for making any causal assumptions, nor can there be a case made for generalizability for the findings these federal agencies discovered in their reports. This is not to say that the ECOA was not effective, it is more about not having enough supporting evidence to determine the reliability of the reform and to determine under what specific circumstances it is effective.

**Evaluating the Effects of Fairness in Lending Act**

It has been argued that the Fairness in lending Act has saved borrowers hundreds of dollars in fees and interest rates with an estimated total of $100 million annually savings (The Pew Charitable Trust, 2020). Before the introduction of the act, a $300 loan over 3 months would have to be paid back with a $222 interest which became only $90 interest after the act; likewise, a $2000 loan over 18 months would have to be paid back with an interest of $7136 which fell to $1068 after the act (The Pew Charitable Trust, 2020). Though the Pew Charitable Trust analysis of this reform might present it as highly effective, there are still families that are being affected by predatory lending behavior in Virginia and Charlottesville specifically. This reform provides enough evidence to show how it addresses small dollar loans and is convincing enough to assume causal impact. The only concern with this reform however is that there is no evidence showing that similar actions can curb the effects of payday loans in particular. The findings were only on the state level which made it difficult to assess how effective the act is in cities or localities with varying demographics. However, it does show promise that if implemented properly, reforms or regulations that intend to address predatory lending in Virginia, can make positive changes.

**Evaluating the Effects of SB 1149 (North Carolina)**

Of all the states that have payday loans, North Carolina ranks third in savings behind New York and Pennsylvania (Center for Responsible Lending, 2018). The success of North

Carolina was chosen for this analysis because of proximity to Virginia and other similarities such as population size and demographics. North Carolina is one of the first states to implement regulations on predatory lending behaviors that have been successful (Center for Responsible Lending, 2017). The state achieved this by preventing predatory terms on 31,500 subprime loans made in North Carolina in 2000, the law is estimated to have saved borrowers more than $100 million in that year (Ernst et al., 2002). North Carolina for the most part has eliminated payday lending altogether and established a 30% interest rate cap and strict interest rates limits for consumer loans (Davis & Lupton, 2018). This cap is very effective in protecting residents, as it saves North Carolina families over $457 million every year in abusive payday and car title lending fees (North Carolina Consumer, 2017). The verified successes of this bill are enough to validate its effectiveness and cause other states and localities to try to mirror some of the systems and regulations that they have in place. There is research showing the effectiveness of the state's actions down to the county level which is granular enough to imply that similar reforms or policies might be effective in Charlottesville or Albemarle county. The main limitation I can foresee with mirroring this regulation is that my client does not have the political power to act on behalf of the city, so the best they could do is to advocate for such a policy. In the meantime, the client is left with looking at how they can address the problem internally, that is, how they can reduce payday loan usage among the families they work with.

**Overview of Possible Alternatives**

Given the scale and scope of Habitat for Humanity, it would be difficult for their organization to influence the problem from the policy level. As a result, the alternatives to be considered are all within the scope of the organization and are directed specifically at the families they work with. The first option to be considered is for Habitat for Humanity to not do anything outside of what they are already doing to address the problem. Maintaining the status quo would mean the client would retain all their resources of time, staff, and finances and wait for the state or another local organization with enough political power to address the problem.

The next option that the client could consider is to offer financial literacy classes to the families they serve. It is explained that partly why so many individuals use payday loans is because they don’t fully understand the terms of the loans that they are getting into because they don’t possess the level of financial literacy to do so (Charron-Chenier, 2020). Lusardi argues that many people do not seem well informed and knowledgeable about their terms of borrowing, with the majority of Americans lacking the basic numeracy and knowledge of economic principles such as the workings of inflation, risk diversification, and the relationship between asset prices and interest rates (Lusardi, 2011). Jo Olsen explained that this idea holds true for the families that Habitat works with, as they often report not knowing that the loans would eventually prove so difficult to pay off. Having this knowledge, the client could offer some form of classes that attempts to increase the levels of financial literacy among their clients.

