High Interest High Cost Loans

BUREAU OF CONSUMER CREDIT PROTECTION

STATE OF MAINE | DEPT. OF PROFESSIONAL AND FINANCIAL REGULATION

Maine Bureau of Consumer Credit Protection

Toll-free Maine Consumer Assistance

1-800-332-8529 (1-800-DEBT-LAW)
TTY users call Maine relay 711

Maine Foreclosure Prevention Hotline

1-888-NO-4-CLŌZ
(1-888-664-2569)

www.Credit.Maine.gov

The Maine Bureau of Consumer Credit Protection was established in 1975 to enforce a wide variety of consumer financial protection laws, including:

- -Consumer Credit Code
- -Truth-in-Lending Act
- -Fair Credit Billing Act
- -Truth-in-Leasing Act
- -Fair Credit Reporting Act
- -Fair Debt Collection Practices Act
- -"Plain Language" Contract Law

The Bureau conducts periodic examinations of creditors to determine compliance with these laws; responds to consumer complaints and inquiries; and operates the state's foreclosure prevention hotline and housing counselor referral program. The Bureau also conducts educational seminars and provides speakers to advise consumers and creditors of their legal rights and responsibilities.

William N. Lund
Superintendent
August 2016

DOWNEASTER COMMON SENSE GUIDE
TO HIGH INTEREST HIGH COST LOANS

By David Leach, MPA and Kyrie Johnson
Production: Steven Lemieux, MBA

Special Thanks to Senior Examiner Douglas Stark, Executive Director Patrick Fleming of the Maine Gambling Control Board, and the Financial Authority of Maine (FAME)

Maine residents can obtain additional free copies of this booklet by contacting the Bureau of Consumer Credit Protection at 207-624-8527 or toll-free at 1-800-332-8529. Non-Maine residents may purchase the publication for $6 per copy, or at a volume discount of $4 per copy on orders of 50 or more. Shipping fees are included in the prices listed.

Dear Maine Consumer,

In 1968, the U.S. Congress enacted Regulation Z: the Federal Reserve Board's *Truth-in-Lending Act*. Reg. Z provides an important credit shopping tool — the annual percentage rate ("APR"). APR is a measure of the cost of credit over a year displayed as a percentage. It is a useful tool for comparison shopping, almost like merchandise tags in a grocery store! Even though APR is a great resource, it does not make everyone wise comparison shoppers. You still have to shop around!

Consumer loans with high APRs come in many different flavors. Payday loans, pawn loans, and private student loans may all feature high APRs. Every day in Maine, consumers sign paperwork for loans with APRs of 18% or higher! Even loans with lower APR, like **home equity lines of credit ("HELOCs")**, pose a risk of credit overuse, and maybe even foreclosure.

The *Downeaster Common Sense Guide to High Interest/High Cost Loans* provides information and advice needed to understand the costs of entering into high-interest loan agreements. As the authors, we hope you find the content in this booklet useful in understanding the impact high cost loans can have on your budget, and how to shop for the best options available if you decide a loan is necessary. As always, "Cash is King." Think before you borrow!

Sincerely,

David Leach, MPA	Kyrie Johnson
Principal Examiner	Margaret Chase Smith Summer Intern, 2016

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I. Payday Loans

Payday loans are short-terms loans made for small amounts of money — usually $300-$800. Payday lenders rarely run credit checks. As such, these loans are often attractive to consumers with poor credit histories. In Maine, payday lenders must hold a license with the Bureau of Consumer Credit Protection. Legitimate payday lenders - those holding licenses - cannot charge a fee larger than $25 on payday loans of $250 or more. This is still a costly way to borrow money, working out to 260% APR on a typical two-week loan!

Not all companies play by the rules. The Maine Bureau of Consumer Credit Protection receives many calls each year from Mainers who have taken out illegal payday loans. The majority of these consumers obtained illegal loans over the internet from unlicensed lenders.

Online lenders often claim usury laws in Maine (and other states) do not apply to them. Illegal payday loans usually start with a consumer filling out an online application. Once the consumer has provided bank account information, the lender wires funds to the consumer's account. Illegal payday loans often feature APRs above 500%. Consumers may find they've paid the lender upwards of $1,000, but the principal balance on their $300 loan has only reduced $10-$20. Many of these companies automatically withdraw weekly, biweekly, or monthly payments from the consumer's account. Often, the only way to stop the company from withdrawing money is to close the bank account.

Several government entities are proposing "ability-to-repay" protections to prevent consumers from falling into potential debt traps caused by payday loans. As part of these protections, lenders would have to ensure the borrower can afford to pay the loan while still paying basic living expenses and other debts. Furthermore, if a consumer is requesting a new or rollover payday loan within 30 days of their last loan, the lender could only offer the loan if there is proof it will improve the financial situation of the borrower. Lenders would also be able to offer only a limited number of loans to the same borrower in any 90-day period.

"A man in debt is so far a slave."

–Ralph Waldo Emerson

Unsure if a payday lender is legitimate? Visit http://www.maine.gov/pfr/consumercredit/rosters/ and click on "Payday Lenders" for a list of businesses licensed to operate in Maine.

One alternative to a payday loan is an overdraft protection line of credit at your local bank or credit union. Checking account customers with an overdraft line attached to their account automatically have that line of credit (typically $500-$1,000) "kick in" when their account balance drops below $0.00. The credit "covers" outstanding payments, and the consumer pays interest for the time that loan is active. Overdraft lines of credit usually feature APRs of 9.9-18%, or a flat per-item fee. A line extension of $100 for a couple of days should only result in interest/finance charges of under $1.00, which is a big savings over a payday loan! Keep in mind, an overdraft protection line is still credit. Like any product, exercise caution when using overdraft lines of credit. Don't treat an overdraft protection line like extra cash in your checking account, it's not

"There are but two ways of paying debt: Increase of industry in raising income, increase of thrift in laying it out."

– Thomas Carlyle

Online Loans and Scam Collectors

Illegal payday lenders sometimes set up fake websites to gather personal information. After victims submit an application, they are often inundated with calls to "pay up" or face jail time, whether they took out a loan or not.

NEVER give out your personal information to unknown lenders, especially on-line!

II. Personal Loans

Many consumers who experience a cash-flow challenge may occasionally turn to a local bank, savings bank, savings and loan, credit union, or even a non-bank finance company for a small-medium sized ($500 - $5,000) personal loan. Common reasons for taking out a personal loan include:

- Lack of cash on hand to meet bills;
- Major unexpected auto repairs;
- Holiday shopping cash
- Winter heating bills (energy loans); and
- Wedding expenses;

Whatever the reason, personal loans are there for those borrowers who need them and require the cash in a hurry.

