To: Mayor Barry Chang, City of Cupertino
From: Melissa A. Morris, Senior Attorney, Public Interest Law Firm, Law Foundation of Silicon Valley
Re: Payday Lending Ordinance Policy Parameters
Date: March 3, 2016

MEMORANDUM REGARDING LAND USE ORDINANCE ADDRESSING FRINGE FINANCIAL SERVICES

This memo[1] was prepared by Public Interest Law Firm on behalf of CAPP, the Coalition Against Payday Predators, to provide information about and recommendations for an ordinance to prevent the proliferation of payday lenders in Cupertino. In compiling this memo, we conducted extensive research on similar ordinances in other jurisdictions and on the legal implications of a variety of ordinance options. We provide general information, as well as our own recommendations, below.

INTRODUCTION[2]

Payday loans are lending transactions in which a borrower provides a lender with a post-dated check and receives immediate cash from the lender. The borrower's check includes not only the principal loan amount, but also any interest and fees charged by the lender. The lender then cashes the borrower's check on the borrower's next payday unless the loan has been repaid by that date.

Payday loans, sometimes called deferred deposit transactions or cash advances, comprise one corner of a larger universe of "alternative" or "fringe" financial services, which also include check cashing services, pawn brokers, and rent-to-own stores.[3] In California, payday loans are small-dollar loans; state law caps them at $300.[4] However, these loans, including the relatively large fees associated with them, must be repaid quickly; the average term of a payday loan is 16

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[1] An earlier version of this memo was provided to Cupertino City Councilmembers and staff in June 2015. This version has been updated to include more recent statistics from the Department of Business Oversight, as well as information regarding Campbell's payday lending ordinance, which was passed in January 2016.
[2] In 2009, Public Interest Law Firm published its *Report on the Status of Payday Lending in California*, commissioned by the Silicon Valley Community Foundation (available at http://www.siliconvalleycf.org/docs/payday-lending-report.pdf); much of the text in this section is taken from that report. More recently, the Pew Charitable Trusts has published reports and analyses in its *Payday Lending in America* series (available at http://www.pewstates.org/research/featured-collections/payday-lending-in-america-85899405692).
[3] *See, e.g.,* Sharon Hermanson and George Gaberlavage, "The Alternative Financial Services Industry," AARP Public Policy Institute (Aug. 2001) (available at http://www.aarp.org/research/credit-debt/credit/aresearch-import-198-IB51.html). The San Francisco Municipal Code also uses the term "fringe financial services" to refer to these types of establishments. San Francisco Muni. Code § 790.111.
[4] Cal. Fin. Code, § 23035, subd. (a).

days.[5] Due to this short repayment timeframe, payday loans carry average APRs[6] of over 360 percent.[7]

Payday lending is widespread in California. In 2014, over 1.8 million Californians were issued payday loans.[8] Although payday loans are advertised as short-term credit products for use in emergencies, data show that most payday loan borrowers are unable to repay their loans in lump sum and that payday loan borrowers are indebted for an average of five months per year.[9] Further, the average payday loan borrower takes out eight loans per year, "often renewing an existing loan or taking out a new loan within days of repaying the previous one."[10] In 2012, over a quarter of all California payday loan borrowers took out 10 or more payday loans in that year alone.[11]

Payday lenders and other fringe financial services tend to be more densely concentrated in lower-income areas and communities of color.[12] One study found that "[e]ven after controlling for income and a variety of other factors, payday lenders are 2.4 times more concentrated in African American and Latino communities. On average, controlling for a variety of relevant factors, the nearest payday lender is almost twice as close to the center of an African American or Latino neighborhood as a largely white neighborhood."[13]

Cupertino does not have any payday lenders currently. We encourage the City to adopt regulations to prevent payday lenders from locating in Cupertino.

STATE REGULATION OF PAYDAY LENDERS

In California, payday lenders are governed by the Deferred Deposit Transaction Law (Fin. Code, §§ 23000 et seq.) and by regulations promulgated by the Department of Business

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[5] California Department of Business Oversight. *Annual Report: Operation of Deferred Deposit Originators Licensed Under the California Deferred Deposit Transaction Law* (2014) 4 (available athttp://www.dbo.ca.gov/Licensees/Payday_Lenders/Publications.asp).