According to FINRA Investor Education Foundation, financial education, on average, improves financial knowledge and downstream financial behaviors. Their study included interventions that improved financial knowledge, budgeting and savings behavior, with the improvements in financial knowledge of comparable size to those made in educational interventions in math and reading (Kaiser et al., 2022). More specifically, studies show that financial literacy was negatively associated with payday loan use when various household characteristics were controlled, suggesting that financially literate households were less likely to use payday loans (Kim & Lee, 2018).

Another possible avenue of action that Habitat for Humanity could take is to partner with a local microfinance organization to offer safer loan options to its clients as a way to shift their use from risker alternatives. In theory this sounds like it would be a plausible solution, but research shows that despite the availability of safer loan options, those who use payday loans don’t adjust their behavior to make use of the safer loan options (Miller & Soo, 2020).

# Criteria for Evaluation

The evaluative criteria to assess each one of the alternatives are cost, effectiveness, and feasibility, with each criteria being weighted equally. A scale of 1-3 is used for each alternative with a higher number being associated with a more favorable outcome. A more detailed description of each criterion is outlined below:

1. *Cost*: this will look at the dollar value associated with the implementation of each alternative. Using a scale of 1-3, each alternative will start with a baseline score of 3 which represents zero costs and will decrease by 0.1 for every $5000 in cost for that alternative. For example, if an alternative cost $10,000, it would receive a score of 2.8 for cost. The value of $5000 is used to reflect the client's willingness to pay. The client has made it clear that they are not willing to spend more than $100k on any alternative. This makes it such that any alternative that has an associated cost of $100k or more will automatically receive a score of 1 for costs on a scale from 1-3 that decreases by 0.1 for every additional $5000.

2. *Effectiveness*: this will assess to what extent an alternative policy reduces the amount of payday loans that are being taken or used by Habitat's clients. This criterion will also use a scale of 1-3, but will instead have each alternative start at a baseline score of 1 which represents zero reduction. For every percent decrease in payday loan usage, the score of each alternative will increase by 0.1. To get a score of 3, an alternative would have to result in a 20% reduction in payday loan use. I used the 20% cut-off to indicate success as the estimates found in Kim and Lee's 2018 study, and Lusardi and de Bassa Scheresberg 2013 study both found a reduction of 22% and 20% respectively in high-cost borrowing or payday loans due to increased financial literacy. For an alternative to be implemented at a smaller scale, it would be a little presumptuous to expect bigger reductions than the ones found in the cited studies.

3. *Administrative feasibility*: this will look into how likely it is that the client will be able to implement this alternative by looking at how many staff members it will require to execute the alternative. This criterion also uses a scale of 1-3. Each alternative will be given a baseline score of 3 which represents zero staff members required and will reduce by 0.25 for each additional staff member required to carry out the alternative. The reduction of 0.25 is due to the fact that there are 8 staff members in the department that would be responsible for implementing any chosen alternative. Any alternative that requires 8 or more staff members would get a score of 1.

# Evaluation of Alternatives

**Option 1: Status quo**

From conversations with Jo Olsen, it was discussed that Habitat has found that many of the families whom they have worked with in the past have had very complicated financial situations due to the terms of the loans that they have (Personal communication, October 2022).[4] The client realizes that unaffordable debt is affecting the chances of low-income families owning a home. Habitat for Humanity currently provides financial coaching for families who are eligible and are being considered to receive a home. This resource is not openly available to all the families who are applying or seeking assistance through Habitat for Humanity. The effects that this resource has on payday loan use can be considered negligible under the assumption that those who are eligible and being considered for a home are those who might already have relatively good credit scores or an acceptable level of financial literacy. With this being the case, any effects these classes have on families behavior towards payday loans would be little to none.

**Cost**

Maintaining the existing order of things ranks low on cost. Under the status quo, there would be no additional direct cost incurred by Habitat for Humanity. Whether or not there has been any intervention to address payday loans, the client wouldn't see any significant disadvantages to their business. The only consideration is that the number of people who apply to own a home through Habitat that are users of payday loans would remain the same or continue to increase. With no action taken and no costs incurred, the status quo retains its starting score of **3.**

**Effectiveness**

Since there is no new action being taken, the status quo would rank very low on the effectiveness criterion. There would continue to be more individuals who default on loans and as a result having a bad credit score with lower chances of owning a home. With no percentage decrease, this alternative retains its starting score of **1**.

