# *'Good' Payday Loans Still Very, Very Expensive*

**NerdWallet**

By Karen Aho – August 16, 2016

With an IPO on the horizon, subprime lender Elevate will have an additional $545 million credit faculty to support its growing customers.

Elevate's niche right now is providing loans to borrowers with creditscores between 575 and 625. As the company expands, it wants to provide loans to customers with even lower credit-scores.

Has a kinder, gentler payday loan arrived?

Traditionally, payday lenders offset the high cost of making short-term loans with annual percentage rates of 400% or more. A borrower who falls behind finds himself on a treadmill of debt, paying only the interest and renewing the loan again and again. But a new crop of alternative lenders say they want to help customers make on-time payments and build good credit, too, so borrowers have access to cheaper loans down the road.

Some call themselves "socially responsible" lenders, saying they don't even plan to make money off the loans.

"We can make a profit on them, but it's razor-thin," says Jeff Zhou, co-founder of Fig Loans, a Houston-based startup expanding beyond Texas. "Every dollar we make is an extra dollar we have to take, and that's tough for people who aren't making a lot of money."

Instead, Fig Loans and other alternative lenders want to move customers toward other financial products, such as long-term loans and credit cards.

"We think the solution is to bring people into the mainstream financial services," says Leslie Payne, head of social impact and corporate affairs for LendUp, a California-based online lender that currently offers loans in 11 states. "The bridge is what's crucial. You've got to bring them in, then raise them up."
Essentially these products share many critical characteristics with payday loans: They're available to people with no credit or bad credit; they're fast, with funds dispensed electronically in 15 minutes to overnight; the loans are for small amounts, usually less than $500; and the payments are due back relatively quickly — in either two weeks or four months, usually.

One final, critical similarity: While these lenders may try to get the price down, these small-dollar loans still come with very high interest rates, almost always starting at over 120% APR.
Alternative but still expensive

Critics of the payday loan industry are not entirely convinced that alternative lenders are better for consumers.

“Anybody who’s making loans over 36% APR, that should be a huge red danger flag to stay away,” says Lauren Saunders, associate director of the National Consumer Law Center.
Cost of a four-month $500 loan*

| APR | MONTHLY PAYMENT | TOTAL INTEREST |
|---|---|---|
| 36% | $134.51 | $38.05 |
| 140% | $163.46 | $153.85 |
| 240% | $193.14 | $272.58 |
| 400% | $243.81 | $475.24 |

*By annual percentage rate (APR), compounded monthly

Lenders say providing fast cash to people without good credit is unavoidably costly. But excluding high-cost loans essentially denies millions of people access to formal lines of credit and “pushes people into more dangerous products, like loan sharks,” Payne says.

Nick Bourke, director of the small-dollar loans project at The Pew Charitable Trusts, concedes that the loans can be expensive to process, but says they should still be manageable and consumer-friendly, something he’s not sure he’s seen in the online lending space, which is rife with “widespread fraud and abuse.”

“There are just some very fundamental challenges that make doing payday lending or high-cost installment lending really costly to do in a friendly manner,” Bourke says.

A 2014 Pew survey found that a third of borrowers had funds withdrawn without their permission and about one-fifth lost bank accounts as a result of payday activity. “Borrowers are very clear,” Bourke says. “They want more regulations, they want more affordable payments. … They want reasonable time to repay the loan.”

What do the new lenders say to such criticism? They agree.

“We think affordability is key,” says Ken Rees, CEO of Elevate, whose Rise loans let borrowers refinance at lower rates. “All of our products are pay down over time, on a schedule that works for them.”
So how do these new lenders claim to put customers first? Here are some features they often have that traditional payday lenders usually don’t:

AFFORDABILITY TESTS

Traditional payday loans make it easy to pay only the interest, rolling over the principal into a new loan on the next payday. Loans from alternative lenders are designed to be paid off, with the principal shrinking after every payment.
That means responsible lenders must carefully consider a customer’s ability to repay. Rees, of Elevate, says, “We have to have affordability calculations, because if a customer is unable to pay back that loan, we have to write that off.”

