Alternative Financial Services

Check cashing services, rent to own stores, pawn shops, tax refund services, and payday lenders have one thing in common – they're a bad deal.

Alternative Financial Services

These services cater to people who cannot or will not seek funds from financial institutions such as banks or credit unions. They often practice predatory lending tactics:

- *Excessive fees* – These are costs not reflected in promoted interest rates. Because these costs can be financed, they are easy to disguise or downplay. Fees can boost the effective interest rate on loans to rates that would never be possible from banks – the equivalent to hundreds of percent per year.

- *Excessive penalties* – Missing payments or even trying to repay the loan early can result in huge fees.

- *High pressure sales* – When a sales person wants you to get started *today*, that's a sign that they are acting in their best interest, not yours.

Focus on Payday Loans

Perhaps the most common alternative lending practice is the payday loan. Unless you live in one of the dozen or so states that prohibit payday loans altogether, you have probably seen the signs in storefront shops or even heard ads on the radio. Like other alternative lenders, payday services promise fast cash, but charge interest and fees much higher than any bank. In fact, the effective annual interest of some of these short term loans can be over 400%! For comparison, a common annual rate for a student loan is just 8%.

What is a payday loan? It's a cash advance secured by a personal check. People in need of money to make it to the next payday may get a loan by writing a postdated check for the loan amount plus the fee charged by the lender. The lender gives the borrower the amount of the check minus the fee, and agrees not to cash the check until the loan is due – usually the borrower's next payday.

The fees on these loans are a percentage of the face value of the check – for example, $15 for every $100 borrowed. If the borrower does not repay the loan on time, they are charged new fees each time the same loan is extended or "rolled over."

Payday loans are among the most expensive legal loans in existence. Say you need to borrow $100 for two weeks. You write a personal check for $115, with $15 covering the fee to borrow the money. The check casher or payday lender agrees to hold your check until your next payday. If you can't repay the loan by payday, you may "roll-over" the loan and are charged another $15 to extend the financing for 14 more days. The cost of the initial $100 loan is a $15 fee. If you roll-over the loan three times, the finance charge would climb to $60 to have borrowed $100 for eight weeks.

The equivalent annual percentage interest rate for the loan equals 391 percent – ten times worse than the most expensive credit cards.

Better Deals for Short-term Cash

Before you decide to take out a payday loan, pawn your property, or seek an expensive income tax refund prepayment, consider speaking with someone at your financial aid office. There may be student loan options that offer much better terms than other loans.

A loan or a line of credit from a credit union or a community organization could be an option.

Finally, a cash advance on a credit card may be possible, but it will have a higher interest rate than regular purchases. Most credit cards also charge a fee in addition to interest.

Shop first and compare all available options before using an alternative service.