Personal loans are installment loans, generally featuring high APRs (9.9% or higher). These loans are expensive because they are **unsecured:** supported only by the borrower's creditworthiness. If you don't repay a mortgage loan, the lender will foreclose on your house. Unpaid car or truck loans result in the repossession of **collateral** securing the loan (the vehicle). Not so with **unsecured loans**. If you don't repay an unsecured loan, the lender cannot offset their loss by repossessing your personal property. As such, lenders find personal loans quite risky.

Most consumer loans in the United States feature **risk-based pricing**. Risk-based pricing is the practice of setting loan terms based on the perceived risk presented by a borrower. **Secured loans —** loans where the borrower has pledged an asset as collateral — present less risk to the lender. As such, they often feature lower APRs than unsecured loans.

Whether you need to pay winter heating bills or your child needs cash to pay for college textbooks, personal loans are expensive. If you're planning on obtaining a personal loan to spend on something non-essential, think twice — you might have cheaper alternatives.

Try setting aside your state and federal income tax refunds in a "rainy day" account. Set up a separate savings account and have money direct-deposited from your paycheck to that account. $25 each week adds up to $1,300 over the course of one year. Set aside $50 each

"I'm living so far beyond my income that we may almost be said to be living apart."

– E.E. Cummings

week, and in two years you will have $5,200! Consider cutting back on non-essential expenses like cable, eating out, or magazine subscriptions. It may take a little longer, but it will save you in the long run!

“Many delight more in giving presents than in paying their debts.”

- Sir Phillip Sidney

The Cost of Credit

Below is a chart of a $4,000/36 month 18% APR personal loan. This (made up) consumer decided a winter trip to Florida Keys, complete with air fare, hotels and some “spending” money, was the perfect “pick me up” in the middle of a long Maine winter. So, what are this consumer’s final costs for a 10-day trip in the Florida sun?

Amount Borrowed	$4,000.00
Length of Loan	36 Months
Monthly Payment	$144.61
APR	18%
Finance Charge	$1,205.96
Total of (36) Monthly Payments	**$5,205.96**

Few of us can argue ten days in Key West in January or February is not a great respite from winter. But, did you realize our consumer's 10 day vacation will take 1,095 days to pay back? By the time the consumer pays off the vacation, it will have cost $5,205 - the original $4,000 borrowed plus $1,205.96 in interest!

III. Private Student Loans

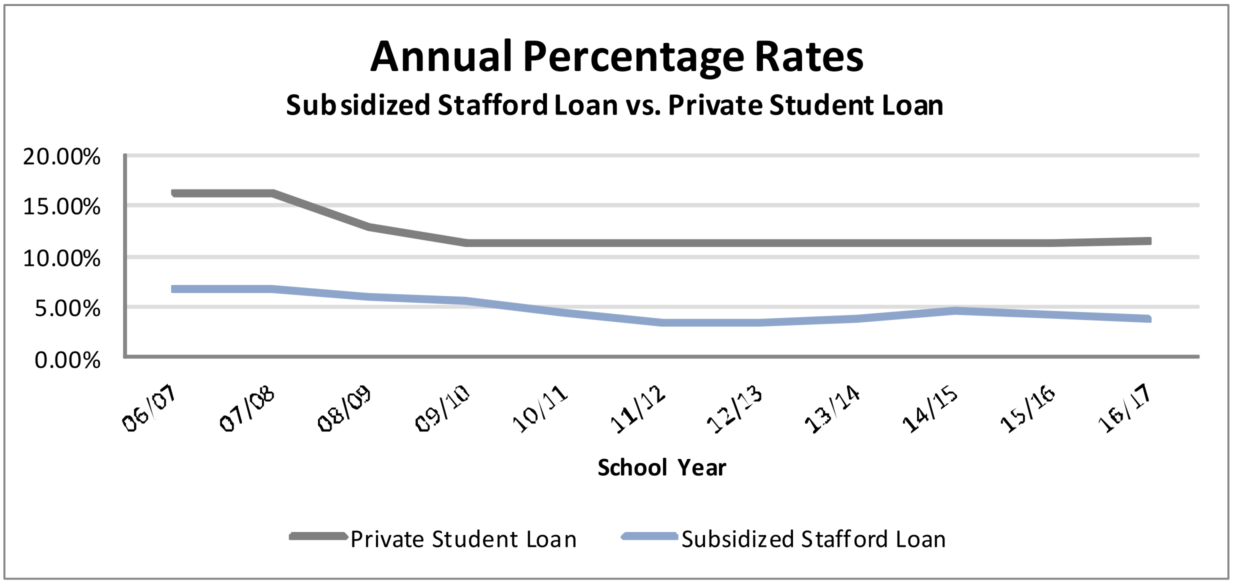
Private student loans, also known as **alternative loans**, are offered through private institutions like Sallie Mae, Wells Fargo, and Citibank. They often feature higher APRs than federal student loans. Federal student loan rates generally range from 3-7%, while private loans often range from 3.5-15%. Additionally, private student loans sometimes feature **adjustable rates** — rates that can change (go up or down) over time.

Many lenders that offer private student loans - all with different repayment plans, forgiveness programs and fees. It is important to "shop around" if you choose private loans to meet your higher education funding needs. Private loans are **unsubsidized**: not backed by the federal government. Unlike some federal loan programs, private student loans accrue interest while you are in school. If you plan on paying your interest in school, be sure there is no prepayment penalty on the loan! If you are able to do so, it will lower your outstanding loan balance when it's time to begin making scheduled payments.

Many private loans risk-based, so individuals with better credit get loans at lower rates. Lenders use an index-plus-margin equation to determine interest rates. The index part of the equation is based on the fluctuation of a specific index (either the **London Interbank Offered Rate ["LIBOR"]** or the **Wall Street**

Index + Margin Example

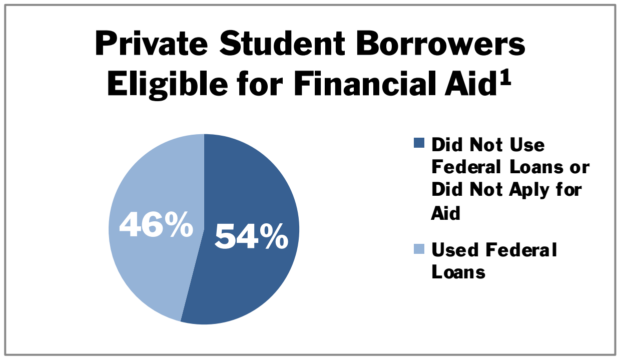
Prime Rate	3.50%
Margin	+ 8
Interest Rate	11.50%



Prime Rate). The margin is dependent on an individual's creditworthiness, usually ranging from 0-15.