**Administrative Feasibility**

The status quo would rank high on feasibility since in this case, it would be highly feasible for the client to not make any changes. The financial coaching they currently offer is done by a staff member whose job it is to provide this service, so this person isn't doing anything additional outside of their job description. With no additional staff members needed for this alternative, it keeps its starting score of **3** on administrative feasibility.

[4] Unless cited differently, when "The client" or "Jo Olsen" is mentioned in this section, this is the source of the information provided.

**Option 2: Financial Literacy Classes**

Habitat for Humanity would prepare and host monthly classes, each an hour in duration, at 7PM in the evening. This service would be offered over a 1-year period and would be administered starting this year, which rules out any need for inflation and discounting cost estimates. The frequency of the classes is once per month to account for the busy schedules of low-income individuals who would otherwise find it difficult to attend a class that happens more frequently. Given that the client will incur a cost for each session, holding classes on a monthly basis rather than a more frequent schedule is a method to control costs. Though offered in person, there will be an online option for those who cannot afford to commute to the office space where the classes will be held. This will make the classes accessible to those who cannot afford to commute. The time of the class being 7PM is to allow for those who work from 9AM-5PM to be able to attend in person after work. The classes will be recorded for those who couldn't join in-person or online. The classes will be conducted on a monthly basis by an internal Habitat staff member. The client has approximately 110 members who are applying to own a home through their program. The average attendance is expected to be approximately 55 individuals per class. Not everyone will be able to attend the classes, and with no existing literature stating the average take-up rate for financial literacy classes, I assume roughly 50% of families will be willing to attend the classes.

In the case of interventions such as this alternative, retention and attendance rates are always issues to be concerned about. To maintain a consistent number of people who attend classes, there will have to be a few intentional steps taken. First there will need to be marketing efforts to initially get people's attention and build interest in attending these classes. These efforts will include emails, social media postings and posters/flyers. To retain the same group of 55 individuals who I predict to attend, the client will need to offer some form of financial incentive outside of just free financial literacy for attendees to keep coming. Studies found that the size of financial incentives are dependent on a person's marginal utility of money or in other words their socioeconomic status (Lynagh, et al., 2011). A quantity of $20 is worth more to a low-income individual than it is to someone in the middle class. Some studies find financial incentives to have a positive effect on changing behavior (Bradley & Saunders, 2020), while others find financial incentives to be damaging to outcomes such as attendance (Brooks et al., 2008).

Since the population we are working with are predominantly low-income individuals, I assume that financial incentives will play a major role in influencing their behavior and could have a positive effect on their attendance to the offered classes. Under the incentive, the goal is to compensate attendees for an hour of their time each month, but paying a cumulative amount at the end of the year rather than an incentive for each session. Given that how much each person values their time would vary across the group, I looked at the average hourly wage rate to get an estimate. The U.S Bureau of Labor Statistics reported that the median hourly rate for all occupations in Virginia in 2021 was $22.69 (U.S. Bureau of Labor Statistics, 2021); adjusted to 2023 dollars, that is $26.10. To make calculations simple, that number is rounded to $30, making it such that each attendee can get a guaranteed $360 if they attend 75% (9) or more of the classes.

To be clear, to get the incentive of $360 ($30 per hour for each of the 12 sessions) at the end of the year, an attendee only needs to attend 9 or more classes.

**Cost**

Eagles Talent estimates that it costs between $500 - $1500 on the low end for a guest speaker to speak at a small conference or at a nonprofit organization (Senek, 2019). Given that Habitat for Humanity already has a financial literacy curriculum, with the Charlottesville affiliate already having staff members who offer financial management training to their partnered families, a decision to have an inside staff member host the classes would be a cost-saving move under this alternative. To make this role attractive, the client can offer an amount of $500 per month for the staff member who decides to take on this role. This amount would cover for teaching the class, preparation time, and executing the necessary marketing efforts. This would mean $500*12 = **$6000** in annual costs to pay inside staff to market classes, prepare and host classes. Other costs to consider are the incentives for attendees and the extra electricity that will be used for that hour to administer the class. In the room the classes will be held, there are lights, a desktop and a plasma TV that will all be used for the hour long class. My calculations for appliances (TVs, computer, lights) are based on rates provided by Warren Recc, and are shown in more detail in the appendix section. Taking together compensation for staff, incentives costs, and the cost to use appliances, the total annual cost associated with this alternative is estimated to be **$24,019.51.**[5]

Going back to our scoring system for costs, this alternative would decrease by 0.44 from the starting score of 3, leaving it with a final score of **2.56**.