[6] The APR, or Annual Percentage Rate of Interest, was developed by Congress "as a standard measure that calculates the simple interest rate on an annual basis (including most fees), accounts for the amount of time the borrower has to repay the loan, and factors in the reduction in principal as payments are made over time." Center for Responsible Lending, "APR Matters on Payday Loans" (June 23, 2009) (available at http://www.responsiblelending.org/payday-lending/research-analysis/apr-matters-on-payday-loans.html).

[7] California Department of Business Oversight. *Annual Report: Operation of Deferred Deposit Originators Licensed Under the California Deferred Deposit Transaction Law* (2013) 8 (available at http://www.dbo.ca.gov/Licensees/Payday_Lenders/Default.asp).

[8] *Id.* at 6.

[9] The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* (Jul. 2012), 6 (available at http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_Payday_Lending_Report.pdf).

[10] *Id.* at 9.

[11] California Department of Business Oversight, *Summary Report: California Deferred Deposit Transaction Law—Industry Survey* (2013) 6 (available at http://www.dbo.ca.gov/Licensees/Payday_Lenders/Default.asp).

[12] *See, e.g.*, Brookings Institution, "From Poverty, Opportunity: Putting the Market to Work for Lower Income Families," (2006) (available at http://www.brookings.edu/reports/2006/07poverty_fellowes.aspx).

[13] Wei Li, *et al.*, "Predatory Profiling: The Role of Race and Ethnicity in the Location of Payday Lenders in California," Center for Responsible Lending (Mar. 26, 2009), 25 (available at http://www.responsiblelending.org/payday-lending/research-analysis/predatory-profiling.pdf).

Oversight (Cal. Code Regs., tit. 10, ch. 3). These laws govern the maximum loan amounts, fees, and other aspects of how payday lenders operate. Because California has adopted this comprehensive regulatory scheme, local jurisdictions are prohibited from regulating the terms of payday loans under the legal doctrine of preemption.

However, local jurisdictions *are* legally permitted to enact local policies that combat the proliferation of payday lenders in their communities and the overconcentration of these types of businesses in low-income and minority neighborhoods, as well as the blight, nuisance, and other problems caused by payday lending stores. Silicon Valley voters are in favor of such local measures according to a 2010 poll, which found that an overwhelming majority of respondents supported restrictions on payday lenders, and over half believed that such restrictions were appropriate actions for city government.[14]

Locally, the cities of San José, Sunnyvale, Gilroy, Morgan Hill, Campbell, and Los Altos, as well as the County of Santa Clara, have already adopted regulations concerning payday lenders. Some of these jurisdictions, including Los Altos and Gilroy, have taken the approach of instituting temporary moratoria on new payday loan stores while they study the impacts of payday lending on the local community, followed by permanent restrictions. Others, like San José and Sunnyvale, have adopted permanent regulations without first imposing temporary moratoria. This memo discusses the range of options for both temporary and permanent regulations, as well as CAPP's recommendations for the City of Cupertino.

COVERED ENTITIES

This memo contemplates only payday loan stores. However, many jurisdictions regulate check cashing outlets and other fringe financial services in the same ordinances that they use to regulate payday loans. Cupertino's Zoning Code does not appear to address payday lenders or check cashers explicitly. In considering how best to regulate payday loan stores, the City could consider imposing additional restrictions on check cashers, car title lenders, and other fringe financial services as well.

