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RENT-TO-OWN: A HIGHLY VISIBLE PURCHASING ALTERNATIVE

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The "rent-to-own" method of merchandising furniture, television sets, videocassette recorders, stereos, large appliances, and jewelry is growing in popularity with retailers. In fact, more than 10 percent of the televisions sold in the United States are sold through rental-purchase agreements [5]. In rent-to-own transactions, the contract the consumer signs is in the form of a week-long or month-long lease. It is renewable for a specified number of weeks or months, usually 18 to 32 months. If all payments are made, the consumer owns the merchandise. Delivery and repair are usually included in the agreement.

Business is growing for rent-to-own outlets. The number has more than doubled in a five-year period, growing from 3,000 dealers in 1983 to over 6,500 dealers in 1988 [5]. This rapid growth has left many consumers unfamiliar with the system and its inherent risks and high prices [9]. The intent of this paper is to provide a summary of the literature related to rent-to-own contracts and to suggest how this topic can be incorporated in educational programs.

Opinions Differ

Consumer advocates and industry representatives differ most often on two aspects of rent-to-own agreements — disclosure of the costs involved and the impact of the industry on low-income consumers. Consumer advocates argue that rent-to-own transactions are leases in form only and are in fact disguised credit sales [4,8,10]. They feel rent-to-own merchants should meet requirements applied to other credit sale transactions, such as stating the annual percentage rate (APR) and refraining from harrassment or abusive collection procedures [4,8,10,11].

On the other hand, industry representatives argue that rent-to-own programs are different from credit transactions because the consumer can terminate the contract and return the merchandise at any time [6]. Therefore, disclosure of an APR would be inappropriate. While the Consumer Leasing Act requires disclosure of the terms of leases, it applies only to leases of over four months in length. Rent-to-own programs usually extend contracts for only a week or a month at a time and are thus exempt.

In addition to concerns over the disclosure of costs, consumer advocates feel that rent-to-own programs have drawn most of their customers from low-income consumers, the segment of the population least able to absorb higher costs for products [7,9]. In a recent study, Swagler and Wheeler [10] found that the rent-to-own participants were predominantly female; they tended to have lower incomes and less than a high school education. Participants had poor credit histories and appeared to be using rental-purchase agreements as substitutes for conventional forms of credit. Swagler and Wheeler also found that rent-to-own customers were frequently confused by and generally dissatisfied with the agreements.

Taking a different approach, industry representatives insist that the rent-to-own market provides a unique service to a certain segment of consumers. Those who are too new in the market to have established credit or who have used up the credit available to them cannot acquire furniture and appliances through conventional credit channels. The rent-to-own plan provides those consumers with the ability to either rent the items on a short-term basis or, if they choose, to take the more expensive ownership option [1,3]. Industry representatives insist that the high cost of rent-to-own is justified by conveniences such as free delivery and repair or replacement if the product needs servicing [3,7].

Manufacturer statistics indicate that as much as 35 percent of the adult American population is unable to obtain credit. Industry representatives estimate that rent-to-own has penetrated only 20 to 25 percent of the market and believe the potential for continued growth and profits is large [5].

How Costly are Rent-to-Own Agreements?

Just how high are the costs? Technically, the consumer is considered a short-term renter of merchandise, and thus rent-to-own stores need not comply with the federal Truth in Lending law by disclosing the total finance charge or APR. Nevertheless, researchers have calculated an implicit APR based on the difference between the total rent-to-own cost and the retail price of the item. They have reported implicit interest rates ranging from 117 percent to 468 percent [7,8,10,11]. A 1988 study of six stores in a southern city (conducted for the Louisiana Consumers League by the authors) indicated that the implicit interest rates ranged from 118 to 288 percent for the products surveyed. Interest rates varied depending on the store, the length of the agreement, and the type of product. The 24-month agreements tended to have higher implicit rates than the 12-month agreements. On a rent-to-own contract, a microwave oven that retailed for $200 cost from $434 to $1,151 (see Table 1).

Another way to calculate the implicit interest rate is to include dealer costs in the equation. Costs incurred by rent-to-own dealers include maintenance and repair, depreciation, and payment collection and processing. Dealers also experience the opportunity costs of investing money in the rent-to-own good rather than elsewhere. When this method is used, the implicit interest rates drop; however, most extimates remain above 60 percent [12]. With either method of calculating the interest rates, costs are high when compared with other ways to obtain credit and often exceed state usury law limits.

Table 1. Implicit Interest Rates for Rent-to-Own Products

Retail		Rent-to-Own	
Product	Cost	Cost Range[a]	APR Range[b]
Clothes Washer	$270	$ 721 - $1,088	148 - 244%
Color TV	209	565 - 1,242	155 - 288
Microwave	200	434 - 1,151	118 - 272
Refrigerator	429	1,062 - 1,400	135 - 188
Stereo	319	719 - 1,403	120 - 230
VCR	230	702 - 1,166	170 - 263

[a]Range of costs across the six stores surveyed.

[b]A standard formula often used to approximate the APR was used to calculate the implicit APR as follows:

$$\frac{M\,(95N + 9)\,F}{12N\,(N + 1)\,(4P + F)}$$

where
M = number of payments per year
N = number of loan payments scheduled over the life of loan
F = total finance charges, and
P = principal amount of the loan.

State Laws

Currently, at least nine states have statutes related to rent-to-own businesses (Florida, Georgia, Maryland, Michigan, New York, North Carolina, Pennsylvania, South Carolina, and Texas). These laws make the actual costs of the rent-to-own transaction more apparent. For example, New York statutes state that a rental-purchase agreement must disclose: (1) whether the merchandise is new or used; (2) the "total cost," which is the amount that must be paid to acquire ownership, and the total number of payments; (3) the cash price, which is the price one would pay if the merchant were to sell the

product on the date that one enters into the rental-purchase agreement; and (4) the conditions under which one may exercise an early option to buy the product. Copies of the various state laws may be obtained from the consumer protection divisions of the various states or from the authors.

Implications for Consumer Educators

The rent-to-own industry conducts a highly visible advertising compaign through television, radio, newspapers, billboards, and flyers. To encourage students to think about the other side of these transactions, consumer educators might begin with a student-conducted local survey of prices for various rent-to-own products. This will yield valuable local data to disseminate through state Cooperative Extension Systems and mass media and give students experience in communicating with individuals who work in the rent-to-own industry.

Other possible classroom applications of the information are to have students:

* compare laws that affect rent-to-own contracts from state to state
* assess the effectiveness of the laws
* compose a comprehensive federal statute
* write news articles for the local or school paper
* debate "what price is convenience?"
* develop a questionnaire to distribute to consumers currently using the rent-to-own system to determine their satisfaction with the process
* compare rent-to-own costs to the costs involved in purchasing with conventional credit options
* debate whether rent-to-own agreements should be included in the Truth in Lending Law and/or the Consumer Leasing Act
* critique the techniques used in rent-to-own advertisements to entice consumers to use this buying strategy.

This paper and the information resulting from the activities mentioned above may be useful to consumer educators, particularly Cooperative Extension agents, in writing newsletters and in working with or writing for the mass media. The information may also be helpful in planning programs related to financial decision making and may be useful with most Extension audiences, especially 4-H participants.

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