**Effectiveness**

The estimates being used to calculate the effectiveness of this alternative is taken from a study conducted by Kyoung Tae Kim and Jonghee Lee, entitled “Financial literacy and use of payday loans in the United States”. Their study contained a data set from the 2012 state-by state version of the National Financial Capability Study (NFCS) commissioned by the Financial Industry Regulatory Authority Investor Education Foundation (Kim & Lee, 2018). Their results found that with an increase in level of objective financial literacy, the use of payday loans decreases by approximately 22 percent (Kim & Lee, 2018). Similarly, Lusardi and Scheresberg found in the working paper series that financial literacy accounts for 20 percent of the reduction in the use of high-cost borrowing (Lusardi & de Bassa Scheresberg, 2013). Given that the classes will increase the financial literacy levels among those who attend, we can expect decreases in the usage of payday loans. Important to note, the sample size in the studies from which I drew my estimates were both over 20,000 observations, so when scaled to a class of 55 people, I assume that the effect will be approximately half the size in the study, ending with a reduction in the rate of payday loan usage of approximately 10 percent. Referencing our criterion, a 10 percent

[5] The important assumptions can be found in the appendix under “Option 2” with the detailed calculations in Table 1

decrease would increase our starting score by 1 point, leaving us with a score of **2** for effectiveness.

**Administrative Feasibility**

Offering financial literacy classes will only require 1 employee/internal staff member per session to operate. According to the 'Who We Are' section on the Habitat website, the Charlottesville affiliate has 8 members on their program staff (Habitat for Humanity of Greater Charlottesville, nd). Based on personal experience as an intern, I've witnessed the program staff being referred to as the Family Services team. This is the team that would be tasked with this alternative, as their core function is to work with Habitat families. With a capacity of only 8, I assume that anything that requires 8 or more staff members would not be feasible and hence receive a score of 1. An additional staff member would decrease the starting of 3 by 0.25. That being the case, Option 2 will have a final score of **2.75** on administrative feasibility.

**Option 3: Alternate Loan Intervention**

The client could indirectly offer an alternative to payday loans. Habitat's MicroBuild Fund is a housing-focused microfinance investment that is dedicated to helping low-income families (MicroBuild Fund, 2023). How the fund works is that it lends to microfinance institutions, which in turn provide small loans to families to assist in building or refinancing durable homes (MicroBuild Fund, 2023. The fund has grown rapidly and has provided access to better housing for more than 643,000 people as of September 30, 2018 (MicroBuild Fund, 2023). It is expected that with the availability of traditional and safer credit options, that consumers will be less likely to use payday loans. Under this alternative, the Habitat Charlottesville affiliate will send a request for the International affiliate to extend its partnership with a local microfinancing organization in Charlottesville, which will in turn offer safer loans to Habitat's clients and low-income families seeking to own a home. This alternative is expected to occur next year and like Option 2, once started, would only last for 12 months.

**Cost**

The cost associated with this alternative is primarily the potential of risky behavior of low-income borrowers. Once the Charlottesville affiliate of Habitat for Humanity gets the international organization to accept the request to partner with a local microfiancing organization in the city, the majority of borrowers who will want to access that new funding would be low-income residents who are a riskier population of borrowers.

Assuming that MicroBuild agrees to extend its partnership with Virginia Credit Union (VACU).[6] The total amount that Microbuild distributed to organizations in 2022 was roughly \$2.7 million.[7] To make this an attractive option, it is expected that the VACU would not want to lose money so MicroBuilds would bear the costs of lending to a risky population. Once this

[6] The VACU is one of the main microfinancing organizations in Charlottesville, who already offer loans for housing related costs. That being the case, they wouldn't have to make major changes to accommodate this partnership.