Compare loan rates and programs before finalizing any private student loans. Federal student aid is often a more affordable option with more flexible payment programs. Many state-based private student loan programs also offer competitive loans at fixed rates. Private student loans may affect financial aid awards. Check with your financial aid office to see if they consider alternative loans when determining your financial aid eligibility.

If you are thinking of taking out a private student loan, don't borrow more than you need. The Finance Authority of Maine (FAME) provides resources for consumers comparison shopping for loans, including salary and debt calculators that can help determine how much debt is acceptable. FAME also provides "The Loan for ME" program, which offers loans at a competitive fixed rate. It even provides loan comparisons for different lenders. FAME can provide information about steps to take before taking out a private loan, choosing a lender, and refinancing or consolidating student loan debt. To access The Loan for ME, visit www.TheLoanforME.com. To contact FAME's Higher Education Division with any student loan questions, call 1-800-228-3734.



"There's more student debt than credit card debt! Everywhere I go, I run into young people trying to build careers while they keep shelling out money on their education loans. If the economy is looking for a new generation of home-buyers, I can't imagine they'll get it from these folks."

– Gail Collins

Taking out a private loan often requires great credit. If you are not creditworthy or are under the age of 18, you might need a cosigner who also has great credit. According to the Consumer Financial Protection Bureau, 90% of private loans in 2011 were cosigned[2]

Cosigning on a loan is a serious commitment! Cosigners are 100% liable for the repayment of the loan. If you are considering cosigning for someone, you should be at least as informed about the loan and its risks as the main borrower.

[1]Consumer Financial Protection Bureau. (2012). *Private Student Loans*. Retrieved from http://files.consumerfinance.gov/f/201207_cfpb_Reports_Private-Student-Loans.pdf

[2]Ibid.

Simple Interest vs. Compound Interest

Lenders calculate finance charges in different ways. Some lenders calculate finance charges based on simple interest. When calculating **simple interest**, the lender charges interest on the original principal balance only. The simple interest formula is, well, simple: Interest = Principal x Rate x Time. If you borrowed $100 at 12% APR for a period of one year, you would accumulate $12 in interest ($100 x 12% x 1 = $12)

When charging **compound interest**, interest is paid on both the principal balance and any outstanding finance charge. Compound interest is usually associated with deposit accounts. But, some loans, including credit cards, do calculate interest using the compounding interest method. The formula for compound interest is a little more complicated than the simple interest formula:

$$FV = PV\left(1 + \frac{r}{n}\right)^{nt}$$

"FV" is the future value of the loan, including interest, "PV" is the initial principal balance, "r" is interest rate, "n" is the number of times the interest compounds each period, and "t" is the number of periods. If you borrowed $100 at 12% APR for a period of one year without making any payments during that year, you would accumulate $12.68 in interest (100 x [1+{12/12}] ^12*1=$112.68=$100 principal + $12.68 interest).

The example below shows how much difference the method used to calculate interest can make. Both loans feature a $5,000 principal balance at 10% APR, payable in one installment after two years. The "compound interest" loan compounds annually.

	Simple Interest	Compound Interest
Year 1 Interest	$5,000 x 10% x 1yr. = $500	$5,000 x 10% x 1yr. = $500
Year 2 Interest	$5,000 x 10% x 1yr. = $500	$5,500 x 10% x 1yr. = $550
Total Interest	$1,000	$1,050
Total Principal and Interest	$6,000	$6,050

Any credit contract (including application folders for credit cards) should contain an explanation of how your interest will be calculated.

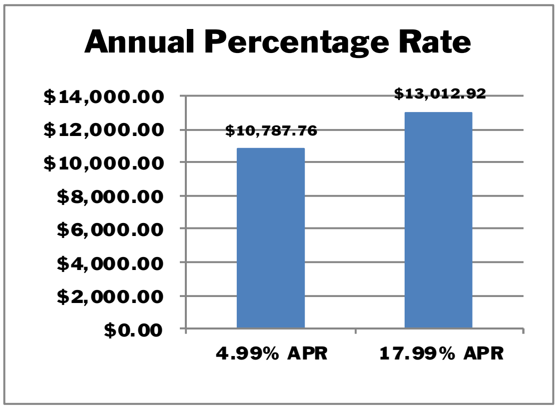
IV. Buy-Here-Pay-Here

Many independent used vehicle dealers feature signs posted outside of their dealerships promising:

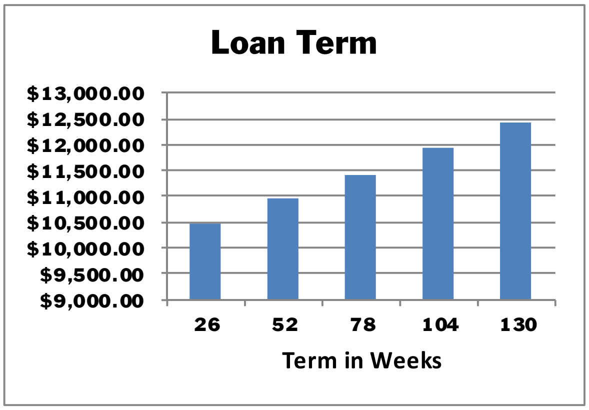
- "We Finance Everyone!"
- "Buy Here & Pay Here; Your Job is Your Credit!"
- "No One's Turned Down for Credit!"

Even consumers with poor credit histories can visit some dealerships, get financing, and drive away with a used car or truck. In true buy-here-pay-here deals, borrowers make payments directly to the dealership — usually weekly. Buy-here-pay-here dealerships rarely perform credit checks. As such, financing can be quite risky for the dealership. To offset that risk, <u>many dealerships charge 18% APR — the highest allowable APR on auto credit sales under Maine law</u>. Some charge slightly less. Be sure to shop around for the best rate available. Strong applicants with steady jobs, limited debt, and high **credit scores** (750 or higher), may be able to qualify for more affordable financing, and possibly a newer vehicle with less mileage, at some dealerships.

