Typical Breakdown of a $100, $500 and $1,000 Loan

Scenario #1 - $100 Loan, 3-month Term

A 3-month, $100 loan could cost the typical bank $35.

- $25 – Program operations and overhead (e.g., IT, underwriting, legal, processing)
- $5 – Cost to cover loan defaults
- $5 – Cost to service customers behind on their payments (delinquency)

Calculating the annual percentage rate (APR):
To obtain a close approximation to an annual percentage rate calculation, the cost of the three-month loan (35% of the total loan) should be multiplied by four (to account for 12 months in the year): 0.35 * 4 = 140%

The APR on this loan would be 140%.

$35 Cost / $100 Loan = 35%
35% * 4 = 140% APR

A higher probability of default is assumed for loan requests nearing the maximum permissible amount.

An additional 10% of all borrowers will have trouble repaying their loans – it will cost $50 to help these customers establish new repayment schedules and to service delinquent loans.
What is the Break-Even Cost of Small-Dollar Loans?

Scenario #2 - $500 Loan, 3-month Term

A 3-month, $500 loan could cost the typical bank $55.

- $25 – Program operations and overhead (e.g., IT, underwriting, legal, processing)
- $25 – Cost to cover loan defaults (5% of loan amount)
- $5 – Cost to service customers behind on their payments

The APR on this loan would be 44%.

$55 Cost / $500 Loan = 11%
11% * 4 = 44% APR
What is the Break-Even Cost of Small-Dollar Loans?

Scenario #3 - $1,000 Loan, 3-month Term

A 3-month, $1,000 loan could cost the typical bank $105.

- $25 – Program operations and overhead (e.g., IT, underwriting, legal, processing)
- $75 – Cost to cover loan defaults (7.5% of loan amount)
- $5 – Cost to service customers behind on their payments

The APR on this loan would be 42%.

$105 Cost / $1000 Loan = 10.5%
10.5% * 4 = 42% APR

The APR required to cover the cost of the loan will depend on size of the loan. The larger the loan size, the lower the APR.