

What are loans?

A loan is borrowed money which must be repaid in one or more payments. Lenders charge interest on the amount you borrow. This means that you pay back more than you receive. This is how a lender covers the cost of doing business and makes profit. The higher the interest rate, the more you must repay. You should know that the lower the monthly payment, the longer it will take you to repay the loan and the more you will pay to borrow the same amount at the same interest rate.

Compare:

- * You borrow \$500 at 18% interest for **12 months:**
- * You pay \$45.84/month x 12 months
\$500.00 principal (you get)
+ \$50.08 interest you pay
= \$550.08 total to repay
- * You borrow \$500 at 18% interest for **24 months:**
- * You pay \$24.96/month x 24 months
\$500.00 principal (you get)
+ \$99.04 interest (you pay)
= \$599.04 total to repay

Sometimes you may need to borrow a few hundred dollars because of an unexpected medical bill, broken appliance, or to buy a used car to obtain keep job. While the amount of cash you may need is small, the amount of interest you will repay may be large.

Always Shop Around

NCLC is a consultant for lawyers and others on consumer issues affecting low- and moderate-income Americans. This brochure was supported, in part, by a grant from the Open Society Institute

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What You Can Do To Avoid Problems

* Save now for unexpected expenses.

Even putting aside a small amount each week will help: Try to save your money before there is an unexpected expense so that you can avoid borrowing. You can talk with budget counselors who can help you understand how you spend your money each month and how you might save.

* Shop around.

Do not look just at the monthly payment. Compare the interest rate (also called the "annual percentage rate"), the total amount you will repay, the number of payments, and the amount of fees added on to the loan.

* Read before you sign,

Make sure you or someone you trust reads the loan papers before you sign them. If the lender will not let you take them home to study them and tries to rush you, walk away. That is a sign of trouble.

* Consider alternative credit.

If you open an account at a credit union (which is like a bank and is backed by the federal government), you can get a small loan at interest rates of 10-20% instead of the 25-830% (for pawnbrokers and rent-to-own stores) or 730% (for the payday loan).

If you need a loan to start up a small business, there may be a non-profit organization in your area that can help.

Where Else To Go For Help?

If you borrowed money from one of these lenders and want to know your rights, you may be able to get free assistance from your local legal aid office.

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Borrower Beware:

The High Cost of Small Loans, Pawnbrokers and Rent-To-Own Stores

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The High Cost of Different Kinds of Small Loans

Payday Lenders

Some check cashers will offer to take a personal check from you or from someone else you know. The lender will hold that check and not cash it for one or two weeks. In return they will give you an amount of cash that is less than the written amount of your check. Sometimes, the lender will charge another fee on top of the interest.

At the end of the two weeks, you must either pay back the full amount of the check (more than what the lender gave you), or the lender will cash the check. Often, the lender will try to get you to write another check in a larger amount and give you little or no cash back. In this way, the lender gets more money from you and you get further in debt.

The difference between the amount of your check and the amount of cash you get in return is interest that the lender is charging you.

For example:

- * You write a \$256 check
 - \$200 loan you get back
 - = \$56 interest you pay (730% on an annual basis)

Compare this to annual interest rates as low as 10-15% that banks and finance companies charge.

Pawnbrokers

Pawnbrokers are companies that allow you to trade something of value such as jewelry, a stereo, or even your car, in exchange for cash. Usually, a pawnbroker will lend less than one-half of the value of your property. You must pay back the loan within a certain period of time or the pawnbroker can sell your property and keep the money. Since you are charged fees, and only receive at most 11% of the value of your property in cash, you may be paying up to 200% interest per year.

Pawning Your Car Title

Some pawnbrokers will allow you to keep the use of your car but take the paper that is your title to the car. In exchange you will get cash; but, again, no more than one half of the car's value. If you do not repay the loan, the pawnbroker will find your car, take it, and sell it. If you can make all the installment repayments, the pawnbroker still makes quite a profit off you.

For example:

- * You give your car title (\$1,000 value) - \$500 loan you get back
- * You pay weekly installments of \$103.30 for 10 weeks
- * $\$103.30 \times 10 \text{ weeks} = \$1,033$
 - \$1,033 you pay
 - \$500 you get
 - = \$533 interest you pay (830% on an annual basis)

Renting A TV, Stereo, Furniture, or Appliances

When you go to a store and rent these items instead of buying them, you will often pay at least three or four times what it would cost to buy them.

For example:

- * You rent a 19-inch color TV (\$300 value)
- * You pay \$16/week x 52 weeks = \$832
 - \$832 you pay
 - \$300 value of the TV you get
 - = \$532 interest you pay (254% on an annual basis)

Sometimes the rent-to-own company will rent you a used TV and tell you it was new. Then, they make even more money from you. And if you miss a payment, the company may repossess the TV, leaving you nothing to show for all the payments you made.

Abuses by Some Small Loan Lenders

- * Some lenders charge very high interest rates.
- * Most lenders will also add fees to the cost of the loan and try to sell you insurance. These extras make the loan even more profitable for the lender and more costly for you.
- * Some lenders make it hard for you to figure out how much the loan is really going to cost.
- * Some will encourage you to borrow from them over and over again so that they can make more money at your expense.