Some used vehicle lots offer buy-here-pay-here financing on only a few select in-stock vehicles. These are often older, high mileage vehicles. Some dealerships mitigate risk by charging well over **fair market value** for these vehicles and requiring a large down payment. If dealership repossesses the vehicle, they may still profit from the initial sale transaction. If your vehicle is repossessed and sold in a commercially reasonable manner, it will only fetch what it's actually worth.. You might still be responsible for the difference between that amount and what you actually owe.



This chart shows the difference in total cost between vehicles with identical $10,000 sale prices and 36-month terms, financed at 4.99% and 17.99% APR.



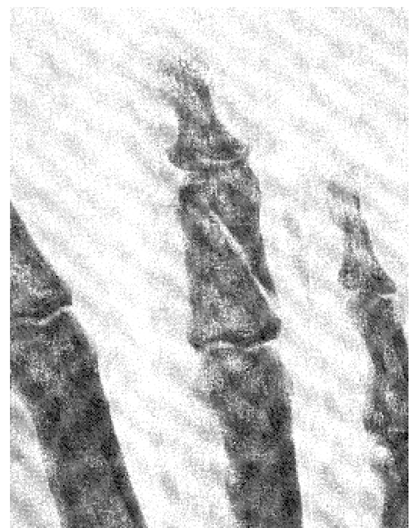
This chart shows the difference in total cost between vehicles with identical $10,000 sale prices financed at 17.99% APR, with terms of 26, 52, 78, 104, and 130 weeks.

Sales Finance Companies

Sales finance companies - a type of non-bank lender - make various types of loans to consumers. Many lend to consumers with challenged credit histories. New car dealerships often offer financing through "captive" finance companies: sales finance companies owned by vehicle manufacturers. Captive finance companies' credit standards are sometime more liberal than those of other lenders. Be careful not to agree to a vehicle loan you cannot afford! You always have the option of walking away from a deal you don't want (or don't understand).

Veni, Vidi, Visa: (Rough Translation)

I came, I saw, I did too much online shopping with my credit card!



"I'm sorry sir, it looks like you have a broken 'clicking' finger."

No Money Down Auto Financing

The table below illustrates the difference in cost between no money down financing and financing with a 20% down payment. The vehicle was sold for $10,000, and financed at 17.99% APR over 104 weeks (two years).

	20% Down	**No Money Down**
Down Payment	$2,000.00	$0.00
Amount Financed	$8,000.00	$10,000.00
Weekly Payment	$91.73	$114.66
Total Paid	**$9,538.88**	**$11,923.60**
Difference in Total Cost: $2,384.72		

V. Casino Loans

Casino loans may not be high-interest bearing loans, but they can result in high costs. In Maine, you cannot play slot machines and table games using debit cards, credit cards, or lines of credit offered by the operator. However, if you travel out of state, you may find casinos offering lines of credit.

Casino lines of credit are usually interest free loans. People use them to avoid carrying cash during casino visits. The loan application involves a credit inquiry (a hard pull on the consumer's credit report), and usually requires account balance information. The credit limits on casino lines of credit are usually close to the average available balance in a consumer's checking account.

When about to play a game the gambler will request a “marker.” A marker is like an IOU. The marker contains bank account information, the amount the individual would like to take out of your line of credit, and, often, some personal information (e.g., name, address, phone number). Once filled out, the consumer can redeem the marker for chips or game tokens.

Casino lines of credit are an alternative to avoiding high casino ATM fees or carrying large sums of cash. However, they are loans. They needs to be paid back in full in a short period of time- usually within a month or less. <u>Never request a line of credit you do not have the money to pay back</u>. Gambling is a high risk activity and there is no guarantee the individual can make up for any losses that may occur.

In some states, it is a crime to not repay gambling debt. A good alternative to casino loans is depositing cash up-front and drawing on those funds. Some casinos offer this option, which allows individuals to deposit a cash amount (e.g., $1,000) and use markers to draw on those funds only. This does not require a credit check or account balance check because there is no risk to the casino.

Gambling online with your credit card carries the same amount of financial risk as playing gaming tables and slot machines in person. The only difference being if a gambler does not pay that balance by the end of the billing cycle, they may be paying off that loss on a high APR credit card!

“It is the debtor that is ruined by hard times.”

– Rutherford B. Hayes

VI. Pawn Loans

Many Maine communities feature pawnshops in their business districts. Pawnshops fill a niche for consumers that need immediate credit and may have less than perfect credit histories. Like any loan, pawn loans require the amount borrowed to be paid back, plus interest. Consumers that use pawn loans bring in an item of value (e.g., jewelry, consumer electronics, collectible coins), and pledge that item as collateral on a short-term loan.

The pawnshop will issue a loan for a percentage of the item's value. In Maine, the maximum charge on pawn loans of $500 or less is 25% per month (300% APR). On pawn loans of greater than $500, the maximum charge is 20% per month (240% APR). By law, the pawnshop must law to keep possession of the property during the pawn term. Once the customer has paid back the loan, the pawnshop returns the item to the borrower. Consumers who do not repay their pawn loan by the due date lose their claim to the item, and the pawnbroker can then offer that item for resale in their shop.

In Maine, the initial period of a pawn transaction must be for a minimum of one month. Consumers may request a one-month extension in writing on an item in pawn at the same terms of the original contract. The pawn shop may issue extra extensions at their discretion, but are only required to issue the one. If you have a question about a pawn shop. call the Bureau of Consumer Credit Protection at 1-800-332-8529.

"Debts are nowadays like children begot with pleasure, but brought forth in pain."

-Moliere

Automobile Title Loans

Automobile title loans are a type of secured loan, where borrowers use their vehicle titles as collateral. In a title loan, the lender places a lien on the vehicle's title, and the consumer surrenders the hard copy of their title for the duration on the loan while retaining possession of the vehicle. Although nearby states them, Maine law prohibits title loans. If you cross the border into New Hampshire to take out a title loan, Maine law will not protect you. Automobile pawn loans, in which the pawnshop stores the consumer's vehicle for the duration of the pawn term, are legal in Maine.

VII. Credit Cards

Nearly everyone has an opinion about credit cards. Here are quotes we've heard from Maine consumers:

- "I got into so much financial trouble with my card in my early 20s; first the balance was just under $1,000, but the next thing I knew it was over $3,000, then approaching $4,000. Now I'm almost 30 and maxed out right near my credit limit of $5,000. I can only afford to make the minimum payment each month, which is around $200—and close to half of that is going toward interest only! At 18% interest, it will take me forever to pay this thing off."

