NORTH CAROLINA CENTER FOR
PUBLIC POLICY RESEARCH INC.

NEWS RELEASE

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N.C. CENTER SAYS RENT-TO-OWN DEALERS SHOULD BE REGULATED

The 1988 N.C. General Assembly should adopt legislation regulating North Carolina's growing rent-to-own industry and limiting the effective interest rate on rent-to-own transactions, says the N.C. Center for Public Policy Research.

Under current law, rent-to-own transactions have few legal restrictions, which gives rent-to-own dealers unfair advantages over other businesses, including banks, retail merchants, and small loan companies, the Center says in the June issue of its quarterly magazine, North Carolina Insight. Without such restrictions, rent-to-own dealers can charge whatever the market will bear -- and interest rates of more than 100 percent are not uncommon.

"Every other type of lender in North Carolina must abide by interest rate restrictions on contract sales," says Insight editor Jack Betts. "Yet the legislature so far has treated rent-to-own dealers as special cases. But it has become increasingly difficult to justify why this one industry has no limits on what it can charge when other businesses and lenders must abide by state-set caps. Isn't it time rent-to-own businesses were brought into the fold?" asks Betts.

North Carolina's rent-to-own industry provides a service to many consumers who might otherwise not be able to purchase items on time. Typically, rent-to-own customers pay rental fees for 18 months on appliances or furniture. By making one final balloon payment, the customer may end up owning the item -- though most do not. Studies show that fewer than one in four rent-to-own customers wind up owning the item.

Many of these individuals are poor and cannot afford to purchase appliances and other items from conventional lenders, where they must pay annual interest rates ranging from 18 to 36 percent. Instead, they turn to rent-to-own dealers. But because state law does not regulate charges by this industry, low-income consumers pay charges equivalent to 100 percent interest or more, and in some cases, more than 200 percent. The irony is that consumers often pay far more for an item than they would if they had been able to get credit from regulated lenders.

P.O. BOX 430 RALEIGH, N.C. 27602 (919) 832-2839

That's one reason that N.C. Attorney General Lacy Thornburg has asked the legislature for tighter controls on the rent-to-own industry. Thornburg last year blasted rent-to-own agreements as a "cruel hoax" on "the poorest of our citizens." He urged the Senate to support a bill sponsored by Rep. Joe Hackney (D-Orange) and passed by the House in 1987. Thornburg says Hackney's bill "closes a loophole through which a relatively small but growing number of companies are able to charge the least fortunate of our citizens, not 18 percent (the maximum credit card rate); not 24 percent (the maximum installment rate); not 36 percent (the maximum small loan rate); but 250 percent per year or more in finance charges, when they are trying to buy washing machines, furniture, televisions, and other goods."

Rent-to-own dealers, who have fought interest rate regulation in the General Assembly for years, say their prices should not be limited because there is no long-term debt obligation involved in their sales. Lawrence Davis, an attorney for Rent-A-Center, says consumers can quit paying on their contracts at any time, and need only return the merchandise to the dealer. "Unlike retail merchants' installment sales customers or small loan customers who could unwittingly sign up for excessive future obligations, the rent-to-own dealers' customers do not sign up for any future obligation except to return the merchandise at the end of the rental period.... There is no extension of credit and no loan is involved in any way," says Davis, so the rent-to-own contracts should not be treated as a loan to which an interest cap should be applied.

A number of legislators say that's legal mumbo-jumbo to disguise the fact that rent-to-own dealers charge exorbitant fees that amount to the same thing as interest rates. It would be unconscionable to allow such practices to continue without restrictions, they say.

A Senate subcommittee has come up with draft legislation that would regulate rent-to-own contracts and require that a certain percentage of each rental payment be applied to the consumer's ownership in the merchandise. The Senate substitute would allow rent-to-own dealers to charge the equivalent of up to 48.67 percent in annual interest rates. That bill is markedly different from legislation that passed the House in 1987. The 1987 bill would limit interest rates to 24 percent annually -- which rent-to-own dealers say would put them out of business.

But some legislators say even the Senate substitute is too restrictive. Sen. Henson Barnes (D-Wayne) prefers legislation modeled on a New York law that would allow the equivalent of interest rates up to 103 percent annually. Barnes says the state doesn't have to regulate every aspect of business.

Attorney W. Woodward "Woody" Webb of Raleigh, who represents the 250 stores that make up the N.C. Association of Rent-To-Own Dealers, agrees. "If the prospective clients are told up front exactly what they're getting into and they're free to turn around and walk out of the store..., why doesn't that satisfy all the requirements of a free enterprise system?" asks Webb.

But consumer protection specialists say the New York-style law would not significantly change the status quo among rent-to-own dealers in North Carolina. "That would cut out the very worst," says Special Deputy Attorney General Jim Gulick, who heads the Attorney General's Consumer Protection Section, "but that probably would not change the average of what is being done now."

Nationally, thirteen states have passed laws that recognize rent-to-own agreements as special contracts and require certain disclosures, such as the total of payments and the cash price. Three states require that a percentage of every payment be applied to equity. North Carolina law does neither. Under North Carolina law, almost all rent-to-own transactions are exempt from retail sales regulations.

The Center acknowledges that rent-to-own companies have higher costs of operating -- including costs related to taking greater credit risks, providing free delivery, providing free service, and allowing consumers to cease making payments and terminate contracts without penalty. These facts justify allowing rent-to-own companies to charge more than other businesses and regulated lenders, the Center says. But those rates must be kept in proportion to what other businesses in North Carolina are allowed to charge. Allowing the industry a rate ceiling of 48.67 percent would still give it more than a 12 percent interest rate advantage over small loan companies, more than a 24 percent interest rate advantage over retail merchants, and more than a 30 percent interest rate advantage over bank credit card and other revolving charge account transactions.

There are two factors, the Center says, that justify a higher interest rate for rent-to-own transactions: (1) Such contracts include the cost of free servicing of the appliances or other items sold under the rent-to-own contract; and (2) the transactions involve customers who are greater credit risks than customers of other businesses. However, the Center could find no evidence that would justify interest rates as high as are currently allowed under North Carolina's system of no regulation of rent-to-own contracts. As William L. Rustin of the N.C. Retail Merchants Association puts it, "It would seem logical that this type of transaction, where equity changes from a seller to a buyer, should have some way to restrict the interest rate that is charged, and that rate should not be out of line with charges that other businesses are restricted to in North Carolina."

The Center outlines 3 reasons why the legislature should begin to regulate the rent-to-own industry, as follows:

(1) Existing interest rates -- sometimes more than 200 percent -- charged by the industry are exorbitant and out of line with other industries. Other businesses are limited under state law to maximum interest rates of 18% (credit card trans-actions), 24% (retail installment sales), or 36% (small loans by finance companies).

(2) Rent-to-own customers often are not getting new merchandise, but used goods. The N.C. Attorney General's Office examined 342 contracts executed by one rent-to-own company in 1986 and found that 51 percent of the goods were used. Generally there was no difference between the stated cash price of the used goods and new goods, contrary to a representation made by the industry.

(3) Fewer than one in four consumers who enter into a rent-to-own contract actually wind up owning the merchandise. Again, a study by the N.C. Attorney General's Consumer Protection Section found that only about 22% of the contracts culminated in sales. Thus, for the vast majority of rent-to-own customers, the television, furniture, or washing machine goes back to the rent-to-own dealer -- there to be rented again to another customer.

The Center says the legislature should (a) require disclosure of all contract terms, (b) require that at least 70 per cent of each rental contract payment be applied to the cost of the item rented, and (c) direct the N.C. Attorney General to monitor rent-to-own transactions and report his findings to the 1991 General Assembly. That report should gauge the industry's compliance with the law and make recommendations whether interest rates should be reduced to match those of small loan companies (36 percent) or retail merchants (24 percent), or increased to ensure the viability of the industry.

The Center also recommends in Insight (d) that the General Assembly adopt legislation to limit the use of the criminal courts as collection agencies for rent-to-own dealers. Under current law, rent-to-own dealers are using the criminal courts before the rental period is up to collect on back payments and recover merchandise. Gulick says such cases were running up to 20 a week in at least one judicial district. But other businesses and lenders are restricted to using the civil courts for such purposes. The Center says the legislature should rectify that situation by limiting rent-to-own companies' use of the criminal courts. Rent-to-own dealers would continue to have full access to civil courts for past-due collection procedures -- as other lenders have under current law -- and would still have access to criminal courts where there is evidence of a crime in the unauthorized disposal of rental property. Such legislation passed the House in 1987 and is now pending in the Senate Judiciary II Committee in the 1988 session.

The N.C. Center for Public Policy Research is an independent, nonpartisan, nonprofit organization created to examine state government programs and important issues of public policy in North Carolina. The Center is supported in part by grants from the Z. Smith Reynolds and Mary Reynolds Babcock Foundations, both in Winston-Salem. Other funding comes from 109 corporate contributors and 700 individual members. In addition to its quarterly magazine, North Carolina Insight, the Center also publishes rankings of the effectiveness of all state legislators and book-length research reports. Recent studies have been issued on state environmental policies, all boards and commissions in state government, and the rise of the two-party system in North Carolina.

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Copies of the issue of North Carolina Insight containing the research on the rent-to-own industry are available for $6.30 (plus $1.00 postage and handling) from the N.C. Center for Public Policy Research, P.O. Box 430, Raleigh, NC 27602, or call (919) 832-2839.

For more information, call Jack Betts at the N.C. Center for Public Policy Research at (919) 832-2839.