[7] This number is calculate in the appendix under "Option 3"

happens, then Habitat's clients who use predatory loans could access this newly available funding. However, to assess the risk or the cost associated with this option, remember that approximately 50% payday loans users default on them (Peterson, 2013). The point of this alternative is to offer safer loans, which implies lower interest rates. With a lower interest rate for loans, it is assumed that less people will default on loans. Assuming a 20% default rate instead of a 50% rate, implementing this alternative would cost MicroBuilds roughly **$580,000** in total costs in the year of implementation which will be 2024.[8] Absent the exact default rate, any cost over $100k would get a score of 1 on a scale that ranges from 1-3 and decreases by .1 for every additional $5000.

With our scale of 1-3 for our cost criterion, this alternative would receive the lowest score possible, which means it would be given a score of **1** on costs.

**Effectiveness**

Existing research shows that despite the improved access to traditional credit, there is no evidence that borrowers reduce their use of payday loans in response (Miller & Soo, 2020). Additional research shows that even when restrictions are placed on payday loans, consumers respond by shifting to other forms of high-interest credit (for example, pawn shop loans) rather than traditional credit instruments (for example, credit cards) (Bhutta et al., 2016). Following the evidence from existing research, I have to assume that increased access to traditional credit through a partnership with the VACU would not guarantee a reduction in payday loan behavior. Based on the findings from research, this alternative keeps the starting score of **1** for effectiveness.

**Administrative Feasibility**

Getting this partnership approved would require one employee working on each one of the steps required. This implies a minimum of five employees including the CEO of Charlottesville affiliate of Habitat to convince the international affiliate that getting involved in this local partnership would be a good idea. The required steps include:

1. Draft proof of the need of the funding from Microbuild
2. Provide a list of suitable microfinancing potential partners
3. Get approval from MicroBuild to issue loan to VACU
4. Convince MicroBuild Fund to move forward with this option despite associated risks
5. Get approval from VACU to accept this fund and issue loans to Habitat clients and other low-income families

With 5 staff members needed to see this alternative through, the starting score would decrease by 1.25 points, and leaves a final score of **1.75** for this alternative on administrative feasibility.

[8] See "Option 3" in the appendix for assumptions and Table 2 for detailed calculations

After evaluating each alternative based on the criteria, their individual scores have been recorded and compared across each other in the outcomes matrix below to just the best scoring alternative overall.

**Outcomes Matrix**

| | Cost | Effectiveness | Administrative Feasibility | Total Score |
|---|---|---|---|---|
| **Option 1: Status Quo** | **3** | **1** | **3** | **7** |
| **Option 2: Financial Literacy Classes** | **2.56** | **2** | **2.75** | **7.31** |
| **Option 3: Alternate Loan Intervention** | **1** | **1** | **1.75** | **3.75** |

# Recommendations & Implementation

Based on the analysis done to obtain the total scores, the option to be implemented by the client is to offer financial literacy classes. While there will be some financial cost for the client to bear and also the use of additional administrative staff to make this option possible, the alternative promises to reduce the usage of payday loans among the families that they serve, making it a more favorable option to maintaining the status quo and Option 3. Option 3 proposed to offer an alternative credit option, but it had very high costs with the existing literature indicating that this policy is not very effective in changing payday loan users behavior, lastly, it would involve 5 staff members which gives it a low rating on administrative feasibility.

**Overview**

To get this alternative up and running, the client will need to complete a few necessary steps to ensure that implementation goes smoothly.[9] There will first need to be approval of the funding needed to administer the program. Secondly, there will need to be a marketing campaign that involves emails, social media postings and phone calls that advertise the program to families to gain their interests. Lastly, there will need to be what I call checking off the fine details. This includes checking the financial literacy curriculum and updating it accordingly to reflect the learning goals for the attendees, ensuring that all the needed appliances such as TV, computers, projectors in the room reserved for the classes are working, and ensuring that the time and structure of the classes reflect preferences of the attendees. According to Sharma (2014), a good physical place with sufficient light and ventilation, calm and clean environment, normal temperature, and some minimum furniture will help learning processes. Therefore, being intentional about how the space is organized is important to maximize effectiveness.

