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Extreme heat drives demand for payday loans

Research published by the Bank of Canada finds that consumers more often were late on payments or defaulted on loans when temperatures rise.

BY: **AVERY ELLFELDT** | 01/10/2024 06:59 AM EST

Maria Barba picks blueberries at the Coopertiva Tierra y Libertad farm on July 7, 2023, in Everson, Washington. A new study found that extreme heat can drive a need for payday loans, particularly among communities that have a high rate of employment in outdoor jobs and are thus more exposed to weather conditions.| John Froschauer/AP

CLIMATEWIRE | Extreme heat can impose financial distress on low-income households by spiking electricity bills, generating additional medical expenses and interrupting outdoor work.

Those challenges, new research says, are forcing people to more frequently take out — and default on — payday loans that borrowers use to make ends meet but can be difficult to pay back. That situation, in turn, can leave households with mounting fees and a tarnished credit history, resulting in potentially "disastrous debt cycles," says a paper published Monday by the Bank of Canada

“Our findings highlight the heightened financial vulnerability of low-income households during extreme weather events and underscore the urgent need for targeted interventions and policies,” says the staff working paper, which was written by researchers with the Bank of Canada, the University of Illinois and Santa Clara University. It has not been peer-reviewed.

The researchers set out to determine how extreme temperatures — both warm and cold — impact household financial well-being, particularly in underserved communities that are disproportionately exposed to extreme weather.

To do so, they decided to examine payday loan markets, which many low-income consumers depend on for money between paychecks.

Notably, payday loans have far higher interest rates than credit cards or traditional loans and are considered by many to be predatory in nature.

Credit cards for instance, typically have an annual percentage rate — or annual cost of borrowing — between 12 to 30 percent. Payday loan fees, meanwhile, can have an annual percentage rate of 400 percent or higher, according to the Consumer Financial Protection Bureau. When borrowers don't repay their loans in time, they rack up additional fees, making the debt even harder to pay off.

The researchers used multiple datasets to gauge how both payday borrowers and lenders respond to extreme temperatures.

One dataset included information on 1 million randomly selected U.S. borrowers between 2012 and 2019 that provides details about each consumer's income, age and ZIP code and the date they applied for a loan. The other provided more specific information about those same consumers — including whether the loan was approved, its term length and whether the customer missed the payment or defaulted.

The researchers then overlaid that information with daily temperatures and precipitation data between 2012 and 2019 to gauge how hot and cold temperatures impacted loan inquiries, approvals and the borrowers' ability to make their payments on time.

They found that demand for payday loans surged during months with more extreme heat days — as did the rate at which consumers were late on payments or defaulted on their loans. The data also revealed that rather than increasing the supply of loans in step with rising demand, payday lenders actually offered fewer loans, presumably to guard against the risk of default.

Notably, the researchers said those findings are strongest in counties with large Hispanic populations, given a high rate of employment in outdoor jobs such as construction and agriculture, which leave workers exposed to weather conditions.

The findings suggest that rising temperatures are driving financially vulnerable households to take out expensive loans that already are difficult to pay back on time — and could become more so with climate change.

"We show that the negative impact on vulnerable households can be amplified through potentially disastrous debt cycles, featuring increasing delinquency and default rates," the researchers wrote.

Kate Murphy
Senior Manager, Business Development, Pro
katelmurphy@politico.com