

Getting Through Tough Financial Times

Avoid Money Traps

Most people don't like to waste money. If you cash checks at a currency exchange instead of a bank, you'll pay a fee for that service. If you go to a local convenience store instead of a full-service store, you pay much more per item. If you have no credit or bad credit and you need to finance a car or small loan, you'll pay an exorbitant interest rate or fees to do so.

If money is tight or you have bad credit, you may be considering using predatory lending. Sometimes called "sub-prime lending" or "fringe banking," predatory lenders take unfair advantage of someone who needs to borrow money. They usually charge high interest rates or exorbitant fees. Loans seem easy to get, and they often are. Most lenders do not check your credit report or determine whether you can repay the loan.

Compare Loans

Borrowing money can be expensive. Always shop around to find the lowest interest rate and best borrowing terms. Check the APR (annual interest rate) to find out the cost of the loan on an annual basis. The law requires that every loan, no matter for how long, must state the APR. Be a good consumer and check out all the facts before borrowing.

Payday Loans

Payday loans, also called cash advance loans, check advance loans, postdated check loans, or deferred deposit check loans, are very common. You'll find companies that offer them in almost every community.

Here's how they work—A payday lender gives you a loan, usually for two weeks, in exchange for your postdated check. The loan includes the lender's interest that is extremely high, 200 percent or more! The lender often will not tell you the interest rate; they will only tell you the fee that will be charged.

For example, if you want to borrow \$200, you write a check for \$240. The \$40 is the interest or fee the lender charges. If you calculate the interest, you will pay 520 percent! When the lender cashes your check, the \$200 loan is repaid, and he keeps the \$40.

The check is usually dated on your payday. If you can't repay the loan when it's due, you can renew it for another time period and an additional fee. To be sure you repay, the lender can threaten to cash your postdated check. If the check bounces, both the bank and lender will charge you fees.

Title Loans

When you use a title loan, you are giving the title for your car or other vehicle as collateral. Interest rates are usually high. If you can't repay the loan, the company can repossess your car even if you owe only a small amount. Can you afford to lose your car if you can't make the payments?

0% Interest/No Payments Until . . .

When a lender offers no interest for a certain time, like six months or longer, the interest rate will be higher than for other loans, often 20 percent or higher. Check the "fine print" to see if there is a clause in the contract that states that if you miss a payment, the interest charges will be charged.

And, you had better have the amount that is due when the offer period ends. If you don't, you'll be charged the interest from the date of purchase which could be a large amount.

Rapid Refund Services

A Refund Anticipation Loan (RAL) enables you to get your tax refund from the government immediately without waiting for it to come in the mail. These services prepare your tax return, file it electronically, and charge you a large fee.

Typically, you borrow less than the anticipated tax refund, and all of the tax refund goes to the lender. Interest rates usually range from 25-200 percent although the APR is rarely stated. Instead, a fee is quoted. If the tax preparer makes an error preparing your return or you don't get all or any of the tax refund, you still have to repay the loan plus the interest!

Instead of using a rapid refund service, you can file your return electronically through the IRS or a free tax assistance program. Several programs are available throughout the state. Contact the **Volunteer Income Tax Assistance (VITA)**, 1-800-TAX-1040 or <http://www.revenue.state.il.us/> for information. The **Tax Counseling Project (TCP)** of the Center for Economic Progress also operates free tax preparation sites in 28 communities throughout Illinois. For more information on site locations and hours of operation, call 1-888-827-8511 or visit <http://www.centerforprogress.org/>.

Rent-to-Own

Rent-to-own plans allow you to have an item, such as furniture, with little or no down payment. You pay a monthly rental fee and eventually own the item. You may actually be renting used items. Your contract should disclose whether the item is new or used, the weekly rental cost, the length of rental, and the total cost of the item. It's important to read the small print!

One problem is you don't own the item until all the rental payments have been made. If you pay late or miss a payment, you can lose the item no matter how much you've already paid.

The amount you pay in rental payments is much greater than if you had purchased the item and financed it through a bank loan. For example, a \$300 television set rented for \$15 a week for a year would cost you \$780—a total of \$480 in finance charges! In this example, the finance charges cost more than the television! Rather than paying these high costs, consider alternatives, such as saving money and paying cash or using a layaway plan.

Pawn Shops

A pawnshop gives single-payment loans for short time periods, usually 30 days. Loans may range from \$20 to several thousand dollars. The amount of the loan is based on the item given as security (collateral), which is typically one-third to one-half the value of the item pawned.

For example, if you pawn a watch worth \$100, you'd probably only receive \$25-\$30. You agree to repay the loan, plus interest, by a specified date or you forfeit the rights to the item pawned. The interest charged is usually about five percent per month plus a two percent monthly storage fee. This may not sound expensive, but the APR in this instance is 84 percent. Because the amount loaned is only a small portion of the value of the item pawned, the effective interest rate is greater than 200 percent annually.

Finance Companies

Loans from finance companies will typically be for longer time periods than typical payday loans. The interest rates are likely to be fairly high compared to a bank loan. A finance company may also pressure you to purchase credit life insurance and credit disability insurance, which will add significantly to the cost of the loan.