- "I do all my on-line ordering through my bank credit card. It's safe, secure, and I'm protected much better than if I used my debit card. It also avoids the hassle of getting a money order or the extra step of mailing a personal check from my credit union or bank."

- "I started with only one credit card, and was good about paying it off before the interest started. Now I've got eight cards, and they've basically taken over my life. The interest alone I'm paying on plastic every month could make a luxury car payment…My bad."

- "A few times when I've been on a long trip, my credit card has come in handy for unexpected car repairs. As long as I'm paying off what I charge every month, it's a good financial tool for me for uses like this."

Credit cards, in reality, are neither good nor bad; it's how you use them!

When compared to typical home loans or auto loans, credit card usually feature much higher APRs. The national average APR for a credit card in the United States hovers around 15%, versus 4.00% APR or less on mortgages. Credit cards can be an expensive way to borrow. The Bureau recommends:

- Not treating credit cards like extra cash. They're not. They are a high-APR revolving loan which you must pay back, with interest.

- <u>If you choose to have a credit card, be financially disciplined</u>. Pay the card's balance in full every month during the card's grace or "free ride" period.

"Before borrowing from a friend, decide which you need most"

-Proverb

- Limiting your credit card use, especially if you're just starting out, to travel and emergency purchases only. It can be difficult to resist impulse buys on clothes, eating out, and online purchases. The rush of the new "plastic" purchases quickly wears off when you realize you can't pay off the balance.

- Limit yourself to no more than three credit cards.

- Shopping for the best deal. A credit card with a low APR, no annual fee, a grace period each month, and maybe a rewards program can a win-win situation for responsible card holders.

You can avoid interest charges altogether with some credit cards by participating in a **same as cash option**. Same as cash, or **deferred interest**, options allow consumers to make installment payments on charged items for a short period of time, avoiding finance charges. If you do not pay the full balance on a deferred interest option by the end of the term, the card issuer may charge a high APR for the rest of the remaining period. Only use same as cash options if you are sure you can pay the full amount during the term. If you don't, it may end up costing you in the long run.

The **Credit Card Accountability Responsibility and Disclosure Act of 2009 ("CARD Act")**, set several standards to protect consumers. Under the CARD Act, in-person credit card bank solicitations cannot happen on college campuses. Applicants under 21 must prove they are capable of making payments or have a co-signer over 21 years of age. The lender must give cardholders must at least 60-days notice, in writing, of any APR increases. Monthly statements must include a notice disclosing the time to pay off the card when making only minimum payments, and must disclose limits on over the limit and late payment fees.

"Who goeth a borrowing, goeth a sorrowing."

– Thomas Tusser

The High Costs of a Credit Card Cash Advance

In addition to allowing you to make purchases, credit cards also can also let you withdraw money from an ATM. Never confuse this transaction with a **debit card** withdrawal from your checking or savings account. Credit card ATM withdrawals are **cash advances**. When you use a credit card, you are drawing down on the card issuer's line of credit. The second money leaves the ATM, that amount begins accruing interest. Cash advances do not feature **grace periods**. APRs on cash advances are often much higher than a credit card's standard rate. Avoid cash advances if at all possible. Plan ahead. Keep cash on your person or use a debit card at a fee free location!

Ice and Snow in a hot Maine Summer?

There are two popular approaches for consumers to pay down multiple debts: the debt snowball method and the debt avalanche (stacking) method.

The "Heavy Credit Card Debt Nor'easter" Scenario:

Four Credit Cards: $5,000 @15.99% APR
$3,000 @ $18.99% APR
$2,000 @ 16.99% APR
$1,000 at 14.99% APR

The Debt Snowball Method: Pay off the card with the smallest balance first. Then pay off the card with the next smallest balance, then the next smallest. For the debt snowball method to be successful, <u>the cardholder must make minimum monthly payments on all active accounts</u>, while making extra payments on the "targeted" account with the smallest balance..

1st: $1,000 @ 14.99% APR, then
2nd: $2,000 @ 16.99% APR, then
3rd: $3,000 @ 18.99% APR, finally
4th: $5,000 @ 15.99% APR

The Debt Avalanche (Stacking) Method: Start with the card with the highest APR. In our example, this card has a $3,000 balance at 18.99% APR. Make large or extra payments on that card while making minimum payments on the remaining accounts. Once the card with the highest APR is paid off, repeat the process with the next card in line!

1st: $3,000 @ 18.99% APR, then
2nd: $2,000 @ 16.99% APR, then
3rd: $5,000 @ 15.99% APR, finally
4th: $1,000 @ 14.99% APR

Using either method, all card balances will eventually reach $0. Think before you borrow, especially with high APR consumer loan accounts like credit cards. Strive to pay all credit card balances in full, every month!

VIII. Rent-to-Own

Rent-to-own contracts allows consumers to rent items on a weekly or monthly basis, with an option to buy at the end of the rental period. Make sure to read the contract. Each contract outlines specific terms, including how to purchase the rented item(s). It also discloses the rental period, charges (if any), and any extra fees that you may incur.

If you make payments on time, rent-to-own contracts are self-renewing. There is no obligation to continue making payments. If you no longer want the merchandise, return it to the store. If you do not make one or more of your payments, the rented merchandise may be repossessed. After repossession, it is sometimes possible to reinstate your rental contract within a specific time frame by making any payments you missed. If you are unable to do so, you may lose the rental contract and the money paid to date on the contract.

Keep in mind, the cash price at rent-to-own businesses is often higher than the market price for identical items at traditional retailers. This is because, in part, no credit check is needed to take part in rent-to-own transactions. Since the business faces a high risk of consumers defaulting on accounts, it charges a higher price.

Most rent-to-own businesses can deliver within 24 hours, which can make it convenient if you need a product immediately. If your oven breaks a week before hosting Thanksgiving dinner, renting a stove while you get ready to buy a new one may be a good option. Renting furniture can also be beneficial. For consumers only living in an area for a few months, renting rather than buying some items for that short period of time may also make sense.

In Maine, consumers have the right to acquire ownership of property under rental purchase agreements if the cash price of the item equals

Rent-to-Own vs. Regular Purchasing
Flat Screen TV: Retail Cost $800.00

	Rent-to-Own	Regular Purchase
Weekly Payments	$19.99	$30.77
Payment Term	90 Weeks	26 Weeks
Total Cost	$1,799.10	$800.00

Total Different: 50 Weeks | $999.10

50% of all rental payments made by the consumer. In other words, if the cash value of a TV is $1,000 at a rent-to-own facility and you have made $2,000 worth of payments towards that contract, you have the right to own that TV at no further cost. If a consumer defaults on their payments for a period of at least three business days and does not return the property, the merchant may send a right-to-cure notice. The consumer then has an additional three days to respond before the merchant can repossess the item or initiate a court action to recover the item or payments due.

