Payday Loans- Disaster Waiting to Happen

Anyone out there spend free time hanging out in Lion Den's? Jumping out of airplanes without a parachute? Then you may be the right person for a payday loan. If flirting with danger isn't you're thing, then my advice would be to avoid these loans.

Normally our articles focus on good financial practices, however, this article looks into the number one biggest don't today- Payday loans. State laws regulate payday lending. Currently, payday loans are only allowed in 35 States. Some companies have gotten around restrictive laws by teaming up with national banks that operate under different state laws. Payday lending has drawn great debate as of late with the rapid growth of the industry. Many are beginning to question why these types of loans are being allowed. With an average of 400% annual percentage rates, many end up in far worse shape after they take out a payday loan. In 2003 around 12 million used the services of a payday lender.

Let's look at how payday loans work. Typically, you request a payday loan for a short period of time, usually one to four weeks. You show proof of employment and identification and write a postdated check for the full amount of the amount you borrowed plus the payday loan fee, which you leave with the lender. The fee may seem reasonable: $15 to borrow $100 for two weeks, for example. However, the annual interest rate on that loan is 360 percent. It may seem worth it if you're in a bind, but people often extend the loan month after month - say for another two weeks - you will pay the fees for each extension and end up paying grossly inflated annual interest rates and end up in worse shape than when you borrowed the money in the first place.

Also, growing rapidly is the use of internet payday lending. People chose these lenders because of the lure of an easy fix. Here is an example of some of there advertising points: No embarrassing waiting rooms, No uncomfortable credit checks, Up to $1500 deposited overnight, Apply online or by phone, Direct Deposit not required, and best of all...(my favorite) LOW RATES. In researching this article I did an internet search and found hundreds of payday lenders. I chose one site to do a real life example borrowing $500.00. The terms of this lender where pretty typical- 485.45% APR, three rollovers allowed before I had to start paying a minimum of $50.00 in principal. I took out the loan and rolled it my allowed three times (which typically happens). In the end I had paid off the loan in six months and had only paid back a mere $1304.65, my $500 plus $804.65 in interest fees. Credit cards are to be used with caution, however, in this example if the person would have used a 20% APR credit card they would have paid around $35 of interest versus $804.65. Payday loans are never a good idea and are certainly not an easy fix.

The US Federal Trade Commission's recommendation is to avoid payday lenders. They recommend these alternatives for safer and less expensive loans:

Contact a local credit union for a small loan.

Ask for a pay advance from your employer.

Consider a loan from family or friends and get the terms of the loan in writing.

Use a credit card advance.

Request additional time to pay the bill from your creditors instead of taking a payday loan.

Find out what your options are before you need a short-term loan.

Look into overdraft protection on your bank account so if you don't have enough funds to cover a check you write, the bank will pay the check and you'll avoid insufficient fund fees and returned check fees.

See credit counseling.

Plan ahead to prevent financial emergencies. (Start a savings account at MECE Credit Union and do not touch unless it is an emergency- a new flat screen TV is not an emergency.)

Payday loans are like throwing gas on a fire. The high rates of payday loans make it difficult for many borrowers to repay the loan because they are already in a desperate financial state. They keep extending the loan and end up paying more in fees than they originally borrowed, putting them in worse financial shape than when they started.

Stay out of the lion's den!