Consolidation Loans

If you have a lot of debts with multiple payments each month, you may be tempted to get a debt consolidation loan. Typically, when you get a debt consolidation loan you exchange paying several smaller debts with varying payment dates and interest rates with one large loan, interest rate, and monthly payment.

Because you have combined your debts, you will usually have a lower payment each month. However, the

interest rate for the consolidation loan is often at a higher rate, and the time it takes to repay the debt will be significantly longer.

There may be several problems with getting a consolidation loan. Many people are tempted to start charging again before the debt is paid. Some of the debts included in the consolidation loan may have been interest-free, such as doctor or hospital bills. Also, don't include any loans that may have only a few payments left. If you do, that loan will not be paid in full until the consolidation loan is paid. And, for many families getting a consolidation loan may be the final step before a real financial disaster.

Before getting a debt consolidation loan, contact your creditors to see if you can negotiate a repayment plan. Do your homework to figure the cost of the consolidation loan and how long it will take to pay it off. Go to <http://powerpay.org> to input your debt information to help you make your decision. You must also decide that you cannot take on any new debt until you get your old debts paid off.

Mortgage and Home Equity Loans

Some mortgage lenders target people who don't have much money and may be poor credit risks. These mortgage lenders offer high-interest loans with hidden fees and leave borrowers deeper in debt or bankrupt. Be leery of telephone solicitations, TV ads featuring sports or other celebrities, or door-to-door salespersons selling mortgage home loans.

Other lenders offer home equity loans in the same way. When you take out a home equity loan, you put up your home as security, or collateral, for the loan. These loans can often look like a good deal, but *you can lose your home if you can't make the payments.*

A home equity loan is often advertised as a way to consolidate different loan payments, such as credit cards, with one payment. The advertisements contain charts showing how monthly payments will decrease if a home equity loan is taken out. However, look closely at how long it will take to pay off the loan. It's likely that it will take much longer and will cost you more money. This is not necessarily the good deal that it first appears to be!

Also, too often when a home equity loan is used to consolidate credit card debt, people still use their credit cards. Then not only is there a home equity loan to pay, there is also new credit card debt.

Beware of creditors who want to lend you up to 125 percent of the value of your home. These creditors may send attractive looking offers via the mail, often accompanied by "fake" checks in the amount of up to \$70,000, or they may contact you by phone. The interest rates on these loans are likely to be much higher than those from a conventional bank. Remember, if for some reason you can't make your payments, then you can lose your home.

Think twice before taking out a home equity loan. Imagine what might happen if for some reason (such as losing a job) you can't repay the loan. Decide if you can still safely afford to repay the home equity loan.

Watch for extra fees or services that may be packaged with home equity loans. Don't let lenders add fees or services that you don't want (such as credit life or regular life insurance) to your home equity loan. Otherwise you will end up with more debt than you want or can afford.

If you decide to take out a home equity loan, shop around for the best interest rates. Read the fine print and ask questions if you don't understand what you are signing.

Before You Borrow Money . . .

One mistake people make is assuming that predatory lenders are their only options for borrowing money. Instead of using rent-to-own plans, save enough money to buy furniture. Or, shop garage or household sales and thrift stores to find lower-priced furniture. If you need money to pay your utility bill, talk with your utility company to see if they have a budget plan or other programs to help you. Also, seek assistance from community or government programs, your church, or your employer.

- Don't take the first loan you're offered—shop around.
- Look for the lowest annual percentage rate (APR).
- Compare the APR and other finance charges.

- Know the total dollar cost of the loan.
- Avoid lenders who pressure you.
- Borrow only as much as you can afford to repay.
- Get a written copy of the loan agreement.
- Read the fine print.
- Don't sign anything you don't understand.
- Consider all of your options.
- Save money by paying with cash!

Check Out These Resources

American Association of Retired Persons

<http://www.aarp.org/>

Better Business Bureau

<http://www.bbb.org/>

Consumer Action

<http://www.consumer-action.org/>

Consumers Union

<http://www.consumersunion.org>

Federal Reserve System

<http://www.federalreserve.gov/consumers.htm>

Federal Trade Commission

<http://www.ftc.gov/>

Illinois Attorney General

http://www.illinoisattorneygeneral.gov/consumers/consumer_publications.html#credit

References

Casey, Michele and McWilliams, Valerie. **Predatory Lending Curriculum**. Champaign, IL: Land of Lincoln Legal Assistance Foundation, Inc., 2001.

Hildebrand, Pat. **Rent-to-Own Deals** (fact sheet). Urbana, IL: University of Illinois Extension, 1998.

Payday Loan Student Worksheet. Champaign, IL: Land of Lincoln Legal Assistance, Foundation, Inc, 2001.

Things You Should Know About ... PAYDAY LOANS. Illinois Attorney General Office <http://www.ag.state.il.us/consumers/paydayloans.html>

Your Money & Your Life Financial Education Curriculum. Lesson 2, Avoiding Money Traps. Urbana, IL. University of Illinois Extension, 2004.

