



## **DELRAY CREDIT COUNSELING**

Debt Consolidation and Credit Counseling

# The Truth About Payday Loans

You will learn:

- The definition of payday loans
- The true cost of payday loans.
- Alternatives to payday loans

### **WHAT IS A PAYDAY LOAN?**

A payday loan is a small short-term loan that is intended to cover one's expenses until the next payday. Payday loans are also known as cash advances, deferred deposit, or paycheck advances. The typical term of a payday loan is two weeks. While payday loans can be obtained from physical storefront locations, payday loans are most commonly marketed through email and web sites. To obtain a payday loan, typically, the consumer completes an online application or faxes a paper application containing personal information such as contact, banking, and employer information. In addition to the application the borrower submits a copy of their paystub and a bank statement. Once the information is received, the cash is direct deposited into the borrower's bank account. On the next payday, the borrower's bank account is drafted the principal balance of the loan plus the fee charged for the loan are debited out of the borrower's account. Alternatively, the payday loan lender may deduct their fees for the loan at the time the loan is given. For example if you borrow \$300.00 and they charge \$50.00, you would receive \$250.00 today (\$300.00 - \$50.00 fee) then on payday you payback \$300 for a total of \$350.00

## THE TRUE COST OF PAYDAY LOANS

Fees are charged for obtaining a payday loan. A payday lender may charge a flat fee for the loan regardless of the loan size or they may charge a flat fee for every increment. For example you may see the fees disclosed like this; for every \$100.00 you borrow, there is a \$20.00 fee. So if you borrowed \$200.00, the fee for the loan in this example would be \$40.00.

### **Example:**

Loan Amount: **\$500.00**

Fee Charged: **\$15.00 PER \$100.00 borrowed**

Term: **2 weeks**

The total fee is \$75.00 ( $\$500.00 / \$100 = 5$ ) (5 times \$15.00 = \$75.) On the day you receive the loan you will receive \$425.00 ( $\$500.00 - \text{the } \$75.00 \text{ fee} = \$425.00$ ). Within the next two weeks you will have to pay \$500.00.

	\$ 75.00 Fee
+	
	\$ 500.00 Loan repayment
	<hr/>
	\$ 575.00 Total repaid within two weeks.

Look at the fee, \$75.00. The fee is 15% of the amount you borrowed. Many payday lenders will compare this percentage to a regular loan or a credit card rate. For example the payday loan company may advertise a credit card rate at 21% and a personal loan at 18%. Comparing interest rates in this way would suggest a payday loan is the LEAST expensive alternative. This is NOT TRUE. Remember the payday loan is a two-week loan. Credit cards and personal installment loans are quoted based on an annual percentage rate. So to compare apples to apples we need to calculate the ANNUAL percentage rate of the payday loan. Remember payday loans are due in 2 weeks. There are 52 weeks in a year. 52 divided by 2 equals 26. So to calculate the ANNUAL percentage rate of the payday loan, take the rate they quoted, and multiply it by 26. **In this example the annual percentage rate of the payday loan is 390% (15% X 26).** Now if we go back and compare a credit card at 21%, a personal loan at 18%, and the payday loan at 390%, you will see that payday loan is the MOST EXPENSIVE option.

What if you cannot repay the loan within the two weeks? The payday loan lender will either extend the loan or possibly give you another payday loan. If you extend or take an additional payday loan, then there are additional fees due, which drives up the total cost of the loan. This is the trap of the payday loan. The more extensions or payday loans you obtain the more expensive they become. At some point they become so expensive you will never get out of them.

Let's go back to our previous example only this time let's assume you have to get a new payday loan to payoff the old payday loan and you have to do that 3 more times.

On the initial \$500.00 you borrowed, you will payback \$800.00. Of the \$800.00, you paid back the \$500.00 loan plus \$300 in fees for all the loans (\$75 per loan X 4). This also assumes the payday lender didn't charge extension fees. Typically a payday lender will charge an extension fee after the second extension. Extension fees are in addition to the loan fees. So back in this case if the payday lender charged a \$50.00 extension fee for the 4<sup>th</sup> payday loan, the total paid back after the 4<sup>th</sup> loan would be \$850.00 (\$500.00 loan + \$300 fees (\$75 X 4 loans) + \$50.00 for the extension). You paid \$350.00 to borrow \$500.00.

As you can see, payday loans from a cost standpoint are the most expensive solutions to a cash flow problem by far. If you are stuck in a payday loan cycle or need quick cash consider the alternatives in the next section.

### **PAYDAY LOAN ALTERNATIVES**

Life happens and sometimes quick cash is needed, but before you jump online or run down to a quick cash store down the street, consider the following alternatives:

- Ask your employer for a payday advance. Your employer may give you more time to pay off the account with little or no interest.
- Obtain a side or second job
- Ask your employer if overtime work is available.
- Sell items you no longer need such as electronics or jewelry at a pawn shop or online.
- Borrow money from a friend or relative
- Take a cash advance on an existing credit card.
- Obtain a personal loan from a credit union. All credit unions are different and have different lending criteria, but many will offer small personal loans to give you time to pay them off.
- Adjust your tax withholding. Adjusting your tax withholding can increase the net amount of your check. Check with your tax preparer before taking this option to discuss the possible effects on your income tax liability.
- Review your household budget to determine where you can cut other expenditures.
- Talk to your creditors about extending your due dates.

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