Under Maine law, delinquency charges on rent-to-own accounts may not exceed the greater of 5% of the missed payment or $3. The merchant can only assess a delinquency charge once on any single missed payment. Administrative fees on rent-to-own accounts may not exceed $15 per consumer, for all rental agreements with a merchant entered into in a single day. You can find the full list of consumer rent-to-own protections in Article XI of the Maine Consumer Credit Code (Title 9-A). If you have questions regarding rent-to-own, contact Bureau of Consumer Credit Protection at 1-800-332-8529.

"The second vice is lying; the first is running in debt."

– Benjamin Franklin

Furniture, Mattress, and Appliance Financing

Many out-of-state lenders offer retail financing for furniture, mattress, and appliance purchases. Enter these types of transaction as you would any other major purchase. Keep your eyes open, and comparison shop for low-APR alternatives.

Take the time to review the application and disclosures, and make sure you understand them. You may find the APRs quite high compared to rates on personal loans through your local bank or credit union. The terms may also include high late fees. If you miss payments, lenders may also increase the APR they assess.

Be aware of any offers that feature no payments/no interest (0% APR financing!) for a certain amount of time (typically six months). There may be penalties if you have not paid the entire balance of your purchase by the end of the grace period. Mark the final day for penalty-free payment your paper or electronic calendar well in advance. Penalties may include the assessment of interest on your purchase all the way back to the beginning of the contract. If you do take advantage of such an offer, make sure you understand and follow the terms.

IX. Home Equity Lines of Credit

Following the passage of landmark federal tax legislation in 1986, financial institutions developed the **Home Equity Line of Credit ("HELOC")**. HELOCs tap some or all the available **equity** in a borrower's home. Equity is the difference between the value of property and any claims held against it (e.g., a mortgage). If a home is valued at $200,000 and the mortgage balance is $140,000, the home has $60,000 in equity ($200,000 - $140,000 = $60,000). Like credit cards, HELOCs are **revolving loans**. A percentage of the loan balance must be repaid each month. Unlike most credit cards, HELOCs are secured loans. If you miss payments, you risk losing your home to **foreclosure**.

Lenders generally look at two kinds of ratios when deciding whether to grant a HELOC. The first is the **loan-to-value ratio**. Loan-to-value ratios are calculated as the amount of money borrowed divided by the fair market value of the property. If a lender allows an 80% loan-to-value ratio, and a consumer's equity equals $60,000, the consumer could potentially borrow up to $48,000 ($48,000 ÷ $60,000 = 80% loan-to-value ratio).

The second kind is the **debt-to-income ratio**. There are two kinds of debt-to-income ratios. **Front-end ratios** are calculated as the applicant's total monthly mortgage payment divided by the borrower's gross monthly income. Front end ratios should not exceed 28%. **Back-end ratios** are calculated as the sum of an applicant's total monthly mortgage payment and the applicant's other monthly loan payments, divided by the borrower's gross monthly income. Back-end ratios should not exceed 43%.

HELOCs are not free money! You must repay back the amount borrowed, plus interest. Many HELOC users write checks to access their lines of credit. APRs on HELOCS are determined by an **index** (e.g., The Wall Street Journal of Money Rates Table), plus a **margin**. The margin is the difference between the index rate and the rate the borrower will actually pay. Most HELOCs are **adjustable rate loans**.

Maine's Foreclosure Protection Hotline (1-888-664-2569) is a great resource for Mainers having difficulty repaying mortgages on their primary residence. This service is free. The Bureau assigns callers to one of several Maine-based foreclosure counseling agencies. These agencies assist callers in trying to save their homes from foreclosure. Some callers admit the main reason for their financial difficulties is over-reliance on HELOCs to pay for non-essential items. Remember, *every dollar you borrow through a HELOC moves you a dollar further away from paying off your mortgage*.

How Much Debt is Too Much Debt?

Many adults struggle under the weight of having high monthly payments and too little income. How do you best avoid this situation? Understand how the debt-to-income ratio calculations work. Stay within certain percentages to avoid being "maxed out" when the bills come due!

Take all monthly debts (mortgage, rent, loan payments, alimony, child support) and divide the sum by your gross (pre-tax) income. For example:

Student Loan Payment..$300

Rent $550

Auto Loan..$299

Total Monthly Debt $1,149

Gross Monthly Income (Annual Income Divided by 12) .... $35,000/12=$2,916

Debt-to-Income Ratio.. $1,149/$2,916=39.4%

If you can keep this ratio at 43% or less, you're potentially in good shape!

"We must make our choice between economy and liberty, or confusion and servitude...If we run into such debts, we must be taxed in our meat and drink, in our necessities and comforts, in our labor and in our amusements...If we can prevent the government from wasting the labor of the people, under the pretense of caring of them, they will be happy."

– Thomas Jefferson

X. Debt Consolidation Loans

Debt consolidation loans are extensions of credit used to retire existing debts. They are often used for unsecured loans (e.g., credit cards, personal loans). The consumer takes out a consolidation loan, using it to pay off their existing debts. After consolidating their debts, the consumer makes a single monthly payment to the new lender.

Consolidation loans can offer a way to pay off loans with a lower percentage of a consumer's income devoted to debt. If you are considering debt consolidation, add you monthly loan payments together and compare the result to the monthly payment on the consolidation loan. Make sure to compare total finance charges on your current loans and the consolidation loan before making a final decision. Although your monthly payments may be lower, the consolidation lender may assess interest at a higher rate that your current lenders, costing you more over time. If you are unsure whether debt consolidation is your best option, reach out to your creditors. You may be able to arrange for a lower APR, lower payments, or a change in payment due date. It may also be helpful to meet with a registered credit counselor to discuss your options.

Debt management service providers ("DMSPs") can help you manage you debts while still affording daily expenses. They may also be able to help you decide whether to consolidate debts. In Maine, DMSPs must hold a registration with the Bureau of Consumer Credit Protection. Always check with the Bureau at 1-800-332-8529 to make sure your DMSP holds a license. It's not uncommon to work with an unlicensed company, only to have them take your cash without providing services!

Regular Loan Terms vs. Loan Consolidation				
	2 Year Personal Loan	**4 Year Personal Loan**	**Total of Personal Loans**	**6 Year Consolidation**
Amount	$10,000.00	$20,000.00	$30,000.00	$30,000.00
APR	14.99%	17.99%		11.99%
Monthly Payment	$484.82	$587.40	$1,072.22 (24 mo.) $587.40 (24 mo.)	$586.34
Finance Charge	$1,635.66	$8,194.98	$9,830.64	$12,217.18
Total Paid	**$11,635.66**	**$28,194.98**	**$39,836.88**	**$42,217.18**
Difference: $2,380.30				

XI. Avoiding Debt Traps

In a perfect world, consumers would pay cash for most items. If they borrowed, high credit scores would allow them to qualify for the lowest APRs possible, and they would pay off their loans quickly. However, in the real world, debt traps - like moguls on a ski course - can spin consumers' financial situations out of control. Classic debt traps include

- Taking out a credit card, and quickly running up a balance greater than $2,000, with no hope of paying it off the foreseeable future;

- Using credit to pay for uncontrolled online buying or gambling;

- Signing a loan agreement on an expensive new vehicle, when all you could afford was a safe, reliable used vehicle with a "sticker price" under $10,000;

- Agreeing to a long-term (5 years or more) "no money down" auto loan. New vehicles lose value the minute they're driven off the lot. If you pay no money down, the loan balance may be greater than the value of the vehicle for the majority of the loan's repayment term. Even worse, if you pay no money down and trade-in a vehicle that already has a loan greater than the vehicle's value, your new loan will include the rest of the old loan's balance, putting you even further behind;

- Forgetting good old Maine common sense: "A house is where you live, not who you are." If you buy a home too expensive for your personal financial situation, you could be "house poor" for the term of your mortgage. Being house poor means applying too much of your financial resources toward the upkeep of a home, without enough left for other expenses.

- Finishing your first year of college owing a significant amount in student loans, when all you took were the basic survey level courses. A more affordable option might living at home and commuting to a Maine university or community college campus to earn "early" credits;

- Passing up a summer job and or in-semester work-study position. You could have used the money you earned to lower your student loan debt;

- Gambling, especially when funding it with your credit card or savings;

- Expensive vacations paid for on credit; and

- Paying for everyday purchases like gasoline, groceries, and heating expenses with your credit card(s), and not paying the balance off in full each month. <u>High card balances can grow like Maine corn in July</u> with this debt trap fail!

Conclusion

So, What Have We Learned?

It's called "the democratization of credit." High APR consumer loans are out there, available to anyone age 18 and older. Credit cards, buy-here-pay-here auto loans, payday loans, personal loans and loans to buy that new living room, mattress or bedroom set.

Consumers with low credit scores can find themselves with limited credit options. Borrowing is expensive for them, and often only adds to their financial hardships. The best way to leave the high APR world behind is to work towards improving your credit score. Paying down your credit balances—especially high APR credit cards. <u>Strive to make every existing loan payment on or before its due date</u>.

Mainers with good to excellent credit, steady jobs, and lower debt payments still fall prey to high APR credit loans. Some also carry high APR credit cards, when comparison shopping for a lower APR card is as easy as phone call or visit to their bank or credit union. A balance transfer from a high APR credit card to a lower one - it's a beautiful thing! The lesson here is:

- Save up, pay cash, and self-fund purchases whenever possible;
- If you have to borrow, shop for the lowest APR and the shortest loan term you can afford;
- Go easy with HELOCs. Drawing down on your home's equity to buy frivolous items is NEVER a good idea, regardless of the APR;
- Keep your credit history and scores in tip-top condition. This should qualify you for lower APRs if you choose to borrow;
- Treat credit for what it is. Not free money, but a loan you have to pay back with interest.

When you have to borrow, borrow smart. <u>Think before you borrow</u>!

"He looks the whole world in the face for he owes not any man."

– Henry Wadsworth Longfellow

Glossary of Terms

Annual Percentage Rate: The total cost of consumer credit expressed as a yearly rate.

Annual Fee: A fee some credit card issuers assess cardholders on a yearly basis for the use of a credit or charge card.

Borrower: The person who receives the loan.

Closed-End Installment Loan: A loan with a fixed term (36 months, 48 months, 30 years) that generally requires monthly payments.

Collateral: Something pledged as security for repayment of a loan to be forfeited in the event of a default.

Consumer Financial Protection Bureau ("CFPB"): A federal agency out of the U.S. Treasury Department tasked with providing protection to consumers who purchase financial products. The CFPB was established by the Dodd-Frank Act in response to the financial crisis that led to the Great Recession

Credit Limit: The highest balance a card issuer will allow a cardholder to charge on an account.

Credit Score: A statistically-derived representation of a consumer's creditworthiness, expressed as a number between 300 and 850.

Debt-to-Income Ratio: A fractional number used by lenders to gauge risk, calculated as monthly debts divided by monthly income.

Debt Load: The total amount of all payments, fees, and interest owed by the debtor.

Delinquent: Failure to make a payment on an obligation when due.

Down Payment: An amount or percentage of the sales price that a consumer must pay up front before financing the balance of the sales price. Down payments made by a borrower lower risk to the lender.

Foreclosure: The legal process of obtaining and selling a mortgaged property to recover the unpaid debt owed to the lender following default of the note by the borrower.

Finance Charge: The total cost of credit including interest and fees, but not charges incurred in a comparable cash transaction expressed in dollars.

Grace Period: The period of time after the end of a billing cycle a credit cardholder can pay their balance in full, avoiding finance charges. Most credit cards feature grace periods of 25 days.

Lender: An individual or entity that makes funds available for others to borrow.

Loan Term: The period of time within which payments on a loan must be made.

Repossession: When a creditor takes possession of collateral from a buyer who is in default on a loan.

Revolving Loan: A loan without an end date like a credit card, overdraft line of credit, or a home equity line of credit/HELOC

Right-to-cure notice: A notice, from a creditor to a borrower, notifying the borrower that they have missed a payment and informing them that the creditor may exercise their rights under the law, including repossession or the start of foreclosure, unless payment of all past-due amounts is made by a specified date. Right-to-cure notices remain effective for 12 months after the original date sent.

Secured Loan: Loans in which a security interest in property is pledged.

Unsecured Loan: A loan where no collateral is pledged.

Usury Laws: Laws setting limits on the maximum allowable APRs charged.

