

## The Truth About Payday Loans

[http://www.credit.com/credit\\_information/loans/The-Truth-About-Payday-Loans.jsp](http://www.credit.com/credit_information/loans/The-Truth-About-Payday-Loans.jsp)

It seems like payday loan offers are everywhere these days. From the local strip mall to the Internet, the payday lending industry is booming. But what is a payday loan? Is it as bad as some people say? Credit.com gives you straight answers about payday loans:

### What is a payday loan?

A payday loan is a small loan (maximum \$500-\$1,000) that does not require a credit check. Payday loans have short terms and must be paid back quickly, usually within a few pay periods. Payday loans are marketed as a way to help you cover your expenses until your next paycheck. Also called “check cashing”, “payroll advance” and “deferred deposit,” these loans offer a fast way to access emergency money. Many payday lenders are not licensed, bonded or regulated by important consumer laws.

Payday loans can be very costly. Borrowers should use them with caution and pay the amount back as soon as possible. These loans are usually priced at a fixed dollar fee, which represents the finance charge to the borrower. Because the loans have such short terms, the cost of borrowing is very high. In return for the loan the borrower usually provides the lender with a pre-dated check or debit authorization.

### How does it work?

Say your car broke down and you decide to borrow \$300 for the repairs from a payday lender. You'll write a post-dated personal check for \$340 (the amount plus a finance fee) made payable to the lender. You enter this information online when applying for a payday loan through the internet. The lender then advances you \$300 for a set period, usually 14 days. When that period is up, you pay the lender \$340 in cash, let them deposit the post-dated check or write another post-dated check for the amount plus an additional finance fee. If you do not pay the debt in full at the end of the term, you will be charged additional fees and finance charges.

### Who uses these types of loans?

Generally, anyone with a checking account and steady income can obtain a payday loan. However, it is most common for borrowers who don't have access to credit cards or savings accounts to use this type of lender. Since these loans don't require a credit check, people with no credit or credit problems often turn to payday loans. Military personnel and recent immigrants also commonly use payday loans.

### What are the benefits?

Payday loans can be a good tool for quickly and easily borrowing cash during an emergency if you don't have other financial options. For example, you might use a payday lender for an immediate and temporary financial need such as a medical bill, car repair or other one-time expense. Payday loans are helpful for people who don't have

credit cards or savings available. Because the loans do not require a credit check, they are easy for people with financial problems to obtain.

### **What are the negatives?**

It is crucial that you repay a payday loan as soon as possible. Many people get into trouble with these types of loans when they are unable to quickly repay the debt. If you can't repay the loan at the end of the term, you'll be charged expensive additional fees. It is very costly to be stuck in a payday loan cycle for a long time and can lead to larger financial problems. Payday loans are also much more expensive than other methods of borrowing money. In most cases the annual percentage rate (APR) on a payday loan averages about 400%, but the APR is often as high as 5,000%. A standard credit card has an APR of 12% and a standard loan APR is around 7%. If possible, it is better to use a credit card or tap into your savings in the event of an emergency.

### **What about usury laws?**

Numerous states have very specific laws that regulate the lending industry. Called "usury laws" these regulations define permissible lending terms and rates. Some states also have laws that regulate the amount a payday lender can lend to consumers and how much they can charge for the loan. Other states ban payday lending outright, such as New York. These laws vary widely. Payday lenders often work around these regulations by partnering with banks based in other states, such as Delaware. It is important to read the fine print on the payday loan offer and understand your consumer rights.

### **Should I apply for a payday loan?**

Before you consider applying for a payday loan, step back and consider your options. Ask yourself if it really is an emergency. Payday loans can be helpful for one-time emergency costs such as medical fees but are not a good idea for funding unnecessary expenses. Is it possible to wait to repair your car or pay your bills until your next paycheck? Remember, a \$25 late fee on a bill is cheaper than a \$40+ finance charge for a payday loan. Think about other ways to borrow money:

### **Alternatives to payday loans**

- Negotiate a payment plan with the creditor
- Charge the amount to your credit card
- Receive an advance from your employer
- Use your bank's overdraft protections
- Borrow money from your savings account
- Ask a relative to lend you the money
- Apply for a traditional small loan
- Ask your creditor for more time to pay a bill

If you have evaluated all of your options and decide an emergency payday loan is right for you, be sure to understand all the costs and terms before you apply.

- Shop around for a trusted payday lender that offers lower rates and fees.
- Borrow only as much as you know you can pay back with your next paycheck.
- When you get paid, your first priority should be to pay back the loan immediately.

**What can I do to prepare for financial emergencies?**

You can't always predict an emergency, but you can be prepared. Ideally, you should keep enough money to cover your household expenses for two months in a savings account. If this goal is too high, aim to save at least the amount of one paycheck. It is also a good idea to have a few credit cards available for unexpected costs. If you don't have a credit card, you can search for a credit card online.

Now that you know all about payday lenders, you can decide if this kind of loan meets your needs. Payday loans can be useful for consumers who need emergency cash for a short period of time. These loans come with high costs and many dangers. If you have limited options and if you understand how to use payday loans correctly, you can make the most of these services.