

Payday loans are short term loans you can use to get through a rough spot. Before you use a payday loan, make sure you understand the costs and risks. This page gives you a quick overview of how they work, and ideas on what you can do to avoid using payday loans.

What are Payday Loans?

Payday loans are small loans you can use when you are temporarily out of money. Most often, payday loans are short term loans (two weeks or so) for a modest amount of money (a few hundred bucks). To get a payday loan, you typically write a check for the amount you are borrowing – plus a fee. You might leave the check with the lender, and they cash it once you are ready to repay.

If you can't repay your payday loan when it comes due, you can "roll it over" so that the loan is extended. You don't have to repay it, but fees keep accumulating.

Costs of Payday Loans

In general, payday loans are extremely expensive. You end up paying an annual percentage rate (APR) that may be several hundred percent. For example, you might pay a \$20 fee to borrow \$100.00 for two weeks. The Consumer Federation of America has some nice calculations comparing payday loans to the alternatives. These show that you would pay about 426% APR on a payday loan.

Payday Loan Pitfalls

The main pitfall with payday loans is that they don't help you solve the problem at hand. If you're having financial difficulties, payday loans can only make the problem worse. You're paying a really high rate of interest which means that your expenses are just going up. As a short term strategy – maybe once or twice – payday loans can make sense. For example, you might need an emergency repair for your car so that you can get to work and keep earning income. As a long-term strategy, payday loans will pull you under.

You can get yourself in trouble if things get out of hand. Bouncing checks that you write to the payday loan establishment can end up on your ChexSystems file. Banks and retailers may then be unwilling to work with you.

Alternatives to Payday Loans

Instead of using a payday loan, consider some alternatives:

Build up an emergency fund in your savings account (sometimes easier said than done)
Keep an open credit card for emergency expenses
Get a signature loan (or unsecured loan) from your credit union
Pick up a part time job for extra cash
Set up a payment plan with your lenders
Investigate overdraft protection plans for your checking account
Try peer to peer lending services for a better deal

Defending Payday Loans

The payday loan industry is not shy about defending itself. They argue that payday loans can be less expensive than bounced check fees and overdraft protection programs. In addition, they argue that payday loans are the best quick and easy way for some people to get money.