Predatory Loans: *Any type of loan that gives the upper-hand to the lender and cheats the borrower out of their money through unfair or excessive lending terms.*

Key Features:

- High interest rates
- Fees
- Penalties
- Unclear terms, or many terms, that can include insurance and other extra costs, or a payment plan that causes a borrower's periodic payments or loan balance to increase over time.
- Offers come via mail, phone, TV, or door-to-door sales tactics—tend to be aggressive.

Targeting:

Common targets are people who have few options, or think they have few options.

Targeted people include:

- those with low income
- those with poor/no credit
- older adults
- people of color
- other groups who may otherwise be unable to obtain traditional mortgage loans, auto loans, personal loans, and other consumer loans as a result of their financial situations.

Note:

While predatory loans generally make your financial life worse, predatory *mortgage* loans can be particularly devastating because you could lose your home if you default because of unaffordable payments.

Source: www.thebalancemoney.com

How Predatory Loans Work

A typical predatory loan benefits the lender at the expense of the borrower.

Example: Rent Centers (Like Rent-A-Center or Aaron's)

In rent-to-own transactions, consumers make weekly or monthly payments on an item. However, the customer doesn't own the item until after making all payments. If you miss one, the rent-to-own company can take back the merchandise without issuing a refund.

One rent-to-own store chain is currently selling a 65-inch Class Smart 4K UHD Samsung TV—it can be yours by paying $79.99/month for 24 months. After two years, you'll have paid $1,919.76. That might sound reasonable for a 65-inch TV if you haven't shopped around, but a similar TV at Walmart sells for a few dollars less than $500.

That $79.99/month might, at first, seem far more reasonable and affordable than $500. But after two years of paying $80/month, you're probably going to wish you had just saved up for the TV in the first place.

And don't forget, if you miss a payment, they'll take back the item, and you lose any money you put towards paying for it.

Example: Home Mortgage

You're on the hunt for a home, but can't qualify for a traditional mortgage because your outstanding debt has put a dent in your credit score.

You're contacted by phone several times by a predatory lender offering you a home loan based on the equity (worth of the home) built up in the home rather than your ability to repay the loan.

Desperate for a home, you take the bait and go through the loan proceedings, unaware that the loan is designed to allow the disreputable lender to seize your equity in the home.

At the advice of the lender, you even inflate your income during the loan application in order to qualify for it. You later determine that you can't afford the monthly payments.

Eventually, you're forced to default on the loan and foreclose on the property.

The end result is that you lose the home, whereas the lender doesn't suffer losses, since the home value exceeds the loan amount when the home is sold in foreclosure proceedings.

This is a predatory mortgage loan granted through "equity stripping," one of many classic predatory-lending schemes.

Types of Predatory Loans

These fraudulent loans can take several forms, but below are some of the most common ones:

- **Payday loans:** Payday loans are short-term loans due on your next payday. They're dangerous because the financing charges on these loans are so high that the annual percentage rate can sometimes amount to three digits. If you default on a payday loan, your credit score can be impacted for years.
- **Title loans:** Title loans are short-term, high-interest predatory loans that use collateral (your car, for example) to secure the loan. A car title loan results in you giving the title of your car to a lender and receiving cash in return for it. If you don't repay the loan in full according to the terms, the lender can repossess your car.
- **Flipping:** This is a loan arrangement where a lender offers to refinance a high-rate or otherwise high-cost loan (often a mortgage) at a slightly lower interest rate, usually within just a year of obtaining the original loan. Once you account for loan origination fees and broker fees, points, and closing costs, you actually increase your debt with such a loan.
- **Balloon payments:** Beware if a mortgage lender tries to sell you a loan where your payments are low at first, but a large payment is due at the end of the mortgage. This large payment is a balloon payment, and this type of mortgage loan is often offered by predatory lenders.
- **Negative amortization:** Negative amortization is a predatory loan payment structure where the borrower pays less than the interest cost every month. The lender then adds the remaining interest cost to your loan balance. For as long as you practice negative amortization, your loan balance grows.
- **Packing:** Packing occurs when a lender pushes a service (credit insurance, for example) that the borrower doesn't need in order to pad the loan balance with unnecessary fees.

Source: www.thebalancemoney.com

How to Avoid Predatory Loans

Predatory lenders are normally fast and slick talkers, but there are some simple ways to avoid them:

- **Recognize the signs of a bad loan:** High interest rates, fees, and penalties; repeated communications; and other high-pressure sales methods are telltale signs that a predatory lending scheme is at hand and it's time to walk away.
- **Read the fine print:** Predatory lenders are rarely upfront about rates, fees, and other loan terms, so carefully read the terms of the loan contract; understand your financial obligations (including the origination fee, prepayment penalty, and any closing costs); and reject any loan you can't afford. Consult a lawyer if you can't determine whether a loan is aboveboard.
- **Report suspicious loans:** File a complaint with the Consumer Financial Protection Bureau (consumerfinance.gov) if you suspect that you have been offered a predatory loan.

Heed any gut feelings that something is wrong with the lender and the loan. If the loan seems too good to be true, it likely is.

Alternatives to Predatory Loans

Instead of getting a predatory loan, consider one of these options:

- **Bank or credit union:** Start with a traditional lender such as a well-reviewed bank or local credit union. Don't assume they will reject your loan application. Credit unions even offer payday alternative loans (PALs), which are short-term, small-dollar loans that are particularly useful for those who need quick infusions of cash. They also tend to offer lower interest rates on loans than banks.
- **Peer-to-peer (P2P) loans:** P2P loans are another option you might consider if you have a problem getting a loan from a bank or a credit union. These are loans that investors with extra money make to individuals in the online marketplace, even those with a spotty credit history.
- **Family loans:** Consider reaching out to a close family member to inquire about getting a small loan, but use a written loan agreement to ensure that everyone is on the same page and to avoid souring the relationship.

Source: www.thebalancemoney.com