Payday loans appear to be an easy solution to your financial problems. A payday loan is typically a two-week advance against a borrower’s next paycheck. Lenders commonly charge $15 on every $100 borrowed, which works out to an annual interest rate of nearly 400 percent! Despite charging exorbitant interest rates, there are now more payday loan stores in the United States than there are McDonald’s restaurants, but you can’t get fries with that 400% payday loan.

THE “HOOK”

Payday loans are designed to look like a quick fix to a financial pinch that will be paid back in a week or two. Payday loans are often marketed as a way to avoid overdraft fees or high interest rate credit cards. Borrowers believe they will have no problem paying back the loan because they know that in one or two weeks’ time they will receive a pay check in the amount of the loan or more than the loan. But often, people borrow more in payday loans than they can afford to pay back in one or two weeks, especially if the borrower is on a fixed income. Borrowers often forget about the financial realities of life: parking tickets, forgotten bills, or any number of unplanned expenses. When unplanned expenses add up, many borrowers fail to repay the payday loan within two weeks and get hit with astronomical interest rates considered preposterous even when compared to credit cards.

THE LESSON

Consider the following before taking out a payday loan:

- PAY DAY LOANS ARE FINANCIAL TRAP. In 2013 a study by the Consumer Financial Protection Bureau (CFPB) revealed that payday loans are designed to lead borrowers into a revolving door of high cost borrowing that the CFPB calls a “debt trap”. According to the study, many consumers are unable to repay their loan in full and still meet their other expenses. Thus, they continually re-borrow and incur significant expense to repeatedly carry this debt from pay period to pay period. The high cost of the loan or advance may itself contribute to the chronic difficulty getting out debt.

- EXTREMELY HIGH INTEREST RATES. Payday loans have outrageous interest rates, equivalent to near 400% per year. Payday loans do not advertise their interest rates but instead charge a flat fee averaging $15 for every $100 borrowed, with payment in full in two weeks. 15% interest for every two-week period means roughly 7.5% interest per week which is the equivalent of 390% interest over a year: 7.5% x 52 weeks = 390%! If payday loans were advertised with 390% interest rates they would be far less appealing than they are by advertising a flat rate. Some would consider this highway robbery.

- THE LOAN MAY HAVE TO BE RENEWED. More frequently than not, borrowers of these loans cannot afford to pay them back. Guess what happens when the deadline arrives? Correct, they renew the loan to receive more time to pay it back, or take out a separate loan to pay off the prior loan. This can be the start of a debt spiral that can swallow borrowers like quicksand and is how the CFPB came up with the term “Debt Trap”.
The lesson continued:

- YOU DO HAVE OTHER OPTIONS. Pay Day loans may seem to be a quick, easy, one-time loan that is the easiest way to set you free of your financial problem. But before jumping at a payday loan, check with your financial institution for other options. They will be a source of knowledge that will help you with much more sensible solutions. They will be able to educate you of other short-term loan options that are available to you. And most certainly the interest rates will be far less than 300% and will benefit you far more than a “debt trap” that will send you in down a spiral of financial suicide.

In short, payday loans are a legal fraud that prey on victims in financial duress. They appear to be a onetime easy fix but often they turn out to be a vicious debt trap. The most logical way to avoid using payday loans is to set aside an emergency fund. Even if you earn a minimal salary or are an hourly wage start putting aside a small amount from every paycheck into a separate account to be accessed only in an emergency instead of using a payday loan. Putting together a spending plan or budget is another a powerful tool that will help you minimize financial emergencies and avoid falling into the debt spiral quicksand of payday loans. Don’t be a victim, be prepared and plan ahead!

The information obtained to write this article can be found at: