
A Quicksand of Loans: Loan Types

Introduction¹

Rachel Moore was an optimistic, cheerful, friendly woman who had recently graduated from the University of Virginia. Hailing from Chesapeake, Virginia, she was the youngest of four children in a very loving, supportive, Christian family. Rachel was the first person in her family to graduate from college and did not mind that it took her six years to complete a four-year degree. She had managed to earn her bachelor's degree in business management thanks to scholarships and grants while working an average of 30 hours a week at a telemarketing firm to pay the difference in her tuition. She was proud to have graduated with no debt.

Rachel had just moved to Fairfax, Virginia, to start her first full-time job as a marketing manager at a marketing company. She rented a room on a month-to-month basis in the house of an older retired woman and had been working for two months when the property owner gave her notice that she was selling her home and moving to Florida to be near her children.

Rachel had to move quickly, and she wanted to get her own apartment. She found a nice one-bedroom apartment within 10 minutes of her office, and she was set to move in two weeks. She realized there were many things she needed, including a couch, loveseat, and end tables for the living room, a dining room table and chairs, and a new TV since her small one from college had broken. She estimated that the cost to purchase all of these items new would be about \$3,000 if she found some good sales. She already had a beautiful cherry bedroom set that her parents had given her for graduation. She had \$1,000 saved in her Navy Federal Credit Union (Navy Federal) account from her new job, but it was not enough to purchase everything.

A week after moving to Fairfax, Rachel met Michael, an investment banker, and they had been dating casually since then. Michael was handsome, fun, and adventurous, and he made her laugh. He shared an apartment with his brother, Gabriel, who was in college studying information systems. As they talked, Rachel found they shared many of the same morals and values. They had discussed that she had no debt from college and that she had no credit. Michael had encouraged her to get a credit card, but she had been dragging her feet. She had always been taught that debt and credit cards were bad things and that she should try to pay cash if she could. As a result, she still had no credit. She realized that since she was now working full time, it might be an appropriate time to have credit available.

¹ Resilience Education, a nonprofit founded at the Darden School of Business, provides high-quality, customized education for vulnerable populations. For more information, contact info@resilience-education.org.

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Rachel felt comfortable asking Michael about his thoughts on her options for getting a loan for the furniture she needed. She called him that evening and explained the situation.

Michael agreed to put some information together for Rachel, and they met that night at 7:00 at Michael's and Gabriel's apartment to discuss it. Michael explained the various loans available to her, and clarified that all of them were credit based:

- personal loan
- payday loan
- car title loan
- rent-to-own loan

Personal Loans

“So what are the differences between each type of loan?” Rachel asked.

“First of all, a personal loan can be obtained from a person or a financial institution like a bank or a credit union. Banks will usually run a credit check and confirm your employment to make sure you can pay the loan back.”

Michael continued, “A ‘person’-al loan could also be a loan from a person, like a relative or friend, and the terms could be whatever you decide together. An example of a personal loan would be someone borrowing money from their parents.”

“I would probably prefer to go through a bank or credit union.”

“Having long-term accounts at a bank or credit union establishes a relationship with the bank, and if it is a good relationship, the bank is more apt to give a personal loan for someone with less-than-stellar credit. The bank or credit union may also require collateral, such as a car. Sometimes a secured loan, which is a loan backed by collateral, is used for people like you with little credit history.”²

Payday Loans

“So what about payday loans?”

“A payday loan is a short-term loan due when you get your next paycheck or by the end of the month,” Michael said. “It is a quick and accessible way to cover emergency expenses such as medical bills, minor car repairs, car payments, or any other cost that you can't afford. These loans are normally approved quickly, and the cash is available the next day. If you are approved, a payday loan can provide the money you need when you are short on cash between paychecks. These loans are typically for up to \$1,000, with the maximum loan amount determined by state laws. Some states, such as Virginia, have a maximum cap of \$500 for a payday loan.”

“That might help my situation a bit. What is the process for getting one of these loans?”

² See **Exhibit 1** for a glossary of terms.