Borrowing Basics

FDIC Money Smart for Young Adults

Building: Knowledge, Security, Confidence
Objectives

• Define credit
• Explain why credit is important
• Identify three types of loans
• Identify the costs associated with getting a loan
• Tell how you are protected against discrimination in the lending process
• Identify the factors lenders use to make loan decisions
• Explain why it is important to be wary of rent-to-own and refund anticipation services
Borrowing Basics

Hey Ramón, check out this new cell phone I bought. It has everything!

It was a really great deal. I signed some papers and only have to pay $30 a month!

Umm, do you know how long you have to keep it? And how can you pay for it— you always borrow money from me!

It's a $90 phone, so I'm sure I only have to pay for 3 months. And don't worry, bro...

...I got a "student credit card!"
Credit

• What is credit?
  – It is the ability to borrow money

• Having good credit makes it easier to borrow money in the future
Why is Credit Important?

- **Credit:**
  - Can be useful in times of emergencies
  - Is more convenient than carrying large amounts of cash
  - Allows you to make a large purchase (e.g., a car or house) and pay for it over time
  - Can affect your ability to obtain employment, housing, and insurance based on how you manage it
Collateral

• **Collateral is:**
  – Security you provide the lender
  – An asset (e.g., a car, home, or savings account)

• **A guarantee is:**
  – A form of collateral
  – For example: having a cosigner on a loan
Types of Loans

• **Credit cards**
  – Give you the ongoing ability to borrow money

• **Consumer installment loans**
  – Allow you to pay the same amount each month in installments for a set period of time
Activity 1: Installment Loan versus Rent-to-Own Services

Complete Activity 1 in your Participant Guide
– Break into 2 groups
– Read through your section of material
– List and describe 5 reasons to choose your payment method
Home Loans

- Home purchase loans
- Home refinance loans
- Home equity loans

Value of home $250,000.00
Minus debt -$200,000.00
Equity $50,000.00
Activity 2: Types of Loans

Complete Activity 2 in your Participant Guide

- Read the description of the purchase to be made
- Fill in the blank with the most appropriate loan type(s) for that purchase
Cost of Credit

• **Fees**
  – Charge for activities (e.g., reviewing your loan application and servicing the account)

• **Interest**
  – Charge for using financial institutions money
    • Fixed rates
    • Variable rates
Truth in Lending Disclosures

• The Federal Truth in Lending Act:
  – Requires banks to disclose charges so you can compare the actual cost of borrowing

• Lenders must disclose:
  – The amount financed
  – Annual Percentage Rate (APR)
  – Finance charges
  – Total payment
Activity 3: Borrowing Money Responsibly

Complete Activity 3 in your Participant Guide

- Answer each question
- Be prepared to explain your answers
Equal Credit Opportunity Act

• This act:
  – Prohibits discrimination during the loan application process
  – Restricts lenders from requesting certain information
  – Requires the lender to notify you in writing, within 30 days, if you have been approved or denied the loan
The Four Cs

- Capacity
- Collateral
- Character
- Capital
Capacity

• **Refers to your ability to meet payments:**
  – How long have you been working at your job?
  – How much money do you make each month?
  – What are your monthly expenses?
Capital

• Refers to the value of your assets and net worth:
  – How much money do you have in your checking and savings accounts?
  – Do you have investments (e.g., stocks, bonds) or other assets (e.g., a car)?
Character

• Refers to how you paid your bills or debts in the past
  – Have you had credit in the past?
  – How many credit accounts do you have?
  – Have you ever filed for bankruptcy, had property repossessed, or made late payments?
Free Annual Credit Report

Visit: www.annualcreditreport.com
Call: 1-877-322-8228
Mail:
Annual Credit Report Request Service
P. O. Box 105281
Atlanta, GA 30348-5281
Collateral

• Refers to property/assets used to secure the loan
  – Do you have assets to secure the loan beyond your capacity to pay it off?
Barriers to Borrowing Money

• Making late payments
• Filing for bankruptcy
• Having property repossessed or foreclosed on because you cannot make the payments
• Having a court order requiring you to pay money to the lender
Legal Terms for Debt Actions

- Attachment
- Bankruptcy
- Collection account
- Foreclosure
- Garnishment
- Judgment
- Lien
- Repossession
Activity 4: Borrowing Barriers

Complete Activity 4 in your Participant Guide

– Reach each scenario
– Indicate which of the Four Cs are affected by each of the barriers to borrowing money
Activity 5: Loan Applications

Complete Activity 5 in your Participant Guide

– Review each section of the Uniform Residential Loan Application
– Match the required information with the appropriate C:
  – Capital, Collateral, Character, and/or Capacity
Credit Report

• A credit report tells lenders:
  – Who you are
  – How much debt you have
  – Whether you have made payments on time
  – Whether there is negative information about you in public records
Activity 6: John Q. Consumer

Complete Activity 6 in your Participant Guide

– Review the sample credit report
– Use the report to answer the questions about John’s credit history
Catch Phrases of Abusive Lenders

“125 percent of your home/car’s value”

“Incredibly low monthly payment”

“No upfront fees”

“Even if you have a bad credit history…”

“It is free and you have nothing to lose”

“Act now, this is a limited-time offer”
Predatory Lending Practices

• To guard against predatory lending:
  – Deal with reputable loan providers
  – Shop around to obtain the best terms
  – Read and understand all terms and conditions
  – Ensure you can afford and make payments according to the loan terms
True Cost of Alternative Financial Services

- Rent-to-own services
- Payday loan services
- Refund anticipation services
Rent-to-Own Services

• Allow you to use the item while you make monthly or weekly payments
  – The store owns the item until you make your final payment.
• Are generally more expensive than a consumer installment loans
Payday Loans

• Short-term loans (usually up to 2 weeks) that can be costly

<table>
<thead>
<tr>
<th>Loan Term</th>
<th>Fee</th>
<th>You write a check for:</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 weeks</td>
<td>$30</td>
<td>$230</td>
</tr>
</tbody>
</table>
Refund Anticipation Loans

- Short-term loans secured by your expected income tax refund
- Consider electronically filing (e-file) your tax return and request direct deposit instead
Module Summary

How's that new cell phone?

I shouldn't have bought it. It was really expensive, and I signed a year-long contract that I can't get out of without paying lots of money.

How come?

I just got too excited. I should have been more careful.
Module Summary

Congratulations! You learned about:

• Credit and what “good” credit means
• Types of loans
• The cost of credit and the cost of using non-loan services
• How lenders make credit decisions