**Stakeholders Involved**

The primary stakeholders involved in executing this alternative are the CEO of the affiliate, the staff member who would prepare for and teach the classes, and the families for whom the program is designed for. The CEO will be needed to approve all funding and give the final greenlight on executing the classes. Once funding is approved, the staff member best suited to teach the classes can start sending out emails, making phone calls, and marketing on social media to get families aware of the classes being offered. The families will then be expected to register and attend the classes and in the end adjust their behavior consistent with the effects we predict the classes to have. I predict that all stakeholders will be supportive of this alternative. The goal of the organization is to house as many families as possible. With relatively low costs and only one staff member required, this policy intervention has the potential to help Habitat for Humanity achieve that goal. The families and the designated staff member teaching this class will benefit from the knowledge and the compensation associated with the alternative.

[9] See the implementation map in the appendix for more details on each phase of implementation.

**Considerations**

A few major considerations for the client are: families' take-up rate/interest in the classes, the staff member's ability to effectively lead class and limited funding. We cannot be certain that the families who commit to attending these classes will see it through to the end and as a result benefit from the material being taught. There are many factors such as time commitment, childcare, working more than one job, that could be responsible for this. That being the case, the alternative offers an attractive incentive for families to want to complete all 12 classes or to attend at least 9 sessions. As for the staff member's ability to effectively lead classes, there are staff members at the organization who already taught financial classes and are expected to show the same level of competence under this monthly class structure. Finally, funding approval for projects is usually not straightforward. The assumption with this alternative is that with it only costing roughly $25,000, it should not be that difficult to get approval given how small it is relative to other expenses associated with building homes.

## Conclusion

Predatory lending through payday loans costs low-income individuals millions per year (General Attorney Herring, 2022). Habitat for Humanity of Greater Charlottesville works with this demographic with the goal of providing them somewhere comfortable and affordable to call home. If individuals borrow at rates that they cannot pay back, their credit scores will be damaged significantly, making the dream of owning a home that much more difficult to achieve. To address this problem among Habitat's clients, I considered three options: maintaining the status quo, offering financial literacy classes, and providing an alternative credit option for low-income borrowers. I find that offering financial literacy classes would ultimately be the most favorable option for Habitat for Humanity to pursue. The research shows implementation costs that would be affordable for the client, promises of potential reductions in the use of the payday loans among Habitat families, and lastly, this alternative would not be an administrative burden for the client.

# Appendix

**Option 2:**

The key assumptions made for Alternative 2 are as follows:

1. It will only require one staff member to execute the alternative.
2. The incentive cost is assumed to be the value of an hour to the attendees, this was based off of the average hourly wage rate for Virginia according to the U.S Bureau of Labor Statistics.
3. To receive any compensation, the attendee must attend 9 or more classes.
4. Even with the incentive, completion rate is still expected to be less than 100%, for the calculations, I assumed a roughly 90% completion rate or 50 attendees attending 9 or more classes.

Table 1: Costs for Option 2

| Alternative 2 Costs | |
|---|---|
| | |
| **LCD Tv being used for 5 hours/day** | $ 2.68 |
| Hourly Cost | $ 0.54 |
| Annual Cost | $ 6.43 |
| | |
| **Desktop Computer w/LCD Monitor being used for 4 hours/day** | $ 3.00 |
| Hourly cost | $ 0.75 |
| Annual Cost | $ 9.00 |
| | |
| **Incandescent (100 W) being used for 4 hours/day** | $ 1.36 |
| Hourly Cost | $ 0.34 |
| Annual Cost | $ 4.08 |
| | |
| **Incentives Cost** | $ 30.00 |
| Hourly Cost | $ 1,500.00 |
| Annual Cost | $18,000.00 |
| | |
| **Staff Compensation** | $ 500.00 |
| Hourly Cost | $ 500.00 |
| Annual Cost | $ 6,000.00 |
| | |
| **TOTAL COSTS** | $24,019.51 |

I used a three different resources to estimate my prices[10]

With only 50 attendees meeting the requirement for the incentive, the annual cost for the incentives is denoted by $30 x 50 x 12 = $18,000