If implemented, new guidelines from the Consumer Financial Protection Bureau would require traditional payday lenders to vet borrowers using affordability tests.

FLEXIBLE OR LONGER PAYMENT PLANS

Many alternative loans start with a four-month repayment period instead of two weeks or one month.
“To have three or four or five paychecks to pay it back, that’s what’s allowing people to restructure their finances and get ahead,” Payne of LendUp says.

The 2014 Pew survey found that nearly a third of people who borrowed from traditional online payday lenders said they’d received threats from those lenders, including threats of arrest by the police. Such threats are illegal.

By contrast, if customers can’t make a loan payment, lenders like Rise say they’d rather reschedule.
If customers don’t pay after 60 days, Rise “just charges it off,” Rees says, although the default does get reported to the credit bureaus.

“We, as a company, are leaving a lot of money on the table by not imposing additional fees and not having more aggressive collections practices,” Rees says. “But that’s just how we’ve done it. We think it fits really well with what [consumer regulators] are trying to do.”

THE PROMISE OF LOWER INTEREST RATES

The CFPB does not regulate interest rates. States do. That means rates can vary wildly from lender to lender and state to state.

In Texas, Fig Loans offers starter loans at 140% APR. Rise and Oportun, a storefront lender in six states, say their rates average about half the cost or less of traditional payday lenders, which is typically around 400% APR, according to the CFPB.

In some states, though, rates from alternative lenders can look just as scary as those of traditional payday lenders. Even so, borrowers may find that if they make on-time payments, they’ll have the option to lower those rates.

Rise says it will refinance its customers' loans and get them to 36% APR within three years, often less, according to Rees, "which is still expensive by prime standards, but for subprime borrowers it's transformative."

LendUp says customers who build points on its lending ladder can eventually qualify for loans at less than 36% APR, "and that's something that's just not available anywhere to the vast majority of our customers," Payne says.

CREDIT REPORTING

A credit history, and the credit scores derived from it, are indispensable for affordable borrowing. Mainstream lenders that lend at rates of 36% APR or less typically require scores of 600 or higher. Most borrowers who turn to payday loans either have no credit history or have one so tarnished that they don't qualify elsewhere.

Traditional payday lenders don't report on-time payments to TransUnion, Experian or Equifax, the major credit bureaus. A selling point for alternative lenders is that they report to the bureaus — sometimes automatically, sometimes optionally.

Oportun, which has been operating with this model since 2005, reports that after three loans its typical borrower attains a credit score of 672, which is about average.

FINANCIAL EDUCATION

Unlike most quick-cash shops, alternative lenders offer customers free online lessons in budgeting, savings and financial literacy. LendUp even rewards those who take courses with points to help attain better loan terms. "It's another signal that these customers are lower risk," Payne of LendUp says.
Triple-digit APRs are still triple-digit APRs

While gentler repayment practices and credit reporting are well-intentioned, they don't make these loans a good deal, experts say.
"High-cost loans are still dangerous loans," says Liz Weston, NerdWallet columnist and author of the book "Your Credit Score." "There are much better ways to deal with a cash crunch and to build your credit than resorting to a loan with triple-digit interest rates."

Financial advisors point out that there are plenty of nontraditional alternatives for fast cash that aren't based on credit scores, such as community-assistance programs, pawnshop loans, bill forbearance programs, employer payroll advances and loans against personal retirement or life insurance funds.
Any alternative that buys a borrower time to build credit through traditional means — a credit-builder loan or secured card, a year of on-time payments on existing debts — may put a more affordable loan under 36% APR within reach.

If you need cash instantly, a lender that reports on-time payments to credit bureaus is probably a better choice than one that doesn't, Weston says. But if you need another loan after the first is paid off, check with a mainstream lender that caters to bad credit to see whether your scores have improved enough to qualify for a loan under 36% APR, she says.

Alternative lenders acknowledge that extremely high-interest loans such as theirs are not the optimal way to build credit.

“We want people to take out those traditional loans,” says Zhou, who modeled Fig Loans largely around the advice of nonprofits and financial coaches. “But there are situations where a financial coach might have to refer someone to a payday lender, and as a last resort we’re just saying come to Fig instead of a payday lender.”

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