UNITED STATES COURTS
DISTRICT OF IDAHO

Idaho - Credit Abuse Resistance Education (I-CARE)

Predatory Lending Traps

Everyday, payday loan stores, rent-to-own centers, check cashing stores, pawnshops and tax refund-anticipation, car title andmore than three-year car loan lenders are unconscionably taking millions of dollars from the poor and financial illiterate, andoften pushing them over the edge to financial ruin and bankruptcy.

PAYDAY LOANS

- Marketed as short-term bridge loans
- Typical initial terms is 2 weeks—until next paycheck
- Typical amount is $300 (median amount is $500)
- Borrower gives post-dated check to lender to be held until next pay check
- Typical fee is $15 (up to $30)
- This is an annualized rate of 130-260%
- If borrower can't repay (91% can't), typical rollover fee is $50
- $50 every two weeks equates to an annual interest rate of 433%
- Payment of rollover fees makes repayment more difficult—this is the predatory TRAP
- 90% of loans go past 90-days
- When rollover fees are added, annualized interest rates average 396-780%, depending on the ultimate term
- This is greatly in excess of traditional usury rates on consumer loans (25-48%)—some state legislatures avoid this by labeling all charges "fees"
- Fees paid on loans that go past 90 days now total $4.2 billion annually--$139 million in Arizona alone
- This money is being extracted from the poorest segment of our population
- A typical borrower pays $793 for a $325 loan
- 15 States have outlawed payday loans
- 33 States have expressly authorized them
- Many payday lenders are partnering with national banks to avoid state prohibitions and restrictions
- An FDIC report concludes that the industry relies on repeat (rollover) borrowers and couldn't make money on initial loans because of processing expenses
- Payday lenders were labeled "loan sharks" during the great depression (this is the origin of the term)

INCOME TAX REFUND ANTICIPATION LOANS ("RAL's")

- Marketed as "Instant Tax Refund" or "Fast Tax Refund"
- First offered by professional tax preparers—now offered by car dealers, furniture retailers and the like
- Loan fees seem small but equate to annual interest rates in excess of 100%
- Saves an average of 1 week between e-filed return and direct deposit of refund into taxpayer's bank account
- Example: Refund = $2,000. Fee = $100. RAL saves taxpayer 10 days. Annual interest rate = 183%
- If other "fees" are factored in, annualized interest rate can increase to as much as 700%
- According to one report, fees may total as much as $900 for a typical refund of $2,150, although this includes the tax preparation fee
- RAL's carry very high interest rates for very safe loans—The IRS e-filing system alerts tax preparers to those most at risk for having their refund withheld
- The taxpayer is at risk if the refund is withheld. The refund may be withheld for delinquent child support, student loans and the like
- Approximately 12 million RAL's cost taxpayers more than $1.2 billion in fees annually
- Most of these are paid by the poorest Americans (79% by those with annual incomes of $35,000 or less)
- Many don't have bank accounts, so special use accounts must be established for the direct deposit of the refund, and fees are charged for these accounts as well
- RAL fees cost working parents who receive "earned income tax credits" $1.57 billion annually
- Free tax preparation sites are available. For a list call 800-829-1040.

AUTO TITLE LOANS

- Marketed as small emergency loans
- Typical term is 1 month, although in AZ there is no limit on the term
- Typical LTV is 55%
- Car must be paid for and lien free at time of loan
- Lender takes title and a duplicate set of keys
- Maximum interest under AZ law is 17% per month (204% annually)
- Interest is lower on loans of more than $500. Lowest in Arizona is 10% per month (120% annually)
- Example: Loan = $500. Monthly interest = $85. After 12 months, borrower has paid $1,020 and still owes $500. The car has depreciated in value.
- Loan fees are added—up to $85 in AZ. The median fee nationally is $25.

- Some AZ lenders also require additional contracts. One requires a "roadside service agreement" that costs $180.
- In the event of a default, the lender will typically repossess and sell the car. The borrower is then liable for any deficiency (the UCC applies in AZ). If the lender chooses, it may sue to collect on the debt rather than repossessing the car, and it can then tack on collection and legal fees.
- The car is a key asset for AZ wage earners
- These loan are made without credit checks or other tests for ability to pay

MORE THAN THREE-YEAR CAR LOANS

- Marketed as a way to reduce monthly payments
- 89% of new car loans are longer than 4 years, 55% are longer than 5 years
- <u>Downsides</u>
  - The longer the term, the more the borrower pays for interest
  - Example: Financing a $25,000 loan over six years instead of three more than doubles the interest paid: $5,240 as opposed to $2,576
  - Unless a substantial down payment is made, the loan will be "upside down" from day one (the average car loses 20% of its value in the first year and much of that occurs when it is driven off the lot)
  - An "upside down" loan is not fully covered by insurance, which generally covers only the car's value. "Gap insurance" can be obtained for the difference, but that adds to the monthly payment.
  - It's harder to sell or trade a car with an "upside down" loan.
  - Some dealers will roll the shortfall into a new car loan, but that just compounds the problem—the new loan is even more "upside down"
  - If there is a default, the lender will repossess and sell the car and the borrower will be liable for the shortfall between the sales price and the debt
- <u>10 tips for car loans</u>
  - Think in terms of price, not monthly payments
  - Buy a used car if you can't afford a new one
  - Make a down payment of at least 20%
  - Take out the shortest loan you can afford—cars lose value and are more likely to need repairs as they age
  - Don't take out a loan for longer than you intend to keep the car
  - If you get into an upside down loan, keep the car until its value at least equals the loan amount
  - Shop around and do your homework before buying (go to kbb.com and similar websites)
  - Sell your used car yourself—you will get more than its trade-in value
  - Spend no more than 20% of your disposable income on car payments
  - Make extra payments on your loan whenever you can—you build equity and reduce the total interest paid over the life of the loan

RENT TO OWN CONTRACTS ("RTO's")

- Marketed as a risk-free way to acquire furniture and appliances
- Because RTO's are not styled as loans, APR's are not disclosed
- The average imputed APR is 100%, based upon the sales price offered by the RTO stores
- When department store prices are used, the imputed APR can increase to 200% or more
- The total cash outlay required to purchase an item from an RTO store is 2-5 times the cash price at a department store
- Many items are not clearly marked as "new" or "used"
- The following comparisons are taken from a 1997 survey by the Public Interest Resource Group (in evaluating these comparisons, keep in mind that the average RTO contract has a term of 18 months):

	RTO STORE	DEPT. STORE	DIFFERENCE
Average cash price for 19" color TV	415.14	217.74	1.9 x higher
Total average RTO payments for 19" color TV	746.71	217.74	3.4 x higher
Average cash price for 19" RCA color TV	451.92	221.79	2.0 x higher
Total average RTO payments for 19" RCA color TV	801.00	221.79	3.6 x higher
Average cash price for 14 cf refrigerator	734.73	516.99	1.4 x higher
Total average RTO payments for 14 cf refrigerator	1,320.78	516.99	2.5 x higher

- The lesson is clear: DON'T RENT TO OWN! Save your money until you can afford to pay cash. At the end of 18 months, you will have your furniture and appliances and much more money.
- The one good thing about RTO contracts is that the consumer does have the option to cancel the lease and return the goods, and isn't obligated for the purchase price.