TEMPORARY CITYWIDE MORATORIUM WITH STUDY PERIOD

Many cities, including Sacramento, San Francisco, Los Altos, Morgan Hill, and Gilroy, have passed temporary citywide moratoria on the establishment of new payday lenders, check cashers, and/or other fringe financial services, in order to study the impact of these types of businesses on the surrounding community.[15] California law authorizes cities to adopt an "interim ordinance prohibiting any uses that may be in conflict with a contemplated general plan, specific plan, or zoning proposal that the legislative body, planning commission or the planning department is considering or studying or intends to study within a reasonable time."[16] Such an

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[14] Goodwin & Simon Strategic Research, *San José Payday Loan Store Restrictions Survey* (Dec. 2010) (available at http://www.responsiblelending.org/california/ca-payday/research-analysis/San-Jose-Payday-Lending-Voter-Poll-Memo.pdf).
[15] *See e.g.,* Sacramento Ord. Nos. 2007-080, 2007-089; San Francisco Ord. Nos. 0001-06, 0034-06, 0115-06; Gilroy Ord. No. 2013-07.
[16] Gov. Code, § 65858, subd. (a).

ordinance may remain in effect for no more than 45 days from its date of adoption, and may either be adopted as an urgency measure or pursuant to the procedural requirements of Government Code, section 95090.[17] If the interim ordinance is adopted as an urgency measure, it may later be extended for 10 months and 15 days, and then for a year, as long as proper notice is provided and procedure is followed for each extension.[18] If the interim ordinance is adopted following the procedures of Government Code section 65090, then it may later be extended for 22 months and 15 days, as long as proper notice is provided and procedure is followed.[19] Both the adoption and the extension of the interim ordinance require a 4/5 vote, as well as a finding that "there is a current and immediate threat to the public health, safety, or welfare, and that the approval of additional subdivisions, use permits, variances, building permits, or any other applicable entitlement for use which is required in order to comply with a zoning ordinance would result in that threat to public health, safety, or welfare."[20]

A temporary moratorium can be a powerful tool, especially if a city needs time to develop the necessary findings to support permanent land use regulations. However, if the city already has sufficient information to impose long-term regulations, it may move forward with those regulations without enacting such a moratorium with a study period.

PERMANENT ORDINANCE RECOMMENDATIONS

Cities are able to restrict the proliferation of payday lenders through their planning and zoning power, which allows cities to regulate particular uses in order to prevent nuisance and to promote the public welfare. Below are some examples of the types of regulations that have been adopted, both in Santa Clara County and elsewhere in California.

Creating a Zoning Category for Payday Lenders

Cupertino's Zoning Code does not currently define or regulate payday loan stores separately from other uses; based on the definitions section of the Zoning Code, payday loan stores would most likely be categorized as retail business or commercial office uses.[21] As such, any ordinance regulating payday lenders must amend the Zoning Code to include payday lenders as a regulated use.

Permanent Ban on New Payday Lenders

Some jurisdictions, such as Santa Clara County,[22]Los Altos,[23] Gilroy[24], and, most recently, Morgan Hill have instituted permanent bans on new payday lenders locating within the jurisdiction; we recommend this approach. For example, Santa Clara County and Gilroy

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[17] Gov. Code, § 65858, subd. (a), (b).
[18] Gov. Code, §§ 65090, 65858, subd. (a).
[19] Gov. Code, §§ 65090, 65858, subd. (b).
[20] Gov. Code, § 65858, subd. (a)-(c).
[21] Cupertino Mun. Code, § 19.60.030.
[22] Santa Clara County Ord. Code, § 2.10.040, subd. (6).
[23] Los Altos Mun. Code, § 14.02.070.
[24] Gilroy Ord. No. 2014-01.

amended their zoning codes' definitions of "Banks" to explicitly exclude check cashing and payday lending businesses. With that exclusion in place, both jurisdictions stated that the "establishment, expansion, or relocation of such businesses is prohibited."[25] Like Cupertino, Los Altos and Santa Clara County had zero payday lenders within their boundaries when they imposed bans on new payday lenders, meaning that payday lending is effectively outlawed in those jurisdictions. Cupertino should do the same.

