

TIPS AND HOW-TOS

## Payday lenders: Seven questions to consider



When your air conditioner folds in the middle of summer or your dental checkup is all bad news, you want a quick solution but getting it isn't cheap. Especially if you haven't budgeted for it. It's in these sorts of circumstances that a lot of people find themselves weighing up payday loans.

In signing up for a payday loan, you're committing yourself to repay your lender a total amount greater than the amount you are borrowing from them. To borrow \$500 to cover Christmas, it might cost you about \$800 to repay your lender over a 12-month term. You might be certain you can repay the \$800 over 12 months without problems but the big question is whether the payday loan is worth it.

It really depends on your circumstances

### **What is a payday loan?**

A payday loan - more formally known as a Small Amount Credit Contract (SACC) - is essentially a high-cost short-term loan. It's for amounts between \$100-\$2000 and it needs to be repaid within the period of 16 days to one year.

## Payday loans' status in Australia today

Payday lenders are currently looming large on the radar of politicians who are endeavouring to ensure borrowers are adequately protected. This October, Labor's NSW Senator Jenny McAllister motioned successfully for a 2019 Senate Inquiry to examine how credit providers such as payday lenders and consumer lease providers affect individuals, communities and the broader financial system.

In the same week, Labor MP Brian Mitchell stated that nearly 800,000 Australian households have been adversely impacted by payday lending. Labor's proposed bill **The National Consumer Credit Protection Amendment (Small Amount Credit Contract and Consumer Lease Reforms) Bill 2018** outlines that, under the bill, it would make various changes including killing residual monthly fees charged to borrowers if they pay out their loan before the term expires. Labor also wants to toughen up penalties and better incentivise payday lenders to be compliant.

## In demand

There is a growing demand for payday lenders. The Australian Centre for Financial Studies commissioned a **report** in 2015 that found demand for payday loans increased 20-fold in the decade leading up to 2014.

## What to consider

If you're wondering how well suited you are to a payday loan, some questions you can ask yourself to help clarify your answer include:

1. How well do I understand the product?
2. Do I understand the total amount I need to repay or just the amount I am seeking to borrow?
3. How detailed and realistic is the plan I have for repaying the loan?
4. Am I borrowing for responsible reasons?
5. Is it essential to borrow now or could my timing be better?
6. Have I considered alternatives to payday loans?

7. What impact would this debt have on my borrowing capacity for other loans, like a home loan?

## **How does the payday loan process work?**

To get approved for a payday loan, you need to provide documentation including bank statements, ID, copies of bills or Centrelink receipts, employment information and income details.

Be sure to be aware of the fees for the different providers. Some of the key ones include the establishment fee, monthly fee, late payment fee and default fee. The maximum establishment fee a lender can charge is 20 percent of the borrowed amount. If you borrow \$500, for example, you'd need to repay that plus an additional \$100 (20 percent of the borrowed amount).

A lender can also charge a monthly fee of up to 4 percent of the original amount borrowed. If you elect to repay your \$500 loan over 12 months, this amounts to \$20 per month for 12 months (\$240). These fees alone mean you'll be repaying the lender \$840 for the \$500 you borrowed. Factor in late payment fees, which are commonly set at \$15 per missed payment, and you can see that it's easy to find yourself with a debt almost double what you borrowed. Default fees (a lender can charge you up to twice the total amount of the loan in default fees before they're capped, inclusive of any repayment fees you made under the contract) too, are significant.

It's therefore good practice to use a loan calculator before you apply for a payday loan to work out all the incremental costs payable on the loan.

## **Do your research to protect yourself**

The better informed you are about payday loans, the better you can protect yourself from potential drawbacks and the more confident your decision making will be. If you make a decision to apply for a payday loan, your due diligence should always involve performing a prior background check of potential lenders and ensuring that you satisfy eligibility requirements for the loan. Conducting your due diligence will go a way to helping you take care of your money and protect your credit report.

## **Still a debt**

Although the amount borrowed may be small, a payday loan still counts as a debt. When applying for other credit, for example, if you were applying for a home loan, this debt would be taken into account in your application.

You might find it useful to visit [MoneySmart's website for further information on Payday Lenders.](#)



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Keystart recommends that you seek your own independent financial advice prior to making any decisions about your financial needs. Any examples given in this post are provided for illustrative purposes only.

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