High-Cost Debt

What is High-Cost Debt?

High-cost debt lending options seem good to consumers who need funds. However, these lending options typically hide high interest rates or risky payback periods. Many consumers who choose these options find themselves paying the lender a much greater sum of money than they originally needed to borrow.

Examples of High-Cost Debt

High-cost debt can come in many different forms. Listed below are some common examples of risky lending practices:

- **Payday Loans -** Payday loans are short-term loans. They are usually made to people who need money right away and plan to pay it back with their next paycheck. However, payday loans can be much more costly than they appear at first glance. If you do not have the money to pay the loan on time, the lender will renew the loan and charge you additional fees. This will increase the total amount you owe.
- **Rent-To-Own Services -** Rent-to-own services let you use an item for a time period by making monthly or weekly payments. The store will set up a plan for you to rent the item until you pay enough to own it. If you miss a payment, the store can take the item back. If this happens, you will not own the item, and you will not get your money back. Rent-to-own agreements are technically not loans, so no interest is charged. Generally, using rent-to-own services is much more expensive than getting a consumer installment loan to buy the item.
- **Refund Anticipation Loans -** Refund anticipation loans are short-term loans secured by your income tax refund. Although the business preparing your income tax return will give you the money, you are receiving a loan from a bank. You may not realize how much this loan is really costing you because you do not have to pay any fees at the time you receive the money.

High-Cost Debt Alternatives

To avoid the cycle of debt that many high-cost debt options use as traps, here are some alternative solutions for finding emergency cash at affordable prices.

- **Borrow From Yourself.** The best way to avoid a cash crunch is to put money into a savings account to help you pay for emergency expenses. Experts say this emergency savings account should equal about three to six months of living expenses to get you through a difficult period. If saving money seems impossible, consider making small, simple changes in money habits or banking practices.
- **Comparison Shopping.** If you do need to borrow money, it pays to comparison shop. When comparison shopping for loans, look at both total dollar costs and the annual percentage rate (APR. Payday lenders, for example, typically charge about $15 for every $100 borrowed. So, on a $500 loan for two weeks, you would pay $75 in interest. That may not sound like a lot of money to pay for a small loan, but it translates to a 391% APR! If you renew or roll over the $500 loan for another two weeks, you would pay an additional $75 in fees. At that rate, in 14 weeks, more is owed in fees ($525) than the original loan!)

- **Emergency Cash Options from Banks.** Many banks offer reasonably priced, small loans that enable money to be borrowed and repaid (with interest) later. One example is a line of credit, which can be used to borrow money for a short period of time. It is best to work with the bank to set up an account in advance instead of waiting until you are in a rush to get cash. As with any other loan, you will be told the APR before signing a formal agreement.

This information is an excerpt from the FDIC Money Smart for Adults website. For more information, visit the FDIC Money Smart for Adults website (https://www.fdic.gov/consumer-resource-center/money-smart) or contact us at 1-800-257-1705 for printed materials.