Caps on the Number of Payday Lenders

A second approach would be for the City to adopt a numerical cap on the number of payday lenders in Cupertino. Several cities have placed caps on the number of payday lenders that can locate within their city limits. In 2012, San José became the largest city in the nation to impose such a cap, limiting the number of payday lenders in the city to 39, the number that were in operation at the ordinance's adoption.[26] More recently, Sunnyvale imposed a cap of 6 payday lenders in the city, 2 below the 8 that exist, [27] and Campbell imposed a cap of 3, one fewer than the 4 that exist currently.[28]

This approach makes the most sense in cities that have existing payday lenders but want to prevent their further proliferation. Since Cupertino does not have any existing payday lenders, a cap of any number greater than zero would allow new payday lenders to establish themselves in the City. As such, a cap is unlikely to be as effective as an outright ban.

Geographic Restrictions

In addition to, or in lieu of, outright bans and caps, many cities have imposed permanent restrictions that exclude payday lenders and check cashers from certain zoning districts or neighborhoods. The rationale behind these types of restrictions is to limit the proliferation of such businesses in areas where their existence runs contrary to the stated purpose of the district (e.g., in residentially zoned areas) or to keep new payday lenders or check cashers from opening in areas that already have an overconcentration of these types of businesses.

Based on the types of distance requirements imposed in other cities—including Sunnyvale, East Palo Alto, Daly City, Sacramento, Oakland, and San Francisco[29]—Cupertino could ban new payday lenders from siting within:

- A quarter mile (1320 ft.) of existing payday lenders or check cashers;
- 500 feet of any residential use or residentially zoned parcel;
- 1000 feet of any school, park, playground, church or religious facility, or child care or preschool facility;

[25] Santa Clara County Ord. Code, § 2.10.040, subd. (6); Gilroy Ord. No. 2014-01.
[26] San José Mun. Code, § 20.80.1060.
[27] Sunnyvale Mun. Code, § 19.20.050, subd. (b).
[28] Campbell Res. No. 11930 (2016).
[29] Sunnyvale's Planning Commission recently adopted staff's recommendation to prohibit new payday lending establishments outside of the highway business commercial zone and within 1000 feet of an existing outlet. *See* Sunnyvale Staff Report, *supra*, at p. 7.

- 500 feet of banks, savings associations, or credit unions; and/or
- 1000 feet of liquor stores.

Other cities have banned payday lenders from certain census tracts or neighborhoods, based either on the overconcentration of payday lenders in those areas or based on the vulnerability of the population to predatory lending practices. For example, San José, in addition to its numerical cap, also prohibits new payday lenders from locating in or near very-low-income census tracts.[30] Similarly, San Francisco established a Fringe Financial Service Restricted Use District, which excludes new payday lenders and check cashers from locating in certain neighborhoods based on the over-proliferation of such uses.[31] Cupertino currently has similar distance requirements on adult-oriented businesses.[32]

If Cupertino opts for this strategy in lieu of an outright ban, it could allow payday lenders to locate only in zones where other commercial uses are permitted; impose distance requirements; and require a permit, as discussed below.

Use Permit

Many cities have imposed special or conditional use permit requirements on new payday lenders.[33] If Cupertino opts not to ban new payday lenders altogether, Cupertino could likewise require a conditional use permit for any payday lender locating in the city. Cupertino requires conditional use permits for a variety of uses, including the concurrent sale of alcoholic beverages and gasoline, so such an approach would be consistent with the larger zoning scheme.[34]

Based on permitting schemes adopted by other cities, Cupertino could impose the following types of requirements as conditions of use permits for payday lenders:

- Restricted hours of operation (Sunnyvale, East Palo Alto, Oakland, and Sacramento have established 7:00 a.m. to 7:00 p.m. unless other hours are approved in the conditional use permit[35]);
- Good neighbor policy;
- Lighting plan;
- Sign plan that conforms with Cupertino's sign ordinance[36]; and
- Graffiti removal.

Requirement to Provide Information About Non-Predatory Alternatives

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30 San Jose Mun. Code, § 20.80.1055.
31 San Francisco Mun. Code, § 249.35.
32 Cupertino Mun. Code, § 19.128.
33 *See, e.g.,* Sunnyvale Ord. No. 3002-13.
34 *See* Cupertino Mun. Code, § 19.132.
35 Sunnyvale Mun. Code, § 19.20.050, subd. (a)(2); Oakland Planning Code, § 17.102.430, subd. (A)(3)(c); Sacramento City Code § 17.24.050, n. 84.
36 Cupertino Mun. Code, § 19.104.