[10]The estimates used to calculate the cost of my appliances were taken from Warren Rural Electric Cooperative Corporation: https://www.wrecc.com/what-uses-watts-in-your-home/
The incentive cost was based on the mean hourly wage in Virginia for all occupations and was taken from U.S. Bureau of Labor Statistics: https://www.bls.gov/oes/current/oes_va.htm
The staff compensation was based off estimates taken from Eagles Talent Speakers Bureau: https://www.eaglestalent.com/how-much-keynote-speaker-cost/

**Option 3:**

The key assumptions made for Alternative 3 are as follows:

1. The expected risk or default rate will be 20% instead of the 50% because this alternative will offer loans at lower interest rates, with the families using the loans expected to be less risky than the state estimate.
2. The funds distributed by Microbuilds were distributed equally among all 59 institutions in 2022.
3. The total per institution would be the maximum amount Micro Builds would be willing to offer as a loan for families to use through the VACU.

Table 2: Costs for Option 3

| **Alternative 3 Costs** | |
|---|---|
| | |
| Total amount Disbursed in loans (2022) | $160,200,000.00 |
| Total number of institutions | 59 |
| | |
| Total per institution | $2,715,254.24 |
| | |
| Estimated default rate of users of this fund | 20% |
| | |
| **Total Costs (2022 dollars)** | $543,050.85 |
| **Total Costs (2024 dollars)** | $583,206.96 |
| | |
| **Inflation Rates** | |
| 2022 CPI (Taken from U.S. Bureau of Labor Statistics) | 287.504 |
| 2023 CPI (Taken from U.S. Bureau of Labor Statistics) | 301.836 |
| Inflation rate used for 2022-2023 | 4.98 |
| Predicted Inflation rate for 2024 (CBO) | 2.3 |

All the cost-related figures used to compute calculations were drawn from the 2022 MicroBuilds Fund Annual Report.[11]

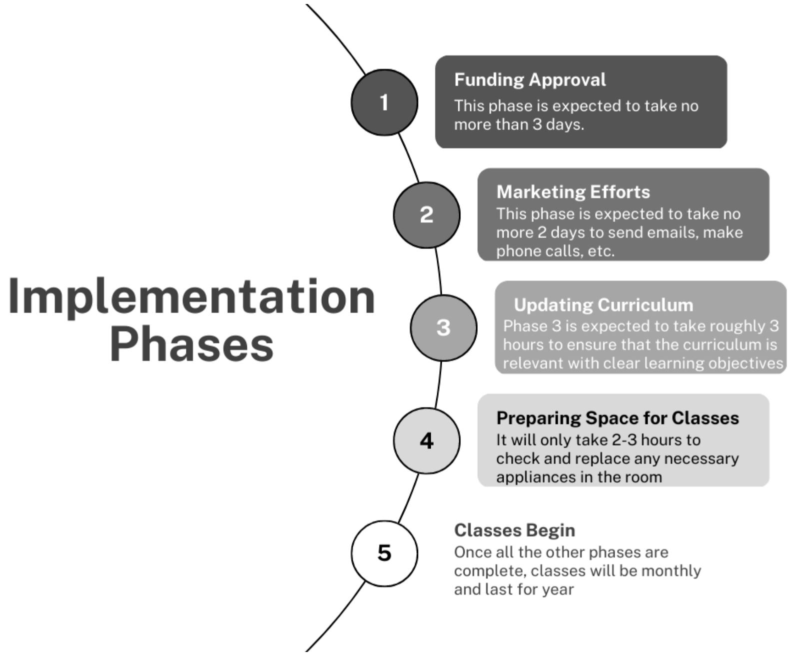
The total cost for 2022 is denoted by (0.2*2,715,254.24)

The total cost for 2024 is denoted by ($543,050.85*1.0498*1.023)[12]

[11] https://www.habitat.org/sites/default/files/documents/FY22_MBF-annual-report.pdf

[12] The inflation rate for 2022-2023 was calculated using the CPI reported by the U.S. Bureau of Labor Statistics. The calculation for this is denoted by [(301.836-287.504/287.504)*100]. The CPI for 2024 was taken from the Congressional Budget Office predictions of 2.3%.

**Implementation Map**




Note: Due to how relatively low the finances associated with our recommendation will be and the low level of complexity associated with each phase, the total time required to get through all phases is estimated to be a little over a week.

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