

What is the Break-Even Cost of Small-Dollar Loans?

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): $0.35 * 4 = 140\%$

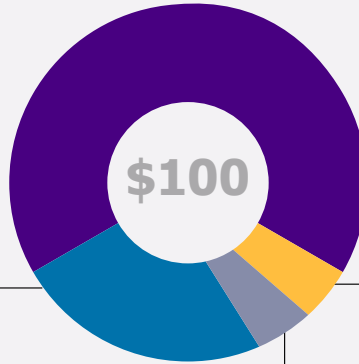
Loan Amount	Probability of Default
\$500 or Less	5%
More than \$500	7.5%

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.

\$25

Program operations and overhead (e.g., IT, underwriting, legal, processing)



\$5

Cost of delinquency

\$5

Cost of default



25¢

Program operations and overhead (e.g., IT, underwriting, legal, processing)

5¢

Cost of default

5¢

Cost of delinquency

The APR on this loan would be 140%.

$$\begin{aligned} \$35 \text{ Cost} / \$100 \text{ Loan} &= 35\% \\ 35\% * 4 &= 140\% \text{ APR} \end{aligned}$$

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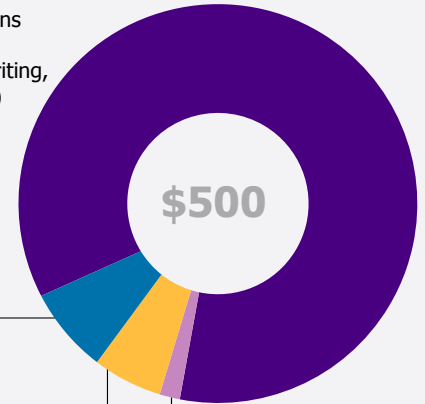
Scenario #2 - \$500 Loan, 3-month Term

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

\$25

Program operations and overhead (e.g., IT, underwriting, legal, processing)



\$25

Cost of default

\$5

Cost of delinquency

5¢

Program operations and overhead (e.g., IT, underwriting, legal, processing)



5¢

Cost of default

1¢

Cost of delinquency

The APR on this loan would be 44%.

$$\begin{aligned} \$55 \text{ Cost} / \$500 \text{ Loan} &= 11\% \\ 11\% * 4 &= 44\% \text{ APR} \end{aligned}$$

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

\$25

Program operations and overhead (e.g., IT, underwriting, legal, processing)

\$75

Cost of default

\$5

Cost of delinquency

2.5¢ Program operations and overhead (e.g., IT, underwriting, legal, processing)



7.5¢

Cost of default

0.5¢

Cost of delinquency

The APR on this loan would be 42%.

$$\begin{aligned} \$105 \text{ Cost} / \$1000 \text{ Loan} &= 10.5\% \\ 10.5\% * 4 &= 42\% \text{ APR} \end{aligned}$$

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.