If Cupertino opts not to ban payday lenders, it could require payday loan stores to post information about alternatives to payday loans. To our knowledge, Sunnyvale became the first California city to create such a requirement when it adopted its ordinance in 2013. State law requires payday lenders to include a notice with the following information each time they issue a payday loan:

(1) Information about charges for deferred deposit transactions;

(2) That if the customer's check is returned unpaid, the customer may be charged an additional fee of up to $15;

(3) That the customer cannot be prosecuted or threatened with prosecution in a criminal action in conjunction with a deferred deposit transaction for a returned check;

(4) The Department of Corporations' toll-free telephone number for receiving calls regarding customer complaints and concerns;

(5) That the licensee may not accept any collateral in conjunction with a deferred deposit transaction; and

(6) That the check is being negotiated as part of a deferred deposit transaction made pursuant to Section 23035 of the Financial Code and is not subject to the provisions of Section 1719 of the Civil Code. No customer may be required to pay treble damages if this check does not clear.[37]

While this notice is important and useful, it does not include information about alternatives to this very expensive, predatory product. We believe consumers should have this information before starting down the hazardous road of taking out a payday loan. Sunnyvale's ordinance further requires:

> At least one sign (minimum four square feet) shall be posted in the business that is clearly visible to patrons from the entrance of the store with information on alternatives to payday loans. The exact language for the sign will be uniform and created by the Community Development Director. All payday lending establishments will be subject to comply with this operational standard six months after the adoption of this ordinance.[38]

CAPP recommends that Cupertino enact such a requirement for its payday loan stores. CAPP partners, including West Valley Community Services, would be happy to work with the City to compile the information for the sign.

Even if Cupertino elects not to require such a sign or flyer at payday loan stores, the City could produce the flyer and distribute it through its usual channels for distributing information to

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[37] Fin. Code, § 23025, subd. (c).
[38] Sunnyvale Mun. Code, §19.20.050, subd. (c)(3).

the public: e.g., publication in City offices, inclusion in email alerts, and promotion at City events. In our experience, the more consumers know about alternatives to payday lending, and the more accessible those alternatives are, the less likely they are to become trapped in the cycle of payday loan debt.

Policies to Encourage the Development of Alternatives

We recommend that Cupertino adopt a resolution encouraging the development of non-predatory alternatives to payday loans and consider policies that incentivize the development of non-predatory alternatives. One option would be to create incentives, such as incentives related to ATM placement, for credit unions that offer small-dollar loan products to their members.[39] Other cities have considered other incentives, such as the express exemption of non-profit services from local regulation of payday lenders; for example, San Francisco specifically exempts non-profit fringe financial services providers from its ordinance.[40] Such incentives should be carefully tailored to encourage credit alternatives that are affordable (i.e., whose interest rate is lower than 36 percent APR) but not to open the door for other financial products with costly or deceptive terms. CAPP members can provide input on policy options based on our experience in other jurisdictions.

Support Statewide Legislation and Federal Regulation

Because the substance of payday loans is regulated by the state, state legislation has the potential to establish meaningful consumer protections. For example, the Consumer Financial Protection Bureau is expected to propose regulations for payday lenders later this spring, and the City could weigh in to support strong consumer protections.

CONCLUSION

CAPP encourages Cupertino to adopt a ban on the establishment of new payday loan stores in the City. We further encourage the City to consider adopting incentives to encourage the development of non-predatory alternatives to payday loans and to support statewide and federal policies that will limit the harmful impact of payday loans on California consumers.

CAPP partners are available to discuss all of the above options with City staff and policymakers. We look forward to working with the City to develop policies that are effective and appropriate for Cupertino.

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[39] Credit unions are prohibited by the National Credit Union Administration's rules from charging more than 28 percent APR. See http://www.mycreditunion.gov/what-credit-unions-can-do/Pages/Short-Term-Loans.aspx.
[40] San Francisco Planning Code, § 249.35, subd. (d).