Publications

Be sure to check out other free booklets from the
Bureau of Consumer Credit Protection:

Downeaster Common Sense Guide: Automobile Buying and Financing – From calculating "how much vehicle" you can afford, to vehicle research, shopping for the best APR and deciding on the best loan term for your needs, this booklet is a comprehensive guide to purchasing and financing a vehicle.

Downeaster Common Sense Guide: Credit Cards—Paper or Plastic? – This comprehensive booklet addresses credit cards: how they work, their responsible use, how to comparison shop for a credit card, when to pay cash, use a debit card charge on a credit card and what to do if you fall behind on your credit card payments.

Downeaster Common Sense Guide: Credit Reports and Credit Scores – This booklet contains valuable contact information for Mainers to place file freezes on their credit reports per Maine law. Learn the basics of credit, gain insight into how credit reporting and scoring work, and discover the impact your credit has on your ability to borrow with this publication from the Bureau of Consumer Credit Protection.

Downeaster Common Sense Guide: Debt Collection – If you are past due on your credit card, mortgage loan, auto loan or student loan, this is the FREE booklet for you! Learn about your rights in a consumer debt collection action, and how to deal with collectors. This booklet also provides guidance in spotting prevalent debt collection scams and contains ample "cease contact" and "debt validation" letters.

Downeaster Common Sense Guide: Finding, Buying and Keeping Your Maine Home – This guide is a resource for first time homebuyers, and provides an overview of the mortgage lending process, types of mortgage lenders and loans, and other related topics.

Downeaster Common Sense Guide: Gone Phishing – Identifying and Avoiding Consumer Scams – This guide is all about helping consumers defend themselves against being scammed. It details tactics and hooks used by scammers, offers advice to consumers so they can protect themselves, and explains how to report the scams to authorities.

Downeaster Common Sense Guide to Student Loans – A comprehensive guide for the prospective college student on the world of educational loans. This book covers loan types, the FAFSA process, how to apply for scholarships and grants, and the rights of a student debtor in the repayment/collection process.

Downeaster Guide to Elder Financial Protection – The "how-to" guide for Maine seniors who are interesting in stopping unwanted telemarketing calls, pre-approved credit offers, and junk mail. This guide has sections on how to stop identity theft and how to recognize and stop elder financial exploitation.

These guides are free to Maine residents. Out-of-state orders are $6.00 each, or at a volume discount of $4.00/copy on orders of 50 or more (shipping included).

To order, call 1-800-332-8529 (in-state) or 1-207-624-8527 (outside of Maine).

"The right way is not always the popular and easy way. Standing for right when it is unpopular is a true test of moral character."

– U.S. Senator Margaret Chase Smith

Annual Credit Report Request Form

You have the right to get a free copy of your credit file disclosure, commonly called a credit report, once every 12 months, from each of the nationwide consumer credit reporting companies, Equifax, Experian and TransUnion.

For instant access to your free credit report, visit www.annualcreditreport.com.

For more information on obtaining your free credit report, visit www.annualcreditreport.com or call 877-322-8228.

[illegible]

[illegible]

[illegible]

First Name | M.I.

Last Name | JR, SR, III, etc.

Current Mailing Address:

House Number | Street Name

Apartment Number / Private Mailbox | For Puerto Rico Only: Print Urbanization Name

City | State | ZipCode

Previous Mailing Address (complete only if at current mailing address for less than two years):

[illegible]

Consumer Protection Resources

Maine Bureau of Consumer Credit Protection	1-800-332-8529 TTY Maine Relay 711
Maine Bureau of Insurance	1-800-300-5000 TTY Maine Relay 711
Maine Bureau of Financial Institutions	1-800-965-5235 TTY Maine Relay 711
Maine Office of Aging and Disability Services	1-800-262-2232 TTY Maine Relay 711
Maine Office of the Attorney General (Consumer Hotline)	1-800-436-2131 TTY 1-207-626-8865
Maine Office of Professional and Occupational Regulation	1-207-624-8603 TTY Maine Relay 711
Maine Office of Securities	1-877-624-8551 TTY Maine Relay 711
Maine Public Utilities Commission (Consumer Assistance Division)	1-800-452-4699 TTY 1-800-437-1220
Maine Real Estate Commission	1-207-624-8524 TTY Maine Relay 711
Commodity Futures Trading Commission	1-866-366-2382
Consumer Financial Protection Bureau (CFPB)	1-855-411-2372 TTY 1-202-435-9742
Federal Reserve Consumer Hotline	1-888-851-1920
Federal Trade Commission Consumer Response Center	1-877-382-4357
Federal Trade Commission ID Theft Hotline **(after dialing, press "0" to reach a live operator)**	1-877-438-4338
Financial Industry Regulatory Authority (FINRA) Call Center	1-301-590-6500
Internet Crime Complaint Center (IC³)	www.ic3.gov
National Credit Union Administration (NCUA)	1-800-755-1030
U.S. Department of Veterans Affairs	1-800-729-5772
U.S. Postal Inspection Office — Portland, ME Field Office	1-877-876-2455

Sustainable Payments

Use this table as a guide to help you decide, before shopping, how high a monthly automobile loan payment you can afford. The recommended maximum monthly payment is 12% of monthly gross household income, a percentage that takes into account additional household expenses such as rent or mortgage payments, utilities and insurance. Since everyone's household financial situation is unique, this chart is intended for use as a general guide only.

Annual Gross Household Income	Recommended Maximum Monthly Payments		Annual Gross Household Income	Recommended Maximum Monthly Payments
$15,000	$150		$95,000	$950
$20,000	$200		$100,000	$1,000
$25,000	$250		$110,000	$1,100
$30,000	$300		$120,000	$1,200
$35,000	$350		$130,000	$1,300
$40,000	$400		$140,000	$1,400
$45,000	$450		$150,000	$1,500
$50,000	$500		$160,000	$1,600
$55,000	$550		$170,000	$1,700
$60,000	$600		$180,000	$1,800
$65,000	$650		$190,000	$1,900
$70,000	$700		$200,000	$2,000
$75,000	$750		$225,000	$2,250
$80,000	$800		$250,000	$2,500
$85,000	$850		$275,000	$2,750
$90,000	$900		$300,000	$3,000

NOTES

This book is not intended to be a complete discussion of all statutes applicable to consumer credit. If you require further information, consider contacting our agency or an attorney for additional help.

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Bureau of Consumer Credit Protection

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www.Credit.Maine.gov

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