

JUNIOR ACHIEVEMENT \$AVE, USA

HIGH SCHOOL GRADES

Parent/Student Financial Literacy Feature



Payday Loan Pitfalls

One of the most important financial decisions teens or adults make is to spend less than they earn. Barraged by TV commercials, Internet ads, and flashy promotions in malls, we're all encouraged to spend more. The problem arises when the amount we want to spend is greater than the amount of our take-home paychecks.

When they run out of money at the end of the month, some people turn to payday loans. These short-term loans appear to be a good way to get through a brief rough spot without having to deal with a bank or other financial institution.

Read the story below with your teen, and discuss how a sensible budget can eliminate the need for short-term borrowing at the end of the month.

Dear Parent/Guardian:

Thank you for downloading this Financial Literacy Feature. We hope the information and activities offered will be helpful in strengthening your family's financial literacy skills.

Activity

Here's the scenario:

You need \$800 to pay your rent due June 1, but you have only \$600 in your checkbook on May 27. You'll get paid June 3, but that doesn't solve your rent problem now.

Your landlord is not the waiting type, and your friends aren't the lending types. Of course, you're too embarrassed to ask Mom or Dad for the money, and no bank will lend you \$200 on the spot, so what can you do? (Continued on Page 2.)



A payday loan might seem like a tempting solution to your problem, but be careful. Payday loans provide cash to get you through to your next payday; hence, the name, but the interest rates on these loans can be astronomical. For example, you might decide to borrow the \$200 with a promise to pay it back in a week. The lender charges a flat fee of \$20 for the week.

“That’s not so bad,” you think.

Let’s see how bad it is really: Paying \$20 for a one-week loan is like paying \$1,040 a year (\$20 x 52 weeks). \$1,040 is five times the amount of your \$200 loan, which amounts to a 500% annual interest rate.

Pretty crazy, huh?

What alternatives do you have if you need money right away?

1. Try to get your landlord to extend your due date.
2. Try to get a side job that pays you before your rent is due.
3. Sell something you don’t need.

Of course, the best solution is to figure out why you can’t afford to pay your bills on time, and then come up with a plan. If you live in an apartment that’s beyond your means, find one that’s less expensive. Lower your cable bill by eliminating premium channels, or reduce your mobile phone options. There are many ways to decrease your spending so that the next time your rent is due, you will have enough to pay it.

Directions: Take a look at the monthly expenses for Lauren, a teacher who earns \$4,000 a month after taxes, but lives beyond her means. Next to each expense, write a new amount if you think it will help her cut back and reduce spending, thus eliminating her need for a payday loan. Don’t simply slash spending in one category, but be sensible in estimating how she can adjust her budget. (Indented items are subheadings, not additional expenses; eating at home and eating out equal Lauren’s total food expense of \$800.)

Current Expenses

- Food \$800
 - At home \$375
 - Eating out \$425
- Clothing \$600
- Transportation \$840
 - Car payment \$450
 - Gas \$200
 - Car maintenance \$40
 - Car insurance \$150

Adjusted Amount

Housing \$1,280

Rent \$1,100

Utilities \$150

Renters' insurance \$30

Health and Life Insurance \$120

Phone \$75

Cable \$100

Internet \$75

Entertainment \$300

Savings Account \$400

Charity \$50

1. What are Lauren's total current expenses: _____
2. How much over budget is Lauren (by how much do her expenses exceed her \$4,000 income)? _____
3. How will the new budget will affect Lauren's lifestyle? Is it a plan she can live with? Is it a plan you could live with? _____



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Answers: 1. \$4,640; 2. \$640; 3. Answers